

# Transfer Pricing Country Summary New Zealand

July 2018

## Legislation

### Existence of Transfer Pricing Laws/Guidelines

New Zealand transfer pricing legislation is contained within Sections YD 5, GB 2, and GC 6-14 of the Income Tax Act 2007 (ITA)<sup>1</sup>.

This legislation closely follows the OECD Transfer Pricing Guidelines, as well as the United States Section 482 Regulations. The Inland Revenue Department (IRD) Guidelines (2000)<sup>2</sup> also endorse the key Australian Tax Office (ATO) rulings to the degree to which they are not inconsistent with the OECD guidelines – specifically the 4-step process in 98/11 and the safe harbor methodology for services in 99/1.

There is no explicit statutory requirement in New Zealand to prepare and maintain transfer pricing documentation. However, it is considered prudent to do so in order to demonstrate and justify that intercompany transactions are aligned with the arm's-length principle. New Zealand, being an OECD member, has stated express agreement with the OECD Transfer Pricing Guidelines. On 3 March 2017, the Government issued a discussion Document "*BEPS- Transfer Pricing and Permanent Establishment Avoidance*"<sup>3</sup> which endorses the OECD recommendations on transfer pricing documentation as the Master File and Local File approach. Even though this documentation is not required in New Zealand, the discussion document states that it might be useful for taxpayers with material transfer pricing risks.

New Zealand introduced new legislation which addresses the OECD's BEPS initiative, effective from July 2018. In fact, New Zealand signed the Multilateral Competent Authority Agreement on exchanging Country by Country Report (CbCR) on 12 May 2016. Articles 17 and 35 of the Tax Administration Act ("TAA")<sup>4</sup> enforce the requirements of the agreement.

### Definition of Related Party

Subparts YA and YB of the Income Tax Act 2007 state that any two companies are associated persons when there is a group of persons that:

- have a 50 per cent or more voting right, market value or income interest in the two companies;
- control the two companies by any other means.

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<sup>1</sup> See <http://www.legislation.govt.nz/act/public/2007/0097/439.0/DLM1512301.html>

<sup>2</sup> See *A guide to the application of section GD 13 of New Zealand's Income Tax Act 1994*, <https://taxpolicy.ird.govt.nz/sites/default/files/2000-other-transfer-pricing-guidelines.pdf>

<sup>3</sup> See <https://taxpolicy.ird.govt.nz/sites/default/files/2017-dd-transfer-pricing-pe.pdf>

<sup>4</sup> See <http://www.legislation.govt.nz/act/public/1994/0166/350.0/DLM348343.html>

There are also definitions of associated person for natural persons, partnerships and trusts. Note that section GB 2 can extend the application of sections GC 7-10 to non-associated parties where there is a collateral arrangement (such as a market sharing arrangement, an arrangement to enter into a particular market, a back-to-back supply arrangement or an income-sharing arrangement).

## Transfer Pricing Scrutiny

The IRD performs audits specifically for transfer pricing issues or may address these issues during an income tax audit. Several key factors can be identified to assist in the measurement of risk associated with transfer pricing. Using these factors, Inland Revenue will be able to assess whether a taxpayer's transfer pricing practices represent a low, medium or high tax risk.

It is considered a low risk of audit if the taxpayers have a strong economic and commercial basis and they are very co-operative. If APAs exist, the risk of audit is diminished. Also, if documentation, which clearly supports the reliable method, is kept in compliance diminishes the risk of audit.

Specific transactions that incur higher audit risk include payment or receipt of interest, royalties, management fees, fees in relation to intangibles and guarantee fees. Transactions with residents of a country New Zealand does not have a double tax treaty with, or are regarded as a tax haven under New Zealand's CFC rules, and relations between head office and permanent establishment are also likely to be questioned.

In conducting audits, IRD has the full support of the transfer pricing specialist team.

## Transfer Pricing Penalties

There are no specific transfer pricing penalties. The standard shortfall penalties apply in case of adjustments arising from transfer pricing issues (Section 141A-F of the TAA:

- not taking reasonable care – 20 % of the tax shortfall;
- unacceptable interpretation – 20 % of the tax shortfall;
- gross carelessness – 40 % of the tax shortfall;
- abusive tax avoidance – 100 % of the tax shortfall; and
- Evasion – 150 % of the tax shortfall.

Interest is also imposed by the IRD by the rate of 8.22 % applicable from May 2017.

These penalties may be reduced depending upon the degree of cooperation of the taxpayer and disclosure of the causes of the shortfall. Late payment interest is due from the date on which the tax had to be paid to the date it is finally paid.

The non-timely, incorrect or incomplete filling of the CbCR is a criminal penalty and can be either:

- (i) Absolute liability offence (article 143 of the TAA): If a person does not keep the documents required to be kept or does not provide information required to. The penalties are:
  - NZD 4,000 maximum (first offence);
  - NZD 8,000 (second offence);
  - NZD 12,000 (third and subsequent offences).
  
- (ii) Knowledge offence (article 143A1 of the TAA): Apply if a person knowing does not keep the documents required to kept, knowing does not provide the information required, knowingly provide altered, false, incomplete or misleading information. The penalties are:
  - A fine not exceeding NZD 25,000 (first offence);
  - A fine not exceeding NZD 50,000 (second and subsequent offences).

## Advance Pricing Agreement (APA)

Section 91E of the TAA allows the IRD to issue unilateral APAs in the form of a binding ruling. Bi- or multilateral APAs may be entered into under the mutual agreement procedure in New Zealand double tax treaties.

The IRD is keen to see more taxpayers seeking APAs in order to avoid potentially costly and time consuming audits, and therefore favors a flexible approach allowing APAs to be concluded in a six-month period. The IRD does not have formal APA guidelines. The IRD suggests a pre-application meeting to make the APA application procedure less time consuming.

## Documentation and Disclosure Requirements

### Tax Return Disclosures

The income tax return has to disclose the following items:

- payments to non-residents (such as dividends, interest, management fees, intangible payments, royalties or payments on basis of a contract) - Disclosure 35;
- whether the company is controlled or owned by non-residents – Disclosure 35A ; and
- whether the company holds an interest in a foreign controlled company – Disclosure 39.

Taxpayers can fill in voluntary disclosures for their tax returns, in order to check if they correctly estimated their tax returns. They can include information about salary or wage earners, individuals,

businesses, trusts and employers. If taxpayers chose to voluntarily disclose their tax returns, they can benefit from a lighter penalty in case of tax problems.

## Level of Documentation

1. Contemporaneous Documentation: There are currently no regulations in New Zealand that requires taxpayers to use the Master File or the Local File OECD approach; however the discussion document considers that such approach is useful for taxpayers with transfer pricing risks to comply with the arm's length principle. The discussion document proposed that a local File and Master File will be required on specific request or audit by the tax authority. Therefore, the IRD expects taxpayers to maintain contemporaneous transfer pricing documentation in the form of:
  - Master file which provides an overview of the multinational's global business operations and transfer pricing policies;
  - Local file which provides the detailed information on the operations of the New Zealand taxpayer and the corresponding associated party transactions. Transfer pricing analysis supporting the arm's length nature of the transactions from a New Zealand perspective is also required.

The IRD expects a taxpayer to make a sensible cost-benefit analysis of the preparation and maintenance of documentation before deciding whether a full or limited transfer pricing analysis is appropriate.

A limited transfer pricing analysis should contain the following minimum documentation:

- identification of the cross-border transactions which are subject to a transfer pricing exposure;
- a broad functional analysis of the taxpayer's operations to identify the critical functions being performed;
- an estimate of the business risk of not undertaking and documenting a more detailed transfer pricing analysis; and
- an estimate of the costs of complying with the transfer pricing rules.

A limited transfer pricing analysis does not preclude the IRD from substituting a more reliable measure of the arm's length price where a cost-benefit analysis indicates the need for a full transfer pricing analysis.

In case of the need of a full analysis, the IRD expects the following documentation:

- a functional analysis;
- an appraisal of potential comparables;

- an explanation of the process undertaken to select and apply the method(s) used to determine the transfer prices, and why it is considered to provide a result that is arm's length compliant; and
- Details of special circumstances that have influenced the price setting.

Taxpayers who prepare documentation on basis of a full analysis or limited analysis (sustained by a sensible cost benefit analysis) are more likely to ensure that the burden of proof shifts to the IRD.

2. Country by Country Report<sup>5</sup>: It applies to corporate groups headquartered in New Zealand with annual consolidated group revenue exceeding equivalent to EUR 750 Million. The following data needs to be reported for each jurisdiction where the multinational operates:
  - Gross revenues showing related and unrelated party categories;
  - Profit (loss) before income tax;
  - Income tax paid on cash basis;
  - Stated capital;
  - Accumulated earnings;
  - Number of employees; and,
  - Tangible assets other than cash and cash equivalents.

The report must be prepared in New Zealand Dollar ("NZD").

## Record Keeping

There are no specific transfer pricing rules for record keeping. General tax rules apply whereby records should be retained for 7 years.

## Language for Documentation

The IRD expects documentation to be in English and can ask for a translation into English if documentation is prepared in another language.

## Small and Medium Sized Enterprises (SMEs)

There are no specific rules for small and medium sized enterprises.

If a taxpayer opines, on basis of a sensible cost-benefit analysis, that a limited transfer pricing analysis is a sufficient basis for the preparation and maintenance of his documentation, this does not preclude the IRD from substituting a more reliable measure of the arm's length price if it can sustain this.

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<sup>5</sup> See Country by Country Report form: <http://www.ird.govt.nz/resources/9/f/9f96d3a8-1c8b-49e4-852f-3ec3bcbc8a31/ir1032.PDF>

## Deadline to Prepare Documentation

There is no statutory deadline. However, since the IRD expects taxpayers to exercise reasonable care and to avoid gross carelessness in their transfer pricing approach, it encourages contemporaneous documentation.

## Deadline to Submit Documentation

Documentation should be submitted upon request of the IRD, generally within 30 days upon the request.

## Statute Of Limitations

The IRD has the power to issue additional assessment notices during four years as from the end of the calendar year during which the income tax return was filed (except in the case of tax avoidance or evasion). The taxpayer can extend this term by maximum 18 months by signing two waivers, which generally arises when a dispute is not resolved and additional time allows settling the dispute by mutual agreement or when another case before a court is likely to resolve the issue in the current dispute.

## Transfer Pricing Methods

The IRD accepts the CUP method, the resale price method, the cost plus method, the profit split method and the comparable profits method / transactional net margin method. The most reliable method should be used, according to article GD 13(7) of the ITA.

## Comparables

The taxpayer can use the data of published annual accounts or more detailed information available in some industries. However, the scope of these is limited. Therefore, taxpayers use comparable entities in foreign jurisdictions (e.g. Australia and US) and the IRD does not prohibit this, provided the necessary adjustments are made to eliminate geographical market differences.

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