

**THE IMPACT OF OECD MEMBERSHIP UPON NEW ZEALAND'S INTERNATIONAL TAX POLICY AND
DTA NEGOTIATIONS –A COMPARATIVE TEXT ANALYSIS**

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ABSTRACT

The Organisation for Economic Cooperation and Development (OECD) has played a significant role in the area of taxation since its inception in 1961. Among its contributions to international tax coordination was the release of a draft model tax convention, revised many times subsequently, which has been adopted by many countries as a template for them to negotiate their double tax agreements (DTAs) from.

New Zealand was not one of the founding members of the OECD. New Zealand joined the OECD in 1973, following Australia in 1971 and Japan in 1964. New Zealand's later entry into the OECD after the Draft Model Convention first appeared in 1963 provides an interesting opportunity to examine the extent that OECD membership has influenced New Zealand's DTA negotiations and international tax policy, using as a primary analysis tool a computer based text comparison programme.

The results obtained show that prior to joining the OECD none of New Zealand's DTAs were based on the OECD Model. Only after it joined the OECD and entered its reservations to the 1977 version of the OECD Model did that Model have any influence upon New Zealand's DTA negotiations. Now nearly forty years on since joining, New Zealand has a network of 37 DTAs, most of which are based upon the OECD Model. Despite this, all of these DTAs depart in some areas from the OECD Model, the reasons for which are analysed further in this article.

Overall it appears the OECD Model has assisted New Zealand's DTA negotiations enabling it also to enjoy the benefits flowing from the international acceptance of the Commentaries as a tool for interpretation. The OECD Model may have also made it harder for New Zealand to negotiate DTAs with articles that differ substantially from international tax norms and has probably been a factor behind some of the latest changes to New Zealand's international tax rules.

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I INTRODUCTION

The Organisation for Economic Cooperation and Development (OECD) has played a significant role in international tax matters since its inception in 1961. Building on work done by the League of Nations in the 1920s and later the OECD's predecessor organisation, the Organisation for European Economic Co-operation (OEEC), the OECD released a draft model tax convention in 1963. This model convention has subsequently become adopted by many countries as a template for them to negotiate their double tax agreements (DTAs) from. In parallel with the emergence of the OECD Model Agreement as the basis for DTA negotiations, the OECD itself has become the preeminent international forum for the examination and discussion of tax and public finance issues.

New Zealand was not one of the founding members of the OECD. The OECD's origins were from a pan American-European organisation, the OEEC, which was established in 1948 as part of the Marshall Plan for United States (US) economic assistance for the reconstruction of Europe after World War II, which obviously did not concern New Zealand. New Zealand's accession to the OECD did not occur until 1973, following Australia in 1971 and the first non-European/American member, Japan, in 1964.

New Zealand's entry into the OECD after the OECD Draft Model Convention appeared in 1963 provides an interesting opportunity to examine the extent that OECD membership has influenced New Zealand's DTA negotiations and international tax policy, using as a primary analysis tool a computer based text comparison programme. The results obtained show that OECD membership has had a pronounced effect upon New Zealand's DTA negotiations, leading to a network of 37 DTAs today, most of which are based upon various versions of the OECD Model Convention. Despite this influence of the OECD Model, New Zealand's DTAs do not consistently adhere to the OECD Model in every respect and in a number of areas feature significant departures from it which are categorised and analysed in this article.

The remainder of this article is organised as follows. In the next section a brief statement of the research method employed in this study is laid out, which is followed in section 3 with a review of the role of the OECD in international tax matters. Section 4 then discusses New Zealand's early DTAs prior to it joining the OECD, which is followed in section 5 by the developments after its accession to the OECD. Section 6 briefly considers the effect that the OECD Model has had on New Zealand's international tax policy. Finally section 7 sets out our conclusions.

II RESEARCH METHOD

In this article we utilise a text comparison function imbedded in a well-known and widely used word processing programme (Microsoft Word 2007) to analyse and review New Zealand's DTAs from the first one negotiated in 1947 with the UK to the latest one (at the time of writing in mid 2011) negotiated with Hong Kong. The analysis in this article focuses on two periods in which DTAs were negotiated by New Zealand, namely before and after New Zealand's accession to OECD membership.

The text comparison function contained in MS Word 2007 produces a single comparison report specifying the additions, deletions and common text between two different text

documents. Using this text comparison function, a comparison report was produced for each of New Zealand's DTAs showing the results of a comparison between it and the corresponding version of the OECD Model when it was negotiated. These reports were used to analyse the content of New Zealand's DTAs to identify trends, similarities and themes in their drafting, as well as areas of departure from the OECD Model with a high level of detail. The text comparison function enables subtle wording differences to be identified and highlighted, making what would otherwise be a substantial and resource intensive exercise possible. This computer-based text comparison also enables patterns in departures from the OECD Model to be identified which are useful in identifying policy points in New Zealand's DTA negotiations which have not usually been publicly discussed or canvassed in policy documents. This is particularly so where paragraphs in OECD Model articles have been supplemented by additional paragraphs inserted at the request of New Zealand or one of the other treaty partners being a common point of departure in many of New Zealand's DTAs from the OECD Model. The use of computer-based text analysis is less useful at determining whether two articles prescribe much the same treatment but using different words. This, however, is less of an issue in this article as this only arises with DTAs New Zealand has negotiated prior to it adopting the OECD Model for its DTA negotiations.

III ROLE OF THE OECD IN INTERNATIONAL TAX MATTERS

Since its inception in 1961 the OECD has played a preeminent role in international tax matters. Not long after its establishment in 1961, it released a draft model tax convention in 1963, followed by a revised version in 1977 which has been regularly revised at more frequent intervals up to the present day. The OECD Model, as it has come to be known, has become the template for DTA negotiations between member states and also with many non-member states.

The OECD has no powers of compulsion in international tax matters. It is a forum of sovereign states represented by their governmental officials. The OECD recommends that member states negotiate DTAs between each other which is a recommendation widely followed by OECD members.

The Council of the OECD also recommends that when members are negotiating DTAs, the agreements should conform to the OECD Model as interpreted by the Commentaries, having regard to any reservations noted.¹ As a result of this recommendation, the DTAs negotiated by member states tend to have a high degree of uniformity between them which is intended by the OECD as being the most appropriate way to address international tax issues:

It has long been recognized among the Member countries of the OECD that it is desirable to clarify, standardize, and confirm the fiscal situation of taxpayers who are engaged in commercial, industrial, financial, or any other activities in other

¹ The intended role of the Commentaries to the OECD Model Tax Convention in the interpretation of DTAs based on the OECD Model has been expressly recognised by the New Zealand Court of Appeal in *CIR v JFP Energy Inc* (1990) 12 NZTC 7,176. New Zealand is also a signatory to the Vienna Convention on the Law of Treaties negotiated in 1969.

countries through the application by all of common solutions to identical cases of double taxation.²

The appearance of the words “standardize” and “common solutions” emphasises that the OECD wishes member states to enter into arrangements that are broadly comparable, which is consistent with the highly degree of uniformity seen between most of the DTAs negotiated by members, whether with other members or non-member states.

This influence of the OECD Model, and the emphasis in the accompanying Commentaries for standardised and common solutions to resolve problems of double taxation, provides an interesting platform for addressing the issues that are the focus of this article due to the adoption of text comparison as the research method.

IV NEW ZEALAND’S EARLY DTAs PRIOR TO OECD MEMBERSHIP

A Background

Despite legislating for the taxation of its residents’ worldwide incomes in 1916, New Zealand was slow to enter into bilateral treaties to address the problems of international double taxation. When residence based taxation was introduced in 1916, the resulting problem of international taxation was addressed by exempting from New Zealand tax any income which had been derived in and had borne tax in other jurisdictions of the British Empire. This exemption was not made pursuant to any bilateral or multilateral treaties but based on a mutual understanding between the British dominions and the United Kingdom (UK).³ No relief of any kind was provided against double taxation on income derived from non-British sources including any deduction for foreign taxes against New Zealand assessable income which often lead to harsh outcomes as was noted by the Gibbs Committee in 1951.⁴ This situation also reflects New Zealand’s focus and high degree of reliance on the UK and the British Empire generally, along with the limited ability for New Zealand residents to access and utilise funds internationally.

Reflecting New Zealand’s status as a capital importing country, from when income tax was imposed in New Zealand it sought to protect and (to some degree) extend its source taxing rights. Unsurprisingly, this assertion of source taxing rights brought it into conflict with other states. Until the early 1960s, any business obtained by a non-resident trader from New Zealand through an independent agent on their behalf was deemed to be sourced in New Zealand. This led to threats of retaliation against New Zealand traders in the 1930s which resulted in New Zealand granting exemptions for non-resident traders on a reciprocal basis if New Zealand traders would be similarly exempt. This matter also led New Zealand to enter into its first bilateral treaties concerning income tax with the UK and Canada addressing the taxation of non-resident traders. Another example of New Zealand’s assertion of source taxing rights was to

² *OECD Model Tax Convention on Income and on Capital*, 2008, OECD Paris, Introduction, [2].

³ For a history of Dominion tax relief in the UK see P Harris, ‘An Historic View of Principle and Options for Double Tax Relief’ (1999) 6 *British Tax Review*, 469, 473-476.

⁴ See Taxation Committee (T N Gibbs Chairman, R E Owen), *Report of the Taxation Committee*, (1951), 98-99, [415].

deem the income of non-resident shipping companies derived from the carriage of goods from New Zealand to be New Zealand sourced. This too brought New Zealand into conflict with other countries that followed the emerging standard that international transport enterprises would only be taxed in the jurisdiction where they were headquartered.

By today's standards these issues may appear trivial. They are important, however, in the context of the analysis contained in this article as illustrations of how New Zealand in earlier times had attempted to maintain international tax policies which were at variance with international norms, even those existing in the 1930s.

New Zealand's first comprehensive DTA was not entered into until 1947 when it negotiated a DTA with the UK. This DTA was concluded as a result of an offer by the UK Government to negotiate DTAs with its dominions after it had negotiated its first comprehensive DTA in 1945 with the US.

After the negotiation of the UK DTA in 1947, New Zealand slowly extended its DTA network. It negotiated DTAs with Canada and the US shortly after the UK one in 1947, but only two further agreements were negotiated in the next decade - one with Sweden in 1956 and another with Australia in 1960. The 1960s saw New Zealand's DTA network extend by one to include Japan in 1963 although the 1947 UK DTA was renegotiated and updated in 1966. New Zealand's DTA negotiations were similarly limited in the early-to-mid 1970s with only three new DTAs signed in this period (being with Singapore 1973, and Malaysia and Fiji in 1976) while the earlier DTA with Australia was renegotiated and updated in 1972. Not until it entered its reservations and observations to the 1977 OECD Model Convention did New Zealand start to extend its DTA network to one commensurately broad for an OECD member state.

B Analysis of New Zealand's DTAs Negotiated Prior to the 1963 OECD Draft Model

In the period from when New Zealand entered its first comprehensive DTA in 1947 until when it entered its reservations and observations to the OECD Model in 1977, it concluded only eleven DTAs with nine countries. It has not been officially disclosed whether a model convention or template was used in these early DTA negotiations, nor whether ones negotiated in the latter part of that period up to 1977 were based on the OECD Draft Model released in 1963. One way these questions can be answered is through the use of a text comparison analysis as adopted in this article.

New Zealand's first DTAs (being those with the UK and Canada in 1947 and 1948, respectively) followed a similar pattern. The number of articles in these DTAs was approximately half those found in a modern agreement based upon the OECD Model Tax Convention. Articles covering business profits, associated enterprises, shipping and air transport, royalties, government service, pensions, professors, students, along with an article to relieve double taxation by requiring foreign tax credits to be granted on a reciprocal basis, were included as well as ones dealing with administrative matters such as information exchange, entry into effect and termination. Also of note in respect of these two DTAs:

- The royalty article in the Canadian DTA applied only to copyright royalties, while the UK DTA contained a more expansive definition which also included industrial royalties

except those relating to mining and natural resource exploitation. The leasing of scientific and industrial equipment was not brought within the scope of the royalty article in either treaty.

- Royalties were exempt from tax in the source state in both DTAs.
- Any business of insurance carried on in New Zealand by a resident of the other contracting state was not covered by the business profits article; however, the converse did not apply. These provisions reflected New Zealand's longstanding policy of reserving the right to tax non-resident insurers under its domestic rules.
- The personal services articles were not clear whether they applied to independent personal services (that is, independent contractors) or employees or both. The respective articles contained wording, parts of which are found in both the independent and dependent personal services articles of more modern DTAs.
- The definitions of "permanent establishment" (PE) were considerably briefer than what is found in modern DTAs today.
- The dividend article in the UK treaty provided for an exemption in the residence state, although dividends paid by New Zealand to UK residents could be taken into account for tax rate scale purposes. Dividends were not covered at all in the Canadian DTA.
- Interest was not covered in either DTA.
- Neither the UK nor Canadian DTAs contained a residence "tie-breaker" clause.

Many matters covered in modern DTAs were not addressed at all. There were no articles dealing with alienation of property, artistes and sportsmen, diplomats or other income. More importantly, there were no articles covering a mutual agreement procedure. On the other hand, there was an article dealing with visiting professors, which is not found in modern DTAs, or in any version of the OECD Model. This may in part be attributed to the typical situation that a university professor would take a year's sabbatical leave and spend this time in another country, usually with another member of the British Commonwealth or in North America.

A text comparison analysis shows some degree of commonality between these two DTAs. This suggests that there was a draft convention of British origins used as a basis for negotiations, possibly one from the UK given that the UK had offered to negotiate DTAs with its dominions (New Zealand, Australia, Canada and South Africa), after concluding its first comprehensive DTA with the US in 1945.

Interestingly, a comparison of this 1945 UK-USA DTA with the DTAs New Zealand negotiated with the UK and Canada shortly after, shows they had little in common, reinforcing the view that a British drafted model (or template) came into existence after the 1945 DTA with the US was negotiated.

The DTA New Zealand concluded with the US in 1948 contained a similar number of articles as the UK and Canadian ones; however, some matters were dealt with in a different manner. The dividend article permitted source taxation of 15 percent on dividends with a reduced rate of 5 percent applying to dividends if the payee was 95 percent or more owned by the recipient of the dividend. Special provision was made for the New Zealand film hire tax imposed on non-resident film renters.

A text comparison analysis confirms that this treaty had very little in common with the UK and Canadian treaties negotiated around the same time. It seems probable that this DTA New Zealand negotiated with the US was based upon a draft supplied by the US given the absence of any commonality with the UK and Canadian DTAs.

New Zealand negotiated three more DTAs before the release of the OECD Draft Model in 1963. These DTAs were with Sweden in 1956, Australia in 1960 and Japan in 1963. The Swedish DTA was New Zealand's first to include an interest article. Interest and royalties were to be taxed on a split basis 60/40 in favour of the source state allowing the source state to maintain their domestic law treatment on the 60 percent allocated to them. This arrangement was not followed in any subsequent New Zealand DTA and therefore is unique. A text comparison analysis shows there was some carryover of articles from the 1947 UK DTA to this agreement suggesting that New Zealand's first DTA had been influential to some extent in subsequent negotiations. This may have been due to language considerations or that New Zealand's negotiators prevailed in some areas for wording from the earlier UK DTA to be adopted.

Surprisingly, there was less carryover from the 1947 UK DTA to New Zealand's first DTA with Australia signed in 1960. The origins of this treaty are unknown but appear not to be closely linked to the UK DTA.

New Zealand signed a DTA with Japan in 1963 which was the result of a number of meetings with Japanese negotiators going back to the late 1950s. Although it was signed in the same year as the OECD Draft Model Convention was released, it has nothing at all in common with the 1963 OECD Draft Model. A text comparison analysis also shows that this DTA had little in common with any of New Zealand's earlier DTAs although some paragraphs are the same as those appearing in the UK 1947 DTA. Again this supports a conclusion that these may be areas where New Zealand negotiators prevailed, possibly reflecting their comfort and familiarity with existing provisions from New Zealand's first DTA signed with the UK in 1947.

C New Zealand's DTAs negotiated after the 1963 OECD Draft Model but before New Zealand's OECD Accession

After the release of the OECD Draft Model in 1963, New Zealand negotiated one more DTA in the 1960s. This was a new DTA with the UK to replace the earlier 1947 agreement. This agreement is New Zealand's first where the newly released OECD Draft Model Convention could potentially have had some influence, especially since the UK was a founding member of the OECD.

This DTA is notable for the comprehensive range of articles it included compared to a much smaller number in the 1947 DTA. However, apart from that aspect, a text comparison analysis shows it has little in common with the 1963 OECD Draft Model. This agreement is significantly different to the earlier one it replaced, and with the UK's membership of the OECD there must have been some chance the OECD Model (to which they would have been presumably a party to its drafting), would have influenced the negotiations. This appears not to have been the case, possibly indicating that the OECD Model had not met with wide acceptance in the mid-1960s as it would achieve in later decades or that the UK was happier to continue with DTA negotiations based upon their models which were in existence prior to the release of the 1963 Draft Model.

In the 1970s, up to when New Zealand first entered its reservations and observations to the 1977 OECD Model, it negotiated four DTAs. The first was one with Australia in 1972

to replace the earlier one negotiated in 1960. As Australia only joined the OECD in 1971, negotiations for this new DTA would have started prior to Australia's accession to the OECD. Unsurprisingly, a text comparison analysis shows that this new DTA with Australia had little in common with the 1963 OECD Model.

New Zealand negotiated three new DTAs with Singapore, Malaysia and Fiji between 1973 and 1976. Two of these (Malaysia and Fiji) were concluded after New Zealand's accession to the OECD, while the Singaporean one was signed the same year as New Zealand's accession. Negotiations for the Singaporean DTA go back to 1968 while the other two commenced around 1970. Interestingly all three DTAs have a high degree of commonality and appear to have been negotiated from the same model or draft agreement; however, a text comparison analysis shows that they are not based on the 1963 OECD Model. The high degree of commonality between the Malaysian and Singaporean DTAs is not surprising as New Zealand had close relations with both Singapore and Malaysia and did not want to be seen to favour one over the other.

In conclusion it can be seen that New Zealand's DTA negotiations prior to its accession to the OECD appear not to be influenced by any underlying model to any great extent. Given that New Zealand had taken the stance that it would not initiate DTA negotiations, but only enter into them in response to a request from another country, it may have resulted in negotiations starting from models or drafts supplied by the other state. In the early stages there were significant differences between each DTA, suggesting that devising standardised solutions to international tax problems was not seen as important, or possibly the differences may have been the result of not basing negotiations upon an internationally accepted model, as the OECD Model has come to be.

V ACCESSION TO OECD – DTAs FROM 1978 ONWARDS

A Introduction

New Zealand joined the OECD in 1973. One requirement of membership was for New Zealand to state its position on the OECD Model by entering any reservations and observations it had to it. New Zealand initially managed to delay this process by determining its reservations and observations with respect to the 1977 version of the OECD Model and not the 1963 Draft Model. It deferred starting any DTA negotiations with other OECD members until the 1977 Model Agreement had been released even though it concluded three more DTAs in the period 1973 to 1976 as explained in the previous section. None of these DTAs were with OECD members and they were all the result of negotiations which had commenced prior to 1973.

After New Zealand had entered its reservations and observations to the 1977 OECD Model Agreement, it commenced negotiations with a number of OECD members and in a relatively short period of time DTAs were concluded with Germany (1978), France (1979), Italy (1979), Netherlands (1980), Switzerland (1980), Denmark (1980), Belgium (1981), Finland (1982), and Norway (1982). In addition four existing DTAs were renegotiated in the same period - Sweden (1979), Canada (1981), US (1982) and the UK (1983) - in each case the earlier DTA was replaced with one based upon the

1977 OECD Model.⁵ Also in the same period New Zealand negotiated DTAs with a number of non-OECD states mainly in the Asia region. Starting with the Philippines in 1980, DTAs were concluded with South Korea in 1981, and China, India and Indonesia all in 1986.

A text comparison analysis shows that all of New Zealand's DTAs negotiated after its input to the 1977 OECD Model have been based upon the OECD Model including those negotiated with non-OECD states. While the fact that the DTAs concluded with other member states follow the OECD Model reflects New Zealand's adherence to OECD recommendations (and the obligations of membership), the fact that all the DTAs negotiated by New Zealand with non-member states since its accession to the OECD also follow the OECD Model suggests something more. It appears that New Zealand saw advantages from negotiating DTAs based on the OECD Model, especially the benefits of the Commentaries in interpreting and applying DTAs based on the OECD Model. It may also have been indicative of a similar acceptance by non-members of the OECD Model, especially since the Commentaries also incorporate input from non-member states, including a number from Asia, in recent times. Another advantage following from the OECD Model for both New Zealand and non-member states would be the efficiencies the OECD Model would have provided for DTA negotiations.

While New Zealand has adopted the OECD Model in all of its DTA negotiations starting with the 1978 German DTA, none them follow the OECD Model in its entirety. There is a pattern in all of New Zealand's DTAs of departures from the text of the OECD Model, usually in similar ways. These departures are not unique to New Zealand DTAs; all member states depart from some parts of the OECD Model when negotiating DTAs to a lesser or greater extent.

A text comparison analysis enables these departures from and differences to the OECD Model in New Zealand's DTAs to be identified and analysed. They can be categorised as follows:

- Matters where Reservations/Observations have been entered to the OECD Model.
- Changes to terminology and phrasing resulting in differences of minor nature.
- Adoption of alternative text from the Commentaries to the OECD Model.
- Revised wording to address deficiencies in the drafting of some articles from the OECD Model highlighted by court decisions.
- Retention of provisions from earlier versions of the OECD Model.
- Clarification and enhancement of articles from the OECD Model.
- Articles concerning taxes which the OECD Model does not cover.

B Matters Where Reservations/Observations Entered to the OECD Model

An obvious reason for departure from the OECD Model is in respect of articles to which either New Zealand and/or the other contracting state have entered reservations or

⁵ Interestingly, it was not until 1995 that New Zealand revised its DTA with Australia to one based upon the OECD Model and in 2009 the Singapore DTA was updated to one based on the OECD Model. As at time of writing only three of New Zealand's DTAs, which are currently in force, are not based upon the OECD Model, namely the agreements with Japan (1963), Malaysia (1976) and Fiji (1976).

observations. The number of reservations entered by New Zealand appears average by OECD standards, and all member states have entered reservations or observations to the OECD Model to some extent.

In respect of Article 5, New Zealand wishes to retain the right to deem construction and assembly projects a PE if they exist for longer than 6 months, not 12 months as found in the OECD Model. In about half of New Zealand's DTAs, construction projects become a PE after 6 months, while in the remainder the 12 month rule prevails.

In respect of Article 7, New Zealand has entered a reservation to retain the primacy of its domestic rules applying to the taxation of insurance by excluding the taxation of insurers from the scope of Article 7. This allows New Zealand to tax premiums derived by non-resident insurers in respect of New Zealand risks despite the absence of a permanent establishment (PE) in New Zealand. This reservation has been incorporated into 36 of the 37 DTAs New Zealand has negotiated. The Swiss DTA is the one exception.⁶ This exclusion of insurance is usually achieved by a separate clause in Article 7 or in an attached protocol negotiated at the same time as the DTA. The latter is more commonly found with DTAs negotiated with other OECD members.

Another area where there is a departure from the text of the OECD Model, reflecting a reservation New Zealand has entered,⁷ is a provision to cover profits derived by a beneficiary of a trust from a business carried on by the trustee through a PE in the other contracting state.⁸ The provision is essentially a "look-through" and deems the beneficiary to derive income from that PE despite it being earned by the trustee.

New Zealand has also entered a reservation in respect of Article 8 (Transport) concerning domestic transport. Many of New Zealand's DTAs include an additional paragraph in Article 8 allowing a contracting state to tax a transport operator from the other state if they carry goods or traffic between two domestic points in the first state. This is important to New Zealand as it permits foreign ships to upload and discharge cargo between New Zealand ports. New Zealand also permits foreign airlines to similarly carry traffic between two New Zealand airports in some situations.

In respect of Article 12, New Zealand has reserved the right to tax royalties at source and not to exempt them. It has also reserved the right to include within the definition of 'royalty' payments for the leasing of industrial, commercial or scientific equipment and of containers, and not to follow the deletion of these activities from the royalty definition arising from the 1992 revision of the OECD Model. As consequence, a large

⁶ Under section CR 3(3) *Income Tax Act 2007* (NZ) (ITA), non-resident general insurers are taxed on a deemed basis, with their net income being deemed to be 10 percent of the gross premiums sourced from New Zealand.

⁷ Commentary on *OECD Model Tax Convention on Income and on Capital*, (2008, OECD, Paris) Article 7 [76]. Australia has also entered a reservation on the same point.

⁸ Found in the DTAs with Australia (2009) in Article 7(7); Singapore (2009) in Article 7(6); Thailand in Article 7(7).

proportion of New Zealand's DTAs still include equipment leasing within the royalty definition.⁹

New Zealand has also entered a reservation to Article 14 (deleted from the OECD Model in 2000) which has resulted in departures from the text of the OECD Model in its DTAs. The independent services article in New Zealand's DTAs usually allows professional services to be taxed where the provider is present in the state for more than 183 days in any 12 month period even though they do not have a fixed base available to them.¹⁰ This 183 day/12 month rule was not found in Article 14 of the OECD Model Convention prior to its deletion in 2000 but was noted in a reservation New Zealand had to that Article.

New Zealand has also reserved its position to the non-discrimination article in the OECD Model. Approximately half New Zealand's DTAs do not contain such an article. In those that do, there are often significant departures from the text of Article 24 from the OECD Model. The second sentence from Article 24(3) of the OECD Model Convention referring to personal reliefs and grants is omitted from paragraph (3) and is usually shifted to a stand-alone paragraph. This means that the exclusions for personal reliefs and grants are not limited to just PEs but apply in respect of all matters (including, for example, employment income).

The equivalent of Article 24(5) in New Zealand's DTAs usually contains a major variation which substantially restricts the way in which the non-discrimination article applies to associated enterprises.¹¹ Article 25(5) of the OECD Model Convention prevents a contracting state from imposing any requirement which is other or more burdensome on enterprises of a contracting state which are controlled by residents of the other contracting state in comparison to similar enterprises of the first state. In the New Zealand DTAs, the restriction is not in terms of the requirements imposed on locally controlled enterprises vis-à-vis non-resident controlled ones but instead when compared to enterprises controlled by residents of third states. Thus Article 24(5) in New Zealand's DTAs becomes more of a "most favoured nation" clause.

In the other direction, several OECD members have entered reservations to Article 9(2) of the OECD Model which requires a contracting state to make compensating adjustments where the other state has made a transfer pricing adjustment pursuant to Article 9. A number of New Zealand's DTAs do not have Article 9(2) included, with nearly all being OECD members that have entered a reservation to that paragraph in the Commentaries.¹²

⁹ The two exceptions being the 2009 DTA with Australia and the 1983 DTA with the US due to revisions from the 2008 protocol.

¹⁰ DTAs with India, Indonesia, Ireland, Norway, Philippines, Russia, Sweden, Taiwan, Thailand, Turkey, United Arab Emirates (UAE), UK and the US.

¹¹ The variation appears in the DTAs with Austria, Belgium, Chile, Denmark, Mexico, Netherlands, Poland, Russia, South Africa, Spain, Thailand and Turkey.

¹² For example, DTAs with Belgium, Finland, France, Germany, Indonesia, Italy, Korea, Norway, Sweden, Switzerland and the UK.

C Differences of a Minor Nature

The computer-based text comparison shows that some of New Zealand's DTAs contain text which has been changed to a minor degree from the OECD Model Convention but not in a way that changes the meaning of that article in any substantial way. In a number of New Zealand's newer DTAs this has occurred because New Zealand has a policy of adopting gender-free wording in its legislation while the OECD Model Convention contains wording in the masculine gender.¹³ Another reason for these minor changes in wording is to adopt terminology found in one or both of the contracting states' domestic law rather than the terms used in the OECD Model Convention. The OECD Model Convention also employs terminology in some parts reflecting civil code legal systems (that is, "immovable property") when New Zealand's legal system is based on common law which may use different terminology.¹⁴

One article which appears to have undergone a significant redrafting from the one from the OECD Model, but often not resulting in any substantial difference, is Article 23 (Methods for Elimination of Double Taxation). The wording found in Article 23 in virtually all of New Zealand's DTAs does not follow the OECD Model. The OECD Model has generic provisions (for either exemptions or foreign tax credits) which apply to both contracting states. New Zealand's DTAs usually have separate paragraphs for each contracting state even though in most DTAs both states agree to reciprocally grant foreign tax credits. The adoption of non-OECD wording appears to have been to reflect specific features of each contracting states' domestic law regarding foreign tax credits.

D Alternative Drafting Options from the Commentaries

There are a number of instances in New Zealand's DTAs where the text departs from that of the OECD Model but the text adopted is from an alternative set out in the Commentaries to that article. For example, in about half of New Zealand's DTAs, Article 8(1) has been amended so that the basis for taxing transport enterprises is not based on the place of "effective management", but merely specifies "enterprises from one contracting state". This variation is suggested as an alternative in paragraph 2 in the Commentaries on Article 8.

Another example can be found in the definition of interest from Article 11(3). New Zealand's DTAs almost always include a clause to the effect that interest includes income treated as income (or assimilated to income) from money lent by the laws, relating to tax, of the Contracting State in which the income arises. This would permit reclassification of lease payments in respect of a finance lease as interest where in the absence of this wording it could be difficult to sustain.¹⁵ This issue is discussed in paragraph 21 of the OECD Commentary on Article 11.

¹³ See G Hunt, 'New Zealand's Evolving Approach to Tax Treaties' (2008) 14(2) *New Zealand Journal of Taxation Law and Policy* 131, 150.

¹⁴ *Ibid* 155-6.

¹⁵ Refer to: Austria DTA Article 11(4), Chile DTA Article 11(3), Czech Republic DTA Article 11(4), Ireland DTA Article 13(3), Italy DTA Article 11(4), Korea DTA Article 11(4), Mexico DTA Article 11(4), Philippines DTA Article 11(3), Poland DTA Article 11(3), Russian Federation DTA Article 11(3), South

In 2000 the OECD Model was revised and Article 14 covering independent personal services was deleted. A number of New Zealand's DTAs negotiated since 2000 have followed this deletion and excluded an equivalent to the earlier Article 14.¹⁶ However, specific reference to such activities has usually been shifted to Article 5 in the definition of "permanent establishment", deeming a PE to arise when professional services are provided using a 183 day/12 month rule similar to that found in Article 14 in earlier DTAs. This has been done by adopting alternative wording from the Commentaries in paragraph 42.23 in respect of Article 5.

E Reversing Unfavourable Court Interpretations

Another reason for a departure from the text of the OECD Model Convention is to overcome an unfavourable interpretation by a court of an article from the OECD Model. A number of New Zealand's more recently negotiated DTAs include a minor but significant variation to Article 15(2)(c) applying to the taxation of dependent personal services.¹⁷ In the OECD Model Convention the paragraph reads "the remuneration is not borne by a permanent establishment..." while in a number of New Zealand DTAs this has been changed to:

"the remuneration is not *deductible* in determining the taxable profits of a permanent establishment".

This revised wording reflects a change in New Zealand's negotiating position as a result of a case *CIR v JFP Energy Inc.*¹⁸ This case concerned the New Zealand taxation of non-resident employees employed by a non-resident oil exploration company while they worked on their employer's oil exploration rig in New Zealand waters drilling for oil. The taxpayer did not charge the salaries of these employees against its New Zealand branch (PE) income in tax returns filed in New Zealand. The CIR contended that New Zealand was entitled to tax the remuneration of these employees under Article 15 of the US DTA as the remuneration was borne by a PE in New Zealand even though no deduction had been sought in New Zealand against the PE's income. The New Zealand Court of Appeal held that because their remuneration had not been deducted against their employer's New Zealand branch income, it had not been borne by a PE in New Zealand and therefore the remuneration paid to these employees was not taxable in New Zealand but solely in the US.

The revised wording New Zealand has adopted in Article 15(2)(c) effectively establishes a nexus test according to whether the employee remuneration would qualify for a deduction against the income of a PE, irrespective of whether a deduction has been claimed or sought by the taxpayer. This revised wording is also consistent with the

Africa DTA Article 11(4), Spain DTA Article 11(4), Taiwan DTA Article 11(3), Thailand DTA Article 11(4), and UAE DTA Article 12(5).

¹⁶ These include the DTAs with Australia (2009), Chile, Czech Republic, Mexico, Poland, Singapore (2009), South Africa and Spain. This is an area where the OECD Model Convention and UN Model Convention differ, and New Zealand has followed the UN Model Convention.

¹⁷ See the DTAs with Australia, Austria, Czech Republic, Mexico, Philippines, Singapore (2009), South Africa, Spain, Thailand, Turkey and the UAE. The DTA with Norway uses the word "connected with" instead of "borne by".

¹⁸ (1990) 12 NZTC 7,176 (CA).

revisions to Commentaries on Article 15, paragraph 2 made in 2000 which clarified what the phrase “borne by” means.¹⁹

It is also interesting to note that several countries (Ireland, Norway and the UK) have entered a reservation to Article 15 to reserve the right to insert “special article provisions regarding income derived from employment relating to offshore hydrocarbon exploration and exploitation and related activities”.²⁰ This is clearly to address the same concerns that New Zealand had from the *JFP Energy* case.

F Retention of Features from Earlier Versions of the OECD Model

Revisions to the OECD Model have not always met with New Zealand’s approval. In 2000 the OECD Model was revised and Article 14 applying to independent personal services was deleted. A number of New Zealand’s DTAs negotiated since 2000 have followed this revision and excluded the equivalent to Article 14.²¹ However, specific reference to such activities has been shifted to Article 5 in the definition of “permanent establishment”, deeming a PE to arise when professional services are provided under a 183 day/12 month rule comparable to that found in earlier DTAs with an independent services article (Article 14). This suggests that New Zealand was not comfortable with the deletion of Article 14 from the OECD Model Convention in 2000, and therefore has effectively retained the provisions of the old Article 14 in its more recently negotiated DTAs. This treatment is also consistent with an option discussed in the revised Commentaries to Article 5.

An area where this will arise in future is in respect of Article 7 (Business Profits). Article 7 underwent a major revision in the 2010 update of the OECD Model; however, New Zealand has entered a reservation to the new version of Article 7 to retain the right to use the previous version of Article 7 taking into account its observations and reservations on that previous version. This is because New Zealand “does not agree with the approach reflected in Part I of the 2010 [OECD] Report *Attribution of Profits to Permanent Establishments*”.²²

G Clarification and Enhancement of Articles from the OECD Model

A feature of many of New Zealand’s DTAs is the inclusion of additional paragraphs in Articles based on ones from the OECD Model. Some of these incorporate discussion from the Commentaries into the DTA to reduce or eliminate ambiguity in the interpretation of an article. In other parts these additions provide greater clarity as to how New Zealand and the other contracting state will apply that article.

¹⁹ Commentary on *OECD Model Tax Convention on Income and on Capital* (2008, OECD, Paris) Article 15 [7].

²⁰ *Ibid.*

²¹ These include the DTAs with Australia (2009), Chile, Czech Republic, Mexico, Poland, Singapore (2009), South Africa and Spain. This is an area where the OECD Model Convention and UN Model Convention differ, and New Zealand has followed the UN Model Convention.

²² OECD, *Model Tax Convention on Income and on Capital -Condensed Version 2010*, Paris, France, July 2010, 153 [95].

In Article 5(3) a number of New Zealand's DTAs include an anti-avoidance provision to prevent the splitting of a large construction contract between associated parties so that each part is of less than 6 or 12 months duration.²³ This issue is discussed in paragraph 18 in the Commentaries to Article 5(3) although no definitive solution to this issue is advanced in the Commentaries.

Many of New Zealand's DTAs also include in Article 5 an additional provision covering supervisory activities that are related to construction projects and where substantial equipment or machinery is used for more than 12 months in a contracting state. Article 5(5) from the NZ-Finland DTA is typical of this provision:

5. An enterprise of a Contracting State shall be deemed to have a permanent establishment in the other Contracting State if:
 - a) it carries on supervisory activities in that other State for more than twelve months in connection with a construction, installation or assembly project which is being undertaken in that State; or
 - b) substantial equipment or machinery is for more than twelve months in that other State being used by, for or under contract with the enterprise.

Some of New Zealand's DTAs also contain specific provisions in Article 5 to ensure that natural resource exploration and exploitation activities constitute a PE. This is an important issue to New Zealand in respect of offshore oil exploration and development.

While Article 9 from the OECD Model has only two paragraphs, some of New Zealand's DTAs have an additional paragraph in this Article, which allows for the use of default assessment methods should there be inadequate information available for a transfer pricing review, and some have time limits upon how far retrospective tax audits may go. These are more commonly found in DTAs with non-OECD members, although Article 9(2) and 9(4) from the Australian DTA and Canadian DTA respectively, are good examples of these provisions despite these states being OECD members.

In some DTAs Article 17 has an additional paragraph which exempts certain Government sponsored or paid individuals or ones sponsored by non-profit bodies. A number of these additional paragraphs are similar to the provision suggested in paragraph 14 in the Commentaries on this Article for this purpose. Several DTAs also have in Article 17 a provision which permits a "look-through" for companies who employ entertainers.

A common feature in Article 23, in the paragraph requiring New Zealand to grant foreign tax credits for tax paid in the other contracting state, is a clause which specifically excludes New Zealand from having to grant foreign tax credits for underlying corporate tax paid on income from which dividends were paid. This

²³ This anti-avoidance provision is found in the DTAs with Australia, Austria (protocol), Chile, Mexico, Poland, Russia (protocol), Singapore (2009), South Africa, Spain, Taiwan, Thailand and Turkey (protocol). Similar anti-avoidance provisions, but with more limited scope, appear in the DTAs with China, Indonesia (protocol) and the US.

provision appears to have been inserted at New Zealand's instigation to clarify that New Zealand has no obligation to grant foreign tax credits for underlying foreign tax paid on company income.

Another area where additional provisions are found for the purposes of clarification is in non-discrimination articles. The New Zealand DTAs that do incorporate a non-discrimination article usually include a paragraph to make it clear that anti-avoidance provisions targeted at non-residents only (such as transfer pricing and thin capitalisation rules) are not discriminatory in terms of the article. Article 25(5) from the Finnish DTA is illustrative of this type of exclusion:

- (5) This Article shall not apply to any provision of the taxation law of a Contracting State which:
- a) is reasonably designed to prevent or defeat the avoidance or evasion of taxes which is in force on the date of signature of this Convention; or
 - b) is substantially similar in general purpose or intent to any such provision but is enacted after that date; provided that any such provision (except where that provision is in an international agreement) does not allow for different treatment of residents or nationals of the other Contracting State as compared with the treatment of residents or nationals of any third state.

H Articles Where the OECD Model has no Equivalent

New Zealand and Australia both levy a special tax on employers (known as "fringe benefit tax") if they provide fringe benefits to their employees. In New Zealand this tax is imposed under the relevant *Income Tax Act* while in Australia it is imposed as a separate tax. The 1995 and 2009 DTAs with Australia contain an article to deal with this tax which has no equivalent in the OECD Model.²⁴

New Zealand does not impose any tax on capital. Consequently, none of New Zealand's DTAs include an article equivalent to Article 22 from the OECD Model concerning the taxation of capital.

VI EFFECTS OF THE OECD MODEL UPON NEW ZEALAND'S INTERNATIONAL TAX POLICY

New Zealand's accession to the OECD has not only led to it expanding its DTA network and basing its DTA negotiations upon the OECD Model, but also to changes in its international tax policy. Prior to joining the OECD, New Zealand had negotiated only eleven DTAs with nine countries in a period of nearly thirty years. It was reluctant to negotiate DTAs because it felt it would have to concede source taxing rights found in its domestic law and also that model agreements used for DTA negotiations favoured capital exporting countries. The former had been experienced with its DTA negotiations in the 1950s and 1960s, when negotiations had sometimes faltered due to its reluctance

²⁴ Article 15, Australian DTA (2009).

to concede source taxing rights (that is, royalties with Germany), or when agreement was only reached after it made concessions (shipping with Japan).²⁵

New Zealand was well aware that by joining the OECD it would have to extend its DTA network. It would have to restart negotiations with a number of European countries when decade's earlier negotiations had stalled because of New Zealand's reluctance to concede source taxation of income such as royalties and dividends. When New Zealand analysed the 1977 OECD Model to determine the observations and reservations it would enter to that Model, it felt as a new member of the OECD it could not enter an excessively large number of observations and reservations. It had to prioritise which matters it wanted to enter reservations about so that the overall number would be acceptable to other OECD members.

In respect of some of the matters New Zealand has entered reservations to, it has been reasonably successful at maintaining them in subsequent DTA negotiations. It has retained the right to tax royalties at source and, until very recently, the right for all dividends to be taxed at 15 percent without a lower rate for parent-subsidiary ones. With one exception, it has been successful in maintaining its domestic rules for taxing non-resident insurers, enabling them to be taxed in the absence of a PE.

It has been less successful at maintaining its reservation about the inclusion of non-discrimination articles. However, in this regard it should be noted that those New Zealand DTAs that do include such an article often contain provisions markedly different to those of the OECD Model which significantly reduces these articles' scope.²⁶ Therefore it can be concluded that New Zealand has perhaps been more effective in upholding its reservation to non-discrimination articles than initial observations would suggest.

The same cannot be said for equipment leasing. New Zealand has been much less consistent at maintaining its right to tax the leasing of scientific, industrial and commercial equipment within the royalty article. Some New Zealand DTAs contain protocols which subsequently shift such leasing to Article 7 meaning that non-resident lessors are not liable to tax in New Zealand unless they have a PE there. Only the recently negotiated Australian DTA and the protocol to amend the US DTA exclude equipment leasing from the definition of a royalty article, bringing them into line with the definition found in the OECD Model.

Since 2008 New Zealand has concluded four treaties which contain some significant differences compared to earlier DTAs. These four DTAs comprise three new DTAs negotiated with Australia, Singapore and Hong Kong, plus a substantial protocol with the US to amend the 1983 DTA with that country. These differences are as follows:

- Inter-company dividends where there is a shareholding of 10 percent or more are now subject to a maximum of 5 percent withholding tax in the source country.

²⁵ See A Smith, 'A History of New Zealand's Double Tax Agreements', (2010) 16(1) *New Zealand Journal of Taxation Law and Policy* 105, 111, 113; Hunt, above n 13, 145.

²⁶ Hunt, above n 13, 166.

- Under the US and Australian DTAs, where a corporate shareholding interest is 80 percent or greater, inter-company dividends are exempt from withholding tax subject to a limitation of benefit provision.
- Royalties are subject to a maximum of 5 percent withholding tax in the source country.
- Certain cross-border payments of interest are exempt from tax in the source country although in some cases this is linked to the payment of AIL by the New Zealand borrower.
- Leasing of scientific, commercial and industrial equipment has been removed from the definition of 'royalty' in the US and Australian DTAs.

What has led New Zealand to agree to lower withholding tax rates for interest, dividends and royalties in these DTAs after resisting lower rates in its DTA negotiations for over 50 years? No explicit reason was given by the Minister of Revenue when announcing that negotiations for these new DTAs had been successfully concluded.

In some cases the reductions in withholding tax in these four new treaties merely reflect unilateral reductions New Zealand had already made in the taxation of non-residents with introduction of the Approved Issuer Levy (AIL) and Foreign Investor Tax Credit (FITC) rules. These reduced withholding tax rates on interest and dividends in DTAs merely ensured a reciprocal reduction for New Zealand investors that had already been made unilaterally to non-resident ones earlier.

Some further explanation can be seen, however, in a discussion document published in 2006 titled *New Zealand's International Tax Review: A direction for change*, containing proposals for revised CFC rules.²⁷ In this document it was suggested that New Zealand's existing CFC rules (which were extremely comprehensive) had indirectly contributed to New Zealand's poor export performance and also encouraged corporate/capital migration, therefore requiring reform. The reforms proposed in the discussion document to introduce an active-passive exemption in New Zealand's CFC rules would result in active income earned offshore by New Zealand businesses no longer being taxed on an accrued basis, but instead becoming exempt from New Zealand tax.

By bringing New Zealand's international tax rules "into line with international norms" it was intended to reduce the barriers faced by New Zealand-based firms under current tax rules and enable them to exploit the benefits of operating internationally. Competitiveness with Australia was seen to be particularly critical:

"It is important that New Zealand's tax system is not out of line with systems in comparable jurisdictions, particularly Australia."²⁸

The same discussion document also examined possible changes to New Zealand's DTA policy by reducing withholding tax rates as a further way of reducing barriers to

²⁷ Rt Hon Michael Cullen and Hon Peter Dunne, *New Zealand's International Tax Review: A direction for change*, (Policy Advice Division, Inland Revenue Department, Wellington, December 2006) 1 [1.5], 3 [1.13-1.14].

²⁸ *Ibid* 1 [1.3].

offshore investment to assist with the internationalisation of New Zealand businesses.²⁹ This partly reflected concerns about the advantages Australian companies had gained when Australia renegotiated its US DTA in 2002, resulting in lower withholding tax rates on passive income. Thus by New Zealand revising its DTA policy for lower withholding tax rates on passive income, this would improve the international competitiveness of New Zealand businesses, especially with respect to Australian firms.

But from a broader perspective, New Zealand is now recognising that, while being a net capital importer, it is also a capital exporter. Therefore reductions in withholding tax rates are not necessarily against its interests when it is done reciprocally under a DTA.

VII CONCLUSION

The use of computerised text comparison provides a useful insight into the influence of the OECD Model on the DTAs New Zealand has negotiated. The results obtained show that OECD membership had had a pronounced effect upon New Zealand's DTA negotiations leading to a network of 37 DTAs at the end of 2010, most of which are based upon the OECD Model. The influence of the OECD Model upon New Zealand's DTAs only became apparent after it joined the OECD and entered its reservations to the 1977 version of the OECD Model. DTAs negotiated by New Zealand prior to this date have little in common with the OECD Model. The convergence of the content in New Zealand's DTAs is also apparent through its use of the OECD Model, especially the 1977 Model, following New Zealand's accession to the OECD. Even so, many of New Zealand's DTAs still differ from the OECD Model in a number of areas. These differences have typically arisen to protect New Zealand's source taxing rights in some areas but also to resolve ambiguity and to place less reliance upon the Commentaries in defining the scope of some articles.

There is evidence that in more recent times OECD membership has also influenced New Zealand's international tax policy. New Zealand has gradually conceded a number of earlier 'sticking points' in its international tax policy, many of which were prevalent in negotiating its early DTAs prior to accession to the OECD, so as to become more convergent with OECD norms. Such a finding should not be a surprise given the growing influence of globalisation on tax policy, the increasing size, number and powers of multinational enterprises, the need to combat international tax avoidance and evasion, and the increasing reliance on international trade and investment by nations. This influence has also been consistent with the direction of New Zealand's economic reforms since the mid 1980s, enabling it to become one of the most economically liberal nations globally in terms of the freedoms for flows of investment and trade even although it remains a net capital importer.

Overall it appears the OECD Model has not only assisted New Zealand in concluding its DTA negotiations but also enabled it to enjoy the benefits flowing from the international acceptance of the Commentaries as a tool for interpretation of DTAs as well as international cooperation in tax administration.

²⁹ Ibid 2 [1.8].