OECD

FORUM ON TAX ADMINISTRATION

New ways of Working Series

Inland Revenue New Zealand

Facilitating international tax compliance for multinationals through targeted campaigns

INTRODUCTION

As part of our "Right from the start" compliance strategy, Inland Revenue New Zealand (NZIR) has recently started to undertake targeted compliance campaigns, focused on specific sectors and compliance issues and making use of a range of information obtained from questionnaires and follow-up interactions. These campaigns are pro-active in nature and reflect the cooperative approach that the administration has taken in general during the COVID pandemic, allowing to assure a significant part of the tax base at a time when traditional audits were generally suspended.

As a result they have had very positive feedback on this new initiative, both from the multinational enterprises themselves (MNEs) as well as from their external advisors.

BACKGROUND

New Zealand's international tax strategy is based on a customer-centric compliance model, which includes a number of principles setting out how they will interact with their customers. As regards multinationals, NZIR takes a pro-active "right from the start approach" the aim of which is to engage with MNE taxpayers to ensure that they pay the right amount of tax at the right time through the right channels. This cooperative compliance environment also involves close working with other tax authorities and key business interests to foster tax certainty and to facilitate trade and investment.

More information on the general approach can be found in our 2019 document Compliance Focus for Multinational Enterprises (ird.govt.nz). Whilst the approach was not specifically designed as a direct response

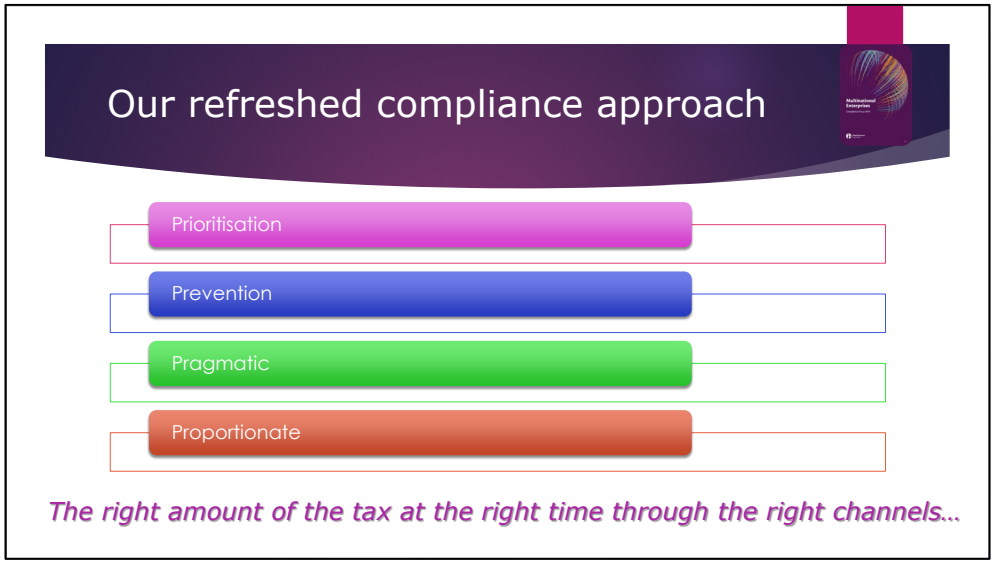
to the COVID-19 pandemic, NZIR has found it to be a highly effective approach in the difficult circumstances of the pandemic with implications for our future compliance approaches.

NEW ZEALAND'S COMPLIANCE APPROACH FOR MULTINATIONAL ENTERPRISES

NZIR has endorsed OECD's concept of "enhanced relationships" as regards MNEs based on risk management and transparency as well as a fair, open and responsive administration. Through this approach, the administration is aiming for cooperative and constructive relationships with taxpayers and their advisors, as well as to create an environment that supports full and frank dialogue. This is reflected in NZIR's "four P's" commitment to taxpayers. These are that NZIR will:

- **Prioritise** their interactions;
- Focus on the **Prevention** of issues;
- Be **Pragmatic** in reaching solutions; and
- Take a **Proportionate** approach in their actions and interventions.

The heart of the "Right from the start" approach is to prevent any non-compliance before it occurs through close monitoring, advance pricing agreements and practical guidance to allow MNEs to better self-manage their international financing and transfer pricing risks.

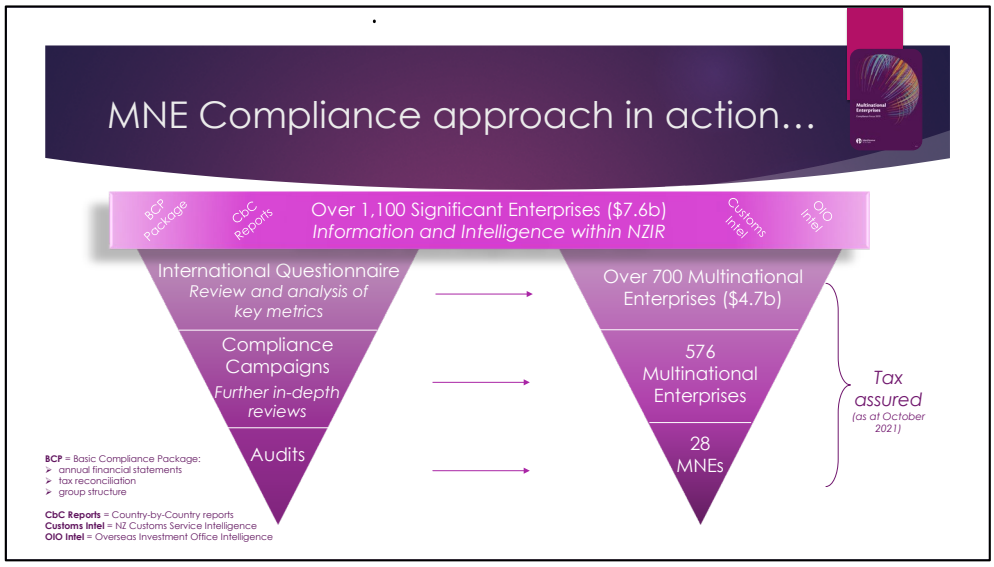


TARGETED CAMPAIGNS - DISTRIBUTORS

As part of this approach, NZIR has been actively monitoring all foreign-owned MNEs with an annual turnover of over $30m (except for banks and insurers, which are separately screened). In order to inform the strategic and operational risk processes in regard to this taxpayer segment, including our anti-BEPS measures, NZIR designed an international questionnaire 2020.pdf (ird.govt.nz) which is completed on an annual basis by these foreign-owned MNEs. Recently, this intelligence gathering process has been further enhanced through the analysis of both the additional information contained in country-by-country reports and in cross-border tax rulings.

The questionnaire covers key financial data as well as a mix of questions addressing new or emerging issues. The two largest sectors of this population were identified as distributors and manufacturers, so to further sharpen their focus NZIR decided to carry out a targeted campaign on distributors in the first instance.

NZIR issued in-depth questionnaires to, and received replies from, 372 MNEs (a 100% response rate). The questionnaires were wide-ranging and concentrated on key areas of risk in respect of potential base erosion and profit shifting. The replies were of a high quality, with many providing supplementary information and explanations.



This campaign had two principal objectives:

- A detailed evaluation of the sector's compliance with transfer pricing rules, there being an opportunity to compare and contrast replies not only across the broad sector but also within specific sub-sectors of the population; and
- Intelligence gathering to enhance our understanding of the sector and inform possible simplification measures and future automated risk rules.

Transfer pricing compliance has been found to be very good with only 13 or 3% of respondents being identified for further review or subsequently being placed on a watch list for close annual monitoring. Of the potentially high-risk cases identified, almost 50% were already subject to NZIR activity, confirming good coverage through existing compliance approaches.

After a comprehensive analysis, it was recommended that NZIR's current wholesale distributor simplification measure not be amended or extended due to the associated fiscal cost. Further, given the diversity of business activities undertaken by the non-routine wholesale distributor population, no opportunities to develop new simplification measures were identified. However, it was recommended that the range of risk indicators and observed features of routine wholesale distributors be incorporated into NZIR's risk rules and case selection processes.

EXPANSION OF TARGETED CAMPAIGNS

Building on the success of this initial campaign, in 2020 the administration successfully ran three further targeted compliance campaigns. This took place during a period when NZIR was also tasked with delivering several key COVID-19 economic support packages, whilst also continuing to deliver our ongoing and extensive business transformation programme.

The resulting resource pressures meant that NZIR had to take an innovative compliance approach. In this regard, they worked through a small team of specialists and deployed a graduated suite of interventions across the MNE population. These interventions ranged from analysis of questionnaire responses through to in-depth reviews

involving discussions with the customers and/or their representatives. These small teams were led by a compliance strategist and supported by an intelligence specialist and an advisor. Higher risk cases were referred to the front line customer compliance specialists (CCSs), supported by technical specialists, to carry out further investigations.

This campaign approach has allowed NZIR to have a wide coverage of the MNE population and to carry out in-depth reviews of key sectors and issues, using a small number of staff who have access to the right strategic and analytical capabilities depending on the level of risk. Across the four campaigns NZIR were able to cover almost half of the total in-scope foreign-owned MNE population.

LOSSES (14 MNES)

To review taxpayers which were persistently loss-making (i.e. that had made tax losses in two or more of the last three years), NZIR used a data gathering questionnaire, evaluated the responses and, in some cases, followed up with further questions. The results were used to place taxpayers into comparable groups as regards the reasons for losses, as well as referring the highest risk candidates for further transfer pricing compliance work. In all, 42 customers were initially analysed and, after further evaluation (based on materiality and other considerations), 14 customers were sent a questionnaire, with two of the 14 customers eventually referred for follow-up transfer pricing reviews.

ROYALTIES/INTANGIBLE PROPERTY (30 MNES)

The nature and mobility of intangible property (IP) arrangements undertaken by MNEs can give rise to international tax risks, predominately around transfer pricing and non-resident withholding tax (NRWT). This campaign was undertaken to examine the compliance among a selection of 30 customers from the in-scope foreign owned MNE population that had been flagged with an IP risk indicator. The review found that additional action or ongoing monitoring was required for 50% of these MNEs. Further, that analysis allowed them to validate the effectiveness of our current risk indicator and its continued use. They also found through this campaign that NRWT compliance was high overall.

FINANCING (84 MNES)

A selection of foreign-owned groups was made based on certain high-risk metrics and characteristics in respect of their financing arrangements. An in-depth Financing Questionnaire was then issued to 84 MNEs. The objective of the campaign was to obtain more detailed information about the financial performance of these MNEs, with a particular emphasis on their compliance with NZIR thin capitalisation and transfer pricing rules. The campaign also helped the administration to identify both new and emerging risks to the tax base with greater confidence. The analysis is not yet complete, but initial results indicate widespread compliance is very much the norm.

WAGE SUBSIDY (436 MNES)

A range of fiscal measures have been introduced in New Zealand to support businesses through the pandemic.

The New Zealand wage subsidy was intended to be a temporary support payment only available where an entity had suffered a required decline in actual or predicted revenue after having taken active steps to mitigate the impact of COVID-19 (for example, engaging with their bankers, or drawing on cash reserves as appropriate, or making an insurance claim). The subsidy must be repaid in a range of circumstances, including if the eligibility criteria have been breached; the funds were not used to pay the wages and salaries of the named employees; or insurance proceeds were received for the costs covered by the subsidies. Therefore, the subsidy supported the payment of wages and salaries but provided no competitive or market advantage. Further, the wage subsidy was specifically linked to the employment-related risks borne by the New Zealand recipient entity. A distressed business in these circumstances would not have been expected to amend its arrangements with independent suppliers or customers upon receipt of the subsidies.

Eligible businesses have included not only small and medium enterprises but also large MNEs operating in New Zealand. As at the end of 2020, 376 foreign-owned MNE groups with an annual turnover in excess of $30m had received NZ$830m in wage subsidies. It is generally expected that the benefits of such subsidies will be retained in New Zealand. However, NZIR identified a risk that MNEs entering into cross-border transactions with non-resident related parties, might inappropriately pass these benefits offshore through the pricing of such transactions.

Embracing a “right from the start” approach wherever possible, Inland Revenue has actively participated in OECD transfer pricing discussions to shape appropriate international consensus-based guidance on government assistance. Simultaneously, NZIR supplemented this international guidance with specific information on our website on the correct treatment of the New Zealand wage subsidy. This was followed up with key stakeholder engagement, including a series of meetings held with major advisory firms, supporting this messaging and providing an opportunity to discuss concepts widely, ensuring our position is well understood and compliance expectations are clear.

Intelligence work, including a comprehensive review of customers in our advance pricing agreement programme and our significant foreign-owned MNE population, identified specific customers who could be potentially impacted. Consequently, letters were sent providing further information to 436 MNEs, setting out the expectation that all of the government’s wage subsidy assistance should remain within the New Zealand economy. The letter provided specific examples and links to guidance, as well as a cautionary message to all MNEs as to the next phase of our compliance work. That compliance work commenced with a compliance campaign gathering further information from 436 MNEs to verify the treatment of the wage subsidy payments, including their transfer pricing practices in this regard. Analysis of questionnaire responses is in progress, to date 387 responses require no further action and the remaining responses are under review. This early detection, followed by specific education and close liaison with impacted advisers and taxpayers, should result in very few cases requiring audit enforcement resources being applied in due course.

OVERALL CONCLUSION

NZIR has found the campaign approach to be extremely effective. This was further reinforced by the positive feedback the administration has received from MNEs and their external advisors, who appreciated the way NZIR adapted their approach to respond to the challenges the pandemic presented.

This approach has also proven to be very successful, not just from a tax compliance perspective, aligning with New Zealand's overall "right from the start" compliance approach, but also by demonstrating the success of our enhanced relationship strategy with multinationals and their representatives, including our "four Ps" commitment to our customers.

The format of the campaigns has included in-depth upfront analysis, with tailored questionnaires sent to the selected candidates. On receipt, all responses were analysed and a "next action" determined, which were:

1. No further action required.
2. Follow-up for further information.
3. Further in-depth review.

Generally, there were very few MNEs (less than 10%) that fell into the third category, which meant NZIR were able to assure a large portion of the corporate tax base without using traditional audit methods during the difficult circumstances of the pandemic.

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