International treaty examination of the Agreement between New Zealand and the Republic of Poland 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 New Zealand and the Republic of Poland 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.

Clayton Cosgrove
Chairperson

NATIONAL INTEREST ANALYSIS

Agreement between New Zealand and the Republic of Poland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Protocol

Date of proposed binding treaty action

1 An Agreement between New Zealand and the Republic of Poland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Protocol (the DTA) was signed on 21 April 2005. Subsequent to the successful completion of the international treaty examination process, the DTA will be incorporated into domestic legislation through an Order in Council. The DTA will enter into force by way of an exchange of notes between New Zealand and Poland, in which each party will notify the other of the completion of their constitutional requirements for giving effect to the DTA in their respective domestic laws.

Reasons for New Zealand to become a party to the treaty

2 New Zealand currently has 29 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 also assist tax administrations in the prevention of fiscal evasion by providing for the exchange of information on tax matters between two countries coupled with an "Assistance in the Collection of Taxes" Article.

4 Negotiations with Poland were entered into as Poland is currently the focus of government interest in Central and Eastern Europe. As a recent European Union (EU) accession State, Poland is a net capital importer within the EU and thus found our Model, which predominately reserves source taxation, agreeable. The Prime Minister opened the New Zealand Embassy in Warsaw on 21 April 2005, which coincided with the signing of the DTA. Poland is also an OECD member, and New Zealand is the only OECD country with which Poland does not have a DTA.

5 The level of trade is also a major factor in deciding with which countries to negotiate a DTA. In terms of area and population, Poland is one of the larger countries in Europe. Its integration into the European Union economy should lead to strong economic growth in the coming years and, in time, significant trade opportunities for New Zealand. In the year to June 2004 New Zealand exported $NZ19.5 million worth of goods to Poland, and imported $NZ15 million from Poland.

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 Poland — 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 counties 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.

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

8 The requirement for New Zealand to provide information on tax matters to Poland 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 29 other DTAs is predominately positive (the benefit gained from being able to request information from the other country more than offsetting the administrative burden of having to provide information pursuant to their requests).

9 The DTA also has an "Assistance in the Collection of Taxes" Article. An advantage of this is that it will provide a mechanism for the New Zealand Government to recover unpaid tax from taxpayers living in Poland. This will result in the New Zealand Government being able to collect tax more effectively and efficiently than it would be able to in the absence of the Agreement. However, this obligation is reciprocal in nature. In other words, the Polish Government is able to require the New Zealand Government to collect its unpaid tax from taxpayers in New Zealand.

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

interests in the new EU accession States of Central and Eastern Europe and in Poland, in particular, by signalling our continued willingness to treat them as serious economic partners.

Obligations

11 The DTA does not impose requirements on taxpayers. The obligations it imposes are on the Contracting States and restricts 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).

12 Under domestic law, New Zealand taxes its residents based on their New Zealand and worldwide income. Non-residents are taxed only on their New Zealand-sourced income, and Poland 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 Poland. Under this DTA, New Zealand and Poland 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 derived through a permanent establishment situated in the other country may be taxed in that country. A permanent establishment generally exists when there is a fixed base in the country in question 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 specific 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 resident 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 (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 (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 on 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. Any alimony or maintenance payments are also 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).

- Tertiary 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 Poland (vis-à-vis residents of any other State); complying with the mutual agreement procedures set out in the DTA; complying with the exchange of information procedures; and assisting Poland with the collection of unpaid tax from taxpayers in New Zealand (Articles 21, 22, 23, 24 and 25 refer).

Economic, social, cultural and environmental effects

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

Costs

14 New Zealand may forgo some revenue from the limitation of our taxing rights in relation to income flows between New Zealand and Poland 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 Polish 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 Poland in respect of which the DTA will lower withholding rates.

15 Poland will also be similarly constrained from taxing certain income flows between Poland and New Zealand, and this reduced Polish 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 New Zealand revenue is not fully offset by the reduction in creditable Polish tax, we would expect that the economic benefits of the DTA will outweigh these costs.

Future protocols

16 No future protocols are anticipated.

Implementation

17 Subject to the successful completion of the international 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.

18 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 and any other enactment relating 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 and will effectively override the Income Tax Act 2004 and the Tax Administration Act 1994.

Consultation

19 The Treasury has been consulted and agrees with the terms of the DTA. No private sector consultation was entered into.

Withdrawal or denunciation

20 Article 28 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 5 years from the date of its entry into force.