International treaty examination of the Agreement between the Government of New Zealand and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income

Report of the Finance and Expenditure Committee

The Finance and Expenditure Committee has conducted an international treaty examination of the Agreement between the Government of New Zealand and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and has no matters to bring to the attention of the House.

The national interest analysis for the agreement is appended to this report.

Shane Jones
Chairperson

Appendix A

National interest analysis—Agreement between the Government of New Zealand and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income

Date of proposed binding treaty action

1 The Agreement between the Government of New Zealand and the Government of the United Mexican States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, with Protocol ("the DTA") was signed in Vietnam on 16 November 2006. Subsequent to satisfactory completion of the Parliamentary treaty examination process, it is proposed that the DTA be incorporated into domestic legislation through an Order in Council, and enter into force by way of an exchange of diplomatic notes.

Reasons for New Zealand to become a party to the treaty

2 New Zealand currently has 32 double tax agreements (DTAs) in force. They are primarily aimed at reducing tax impediments to cross-border trade and investment, but also help tax administrations to detect and prevent tax evasion.

3 DTAs give residents of both countries who are considering entering into cross-border trade and investment greater certainty of tax treatment. DTAs also contain a mutual agreement procedure for resolving disputes or issues that might arise in relation to the DTA. DTAs assist tax administrations in the prevention of fiscal evasion by providing for the exchange of information on tax matters between two countries.

4 Negotiations were entered into with Mexico as part of the Government's Latin American strategy. They arose specifically out of personal agreement in 2001 between New Zealand's Prime Minister and President Fox of Mexico that a DTA should be pursued.

5 The level of trade is also a major factor in deciding with which countries to negotiate a DTA. Since the early 1970s Mexico has consistently been New Zealand's top Latin American trading partner and currently accounts for nearly half of New Zealand exports to the region. It is among our most important milk powder markets anywhere in the world. New Zealand exports to Mexico in the year to June 2006 were worth $NZ429 million, consisting primarily of dairy products and meat. Mexican exports to New Zealand, mostly computers, transmission apparatus, motor vehicles, and beer were worth NZ$122 million.

Advantages and disadvantages to New Zealand of the treaty entering into force

6 The advantages to New Zealand of this DTA entering into force are:

- it will remove tax impediments to cross-border transactions between New Zealand and Mexico – in particular, it shares the cost of relieving the double taxation of income. The DTA will regulate how transactions should be taxed between the two countries so the income is effectively taxed only once

- it will generally reduce withholding taxes on dividends, interest and royalties to 15 percent, 10 percent and 10 percent respectively, and will exempt many short-term activities of individuals and businesses in the host country

- when both countries are permitted to impose tax, it will ensure that the country of residence allows a credit or exemption for the tax paid in the country of source

- the DTA will provide taxpayers with greater certainty of tax treatment, along with a mutual agreement procedure for resolving disputed issues that may arise in relation to the DTA

- the DTA will also assist the tax administrations of both countries by facilitating the exchange of information relating to taxes for the prevention of avoidance and evasion.

7 One disadvantage of the DTA is that New Zealand may forgo some revenue because of the reduction in levels of New Zealand tax and the allocation of some taxing rights to Mexico. Although, as explained in the discussion under "Costs" (below), the reciprocal nature of the DTA means that these revenue costs will be offset by increases in revenue where taxing rights are allocated to New Zealand and where Mexican tax is correspondingly reduced under the DTA.

8 The requirement for New Zealand to provide Mexico with information on tax matters under the DTA's exchange of information provisions may be seen as a disadvantage. However, again, the ability to request information is reciprocal, and New Zealand's experience with exchange of information in relation to its 32 other DTAs is predominantly positive; the benefit gained from being able to request information from the other country more than offsets the administrative burden of having to provide information pursuant to its requests.

9 On balance, it is in New Zealand's interest to conclude a DTA with Mexico. It is expected to enhance cross-border trade and investment and will assist the New Zealand Government in the prevention of fiscal evasion.

Obligations

10 The DTA does not impose requirements on taxpayers. The obligations it imposes are on the Contracting States, restricting their taxing rights under domestic law on a reciprocal basis. A DTA can only reduce tax already imposed under domestic law; it cannot impose tax.

11 New Zealand taxes its residents based on their New Zealand and worldwide income. Non-residents are taxed only on their New Zealand-sourced income. Mexico has a similar system. This gives rise to the possibility that cross-border flows of income will be subject to double taxation. The DTA provides a way of allocating taxing rights as between New Zealand and Mexico. Under this DTA, New Zealand and Mexico will be required to comply with the following rules when imposing tax on residents of either country:

- income from immovable property will generally be taxed in the country where the property is situated (Article 6 refers)
- business profits will generally be taxable only in the country where the business is resident. However, the profit attributable to a permanent establishment situated in the other country may be taxed in that country. A permanent establishment generally exists in the country in question when there is a fixed place of business where the business of an enterprise is carried on (Article 7 refers)
- profits of an enterprise of a country from the operation of ships or aircraft shall be taxable only in that country, subject to various rules applicable in specific situations (Article 8 refers)
- dividends paid by a company of one country to a resident of the other country may be taxed in that other country. The source country may also tax the dividend up to a maximum of 15 percent on the gross amount of the dividends (Article 10 refers)
- interest may generally be taxed in both countries. However, the country in which the interest arises must not impose tax in excess of 10 percent if the interest is paid to a resident of the other country (Article 11 refers)
- royalties may generally be taxed in both countries. However, the country in which the royalties arise must not impose tax in excess of 10 percent of the royalties if they are paid to a resident of the other country (Article 12 refers)
- specific rules apply to the taxation of income, profits or gains derived from the sale of property. In the case of immovable property the profits are taxable where the property is situated (Article 13 refers)
- income from employment will be taxable only in the country where the employee is resident, unless the employment is performed in the other country. In this case, the country where the employment is performed may also tax the income, if the employee is present for at least 183 days and various conditions are met (Article 14 refers)
- directors' fees may be taxed in the country where the relevant company is resident (Article 15 refers)
- entertainers and sportspersons may be taxed in the country in which the activities of the sportsperson or entertainer take place (Article 16 refers)

- pensions and annuities are only taxable in the country where the recipient is resident. Alimony or maintenance payments are only taxable in the country where the payment was made (Article 17 refers)

- salaries and wages for services to a Government of one country are generally exempt from tax in the other country (Article 18 refers)

- students are generally not taxed on payments received from outside the country when those payments are for the maintenance and education of the student (Article 19 refers)

- New Zealand has to comply with the various administrative requirements of the DTA that make its operation possible. These include, in particular, the elimination of double taxation by exempting or giving credits for overseas tax paid in certain situations; not enacting tax laws that discriminate against residents of Mexico (vis-à-vis residents of any other state); complying with the mutual agreement procedures set out in the DTA; and complying with the exchange of information procedures (Articles 21, 22, 23 and 24 refer).

Economic, social, cultural and environmental effects

12 No social, cultural or environmental effects are anticipated. Any economic effects are expected to be favourable, as noted above.

Costs

13 New Zealand may forgo some revenue from the limitation of our taxing rights in relation to income flows between New Zealand and Mexico and which we are currently able to tax under our domestic laws. This revenue cost could include, for instance, tax forgone in relation to short-term activities of Mexican residents in New Zealand, which the DTA will exempt. It could also include tax forgone on dividends, interest and royalties paid by New Zealand residents to the residents of Mexico in respect of which the DTA will lower withholding rates.

14 Mexico will also be similarly constrained from taxing certain income flows between Mexico and New Zealand, and this reduced Mexican tax will often flow through to the New Zealand tax base through a reduction in credits for foreign tax paid. It is likely that these factors will offset each other to some extent over time. But, to the extent that the cost to the New Zealand revenue is not fully offset by the reduction in creditable Mexican tax, we would expect that the economic benefits of the DTA will outweigh these costs.

Future protocols and amendments

15 No future amendments are anticipated. However, if the need arose to amend the DTA, this would be done by way of a Protocol.

Implementation

16 Subject to the successful completion of the Parliamentary treaty examination process, this DTA will be implemented domestically by Order in Council in accordance with section BH 1(3) of the Income Tax Act 2004.

17 The DTA will be implemented by way of an overriding treaty regulation. Section BH 1 of the Income Tax Act 2004 enables DTAs to be given effect by Order in Council. It also provides that the DTA will override the Income Tax Act 2004, the Tax Administration Act 1994, any other Inland Revenue Act, the Official Information Act 1982, the Privacy Act 1993 in relation to income tax, unpaid tax and the exchange of information relating to a tax. This override is necessary to give effect to the terms of the DTA.

Consultation

18 The Ministry of Foreign Affairs and Trade and the Treasury have been consulted and concur with the terms of the DTA. No private sector consultation was entered into.

Withdrawal or denunciation

19 Article 27 of the DTA provides that either Contracting State may terminate the DTA by giving notice, through diplomatic channels, of termination on or before 30 June in any calendar year beginning after the expiration of five years from the date of its entry into force.

Prepared by: Inland Revenue Department
October 2006