EXPLANATORY MEMORANDUM

Title of instrument

The Double Taxation Relief (Taxes on Income) (New Zealand) Order 2004.

Legislative Powers

This Order is made under section 788 Income and Corporation Taxes Act 1988 and section 277 Taxation of Chargeable Gains Act 1992, as amended by section 198(1) and (2) of the Finance Act 2003.

Affirmative Resolution

This draft Order is subject to affirmative resolution. Further details of the Protocol scheduled to the draft Order are annexed to this memorandum.

European Convention on Human Rights

The Paymaster General (Dawn Primarolo) has confirmed that, advice provided to her confirms that, the provisions of this draft Order are compatible with the European Convention on Human Rights.

Policy Background to the instrument

This draft Order is intended to give effect, in accordance with the legislative powers, to a Protocol to the Double Taxation Convention that was concluded in 1983 between the Governments of the United Kingdom and New Zealand.

The Protocol, which is scheduled to the draft Order, makes a number of amendments to that Double Taxation Convention. The amendments are intended primarily to prevent abuse of the Convention by those seeking to avoid the payment of tax in either country. The alienation of property article is modified to close an alleged loophole which, it is claimed, enables offshore trusts to be used to avoid liability to United Kingdom capital gains tax. The existing exchange of information article is replaced with a new article that will allow more comprehensive exchanges as provided by the new standards recommended by the OECD. The existing dividend article is replaced with a new article that (unlike the existing article) does not entitle New Zealand residents to payment of part of the tax credit attaching to dividends paid by United Kingdom companies. The new dividend article includes modern anti abuse provisions, and similar anti abuse provisions are inserted into the articles applying to interest and royalties. In addition, the business profits article is amended to limit the taxation to which insurance companies may be exposed, and a new article (“Other income”) is inserted to clarify the treatment that is to apply to income that is not dealt with by any of the other articles of the Convention.

Regulatory Impacts

The provisions of this Protocol do not significantly increase or reduce the regulatory impact of the Double Taxation Convention it modifies.

Financial Effects

The Protocol is expected to have no revenue impact, but has the effect of protecting the Exchequer.

Extent

The draft Order applies to the whole of the United Kingdom of Great Britain and Northern Ireland.

ANNEXE

GENERAL

All of the United Kingdom's recent Double Taxation Conventions largely follow the approach adopted in the OECD's *Model Tax Convention on Income and on Capital*. This Protocol continues that approach. In addition, it takes account of changes in policy and legislation in the United Kingdom and New Zealand since the entry into force of the current Convention between the two countries.

NOTES ON DETAILS

ARTICLE I
Article 8 – Business profits

This Article substitutes a new paragraph (6) in place of the existing paragraph (6) of Article 8 of the Convention. Like the existing paragraph, the new paragraph preserves the right of either country to tax, in accordance with its domestic legislation, income or profits from any kind of insurance issued by an enterprise of the other country. Additionally however, the new paragraph limits the amount that may be taxed in this way, in the case of insurance other than life insurance. The limit, which applies where an enterprise of one country derives premiums for the insurance of risks in the other country, otherwise than through a permanent establishment situated there, is set at 10 percent of the gross amount of the gross premiums paid.

ARTICLE II

This Article deletes existing Article 11 of the Convention and substitutes a replacement Article 11 which provides rules for the taxation of dividends paid by a company which is resident of one country to a resident of the other.

Article 11 – Dividends

<u>Paragraph (1)</u> provides that dividends paid by a company resident in one country (the source country) to a resident of the other country may be taxed in that other country.

<u>Paragraph (2)</u> provides that such dividends may also be taxed in the source country, but if the beneficial owner is a resident of the other country the tax will not exceed 15 per cent of the gross amount.

<u>Paragraph (3)</u> defines the term “dividends”.

Paragraph (4) provides that the provisions of paragraphs (1) and (2) will not apply where a resident of a country who is the beneficial owner of dividends paid by a company resident in the other country carries on business in that other country through a permanent establishment there, or performs independent personal services in that other country from a fixed base there, and the holding from which the dividends arise is effectively connected with that permanent establishment or fixed base. In those circumstances the taxation of the dividends is governed by Article 8 (Business Profits) or Article 15 (Independent personal services) of the Convention.

Paragraph (5) rules out the extra-territorial taxation by one country of dividends paid by a company that is a resident of the other country. The first country is not to tax the dividends unless they are effectively connected with a permanent establishment or a fixed base there or are paid to a resident of that country. Similar provision is made in relation to undistributed profits.

Paragraph (6) is an anti-abuse provision, and ensures that the provisions of the Article will not apply if the shares or other rights in respect of which the dividend is paid were created or assigned mainly to take advantage of the Article.

ARTICLE III
Article 12 - Interest

This Article adds a new paragraph, paragraph (9), to Article 12 of the Convention, which is an anti-abuse provision. It ensures that the provisions of Article 12 will not apply if the debt claim in respect of which the interest is paid was created or assigned mainly to take advantage of the Article.

ARTICLE IV
Article 13 - Royalties

This Article adds a new paragraph, paragraph (7) to Article 13 of the Convention, which is an anti-abuse provision. It ensures that the provisions of Article 13 will not apply if the rights in respect of which the royalties are paid were created or assigned mainly to take advantage of the Article.

ARTICLE V
Article 14 - Alienation of property

This Article substitutes replacement paragraphs (1) and (4) and inserts a new paragraph (5) into Article 14 of the Convention, which contains the rules for the taxation of income or gains deriving from the alienation of property situated in one country by a resident of the other.

Paragraph (1) substitutes a replacement paragraph (1) for the existing paragraph (1) of Article 14 of the Convention. The replacement paragraph provides that income or gains derived by a resident of one country from the alienation of immovable property situated in the other country may be taxed in

the country in which the property is situated. It extends this treatment to the alienation of shares in a company deriving their value from such property.

Paragraph (2) substitutes a replacement paragraph (4) for the existing paragraph (4) of Article 14 of the Convention. The replacement paragraph provides that income or gains from the alienation of property shall be taxable only in the country of which the alienator is resident, except as provided in paragraphs (1), (2) and (3) of Article 14 of the Convention.

Paragraph (2) also adds a new paragraph, paragraph (5) to Article 14 of the Convention, which is an anti-abuse provision. It preserves the right of the United Kingdom to tax income or gains from the alienation of any property by a person (including an individual, company or trustee) who is a resident of the United Kingdom at any time during the tax year in which the property is alienated, or has been so resident at any time during the preceding six years.

ARTICLE VI

This Article inserts a new Article, Article 21A, into the Convention to deal with income which is not specifically dealt with elsewhere.

Article 21A – Other Income

Paragraphs (1) and (3) together provide that any item of income not dealt with by preceding articles of the Convention, shall be taxed only by the country of which the beneficial owner is a resident, except where the income concerned arises from a source in the other country. In that case, the income may also be taxed in that other country.

Paragraph (2) provides that the provisions of paragraph (1) will not apply, other than to income from immovable property, if the right or property in respect of which the income is paid is effectively connected with a permanent establishment situated in the country of source. In that case, the provisions of Article 8 of the Convention will apply.

Paragraph (4) provides that where, because of a special relationship between the payer and the recipient, the amount of income paid is excessive, the provisions of the Article will apply only to the amount that would be payable in an “arm’s length” situation.

Paragraph (5), an anti-abuse provision, ensures that the provisions of the Article will not apply if the rights in respect of which the income is paid were created or assigned mainly to take advantage of the Article.

ARTICLE VII
Article 25 - Exchange of information

This Article deletes existing Article 25 of the Convention and substitutes a replacement Article 25 providing new rules governing the exchange of certain information between the competent authorities of the two countries. The replacement Article follows the new standards recommended by the OECD. It requires the competent authorities to exchange information that is foreseeably relevant to the administration or enforcement of the provisions of the Convention or of the domestic laws of the two countries, insofar as the taxation is not contrary to the Convention. Each competent authority is to use its information gathering measures to obtain requested information even though it may not need the information for its own purposes, and may not decline a request solely because the information concerned is held by a bank or financial institution. No information containing trade etc. secrets or information the disclosure of which would be contrary to public policy is to be exchanged.

ARTICLE VIII – Entry into force

This Article provides that each country will notify the other that it has completed the procedures required by its law to bring the Protocol into force. The Protocol will enter into force on the date of the later of these notifications.

When the Protocol enters into force, the amendments in respect of the provisions relating to capital gains and the exchange of information will have effect in both countries from the date on which the Protocol was signed on behalf of the Governments of the United Kingdom and New Zealand (4 November 2003). In the United Kingdom the other provisions will take effect from 1 April (for corporation tax purposes), and from 6 April (for income tax and dividend tax credit purposes) following the date of entry into force. In New Zealand, the other provisions will take effect from 1 April following the date of entry into force.

ARTICLE IX - Termination

This Article provides that the Protocol will remain in force as long as the Convention remains in force.

EXCHANGE OF NOTES

The Exchange of Notes contained in Part II to the Schedule constitutes a formal agreement between the Governments of both countries, and clarifies the intended interpretation of paragraph (5) of Article 14 of the Convention as inserted by paragraph (2) of Article V of the Protocol.