COMMISSIONER'S STATEMENT

Withholding obligations arising in relation to transfer pricing arrangements

Issued: 30 August 2024

CS 24/02

This Commissioner's statement sets out the Commissioner's position and operational approach in relation to the withholding obligations that may arise in relation to transfer pricing arrangements.

All legislative references are to the Income Tax Act 2007 (the Act) unless otherwise stated.

Introduction

1. This Commissioner's Statement sets out the Commissioner's position in relation to the withholding obligations that may arise from transactions that constitute a transfer pricing arrangement, and confirms that the Commissioner's position and operational approach remains unchanged from his current practice.
2. This statement also confirms how the transfer pricing rules in Subpart GC of the Act interact with the dividend rules in Subpart CD when determining the withholding obligations that arise under Part R for payments made under a transfer pricing arrangement.

Discussion

3. The transfer pricing rules operate to substitute an arm's length consideration in the calculation of a person's net income if the person's net income is reduced by the terms of a cross-border arrangement with an associated person. This may occur where the amount paid by the person under the transaction is more than an arm's length amount, or where the amount received by the person under the transaction is less than an arm's length amount.
4. Under the dividend rules, a transfer of value from a company to a person that has been caused by a shareholding will be treated as a dividend and taxed accordingly.
5. In many cases, a transfer pricing arrangement where an amount paid (or received) is more than (or less than) the arm's length amount will give rise to a transfer of value from a company that constitutes a deemed dividend as determined pursuant to Subpart CD.[1]
6. This deemed dividend arises at the time of the transfer of value and will generally be subject to non-resident withholding tax (NRWT). Currently, the dividend NRWT rate is 30%, although this rate may be reduced pursuant to a relevant double tax agreement (DTA).
7. Whether or not an application for matching treatment is made pursuant to section GC 11 does not affect whether or not there is a deemed dividend subject to dividend NRWT.

[1] A downward transfer of value would not give rise to a deemed dividend if the conditions of s CD 27(3) are satisfied.

8. Section GC 12 provides that transfer pricing adjustments do not have an effect on an obligation of a taxpayer to withhold under Part R of the Act. Part R provides for a dividend withholding obligation in these circumstances.

9. Where NRWT has previously been withheld and paid on the basis that the excess amount had been treated as interest or a royalty, that interest NRWT or royalty NRWT could be refunded or potentially offset against the dividend NRWT obligation provided the applicable provisions in the Act are satisfied.

10. Where deemed dividends arise in relation to a transfer pricing arrangement, those dividends will generally constitute non-cash dividends,[2] and relief may be available, for example:

    a) Imputation credits may be retrospectively attached to transfer pricing arrangement dividends, pursuant to section OB 62.

    b) A fully imputed non-cash dividend is subject to 0% NRWT pursuant to section RF 10(5B).

    c) The dividend NRWT liability may also be reduced or removed by applying section CD 42, which allows for dividends to be repaid in certain circumstances if certain requirements are met.

11. Whilst a dividend withholding obligation arises automatically in these circumstances, it would be desirable for the legislation to be clearer on the point. To this end, an amendment is included in the Taxation (Annual Rates for 2024-24, Emergency Response and Remedial Measures) Bill introduced on 26 August 2024 which seeks to clarify the position.

Interest limitation rules

12. An amount of interest paid by a New Zealand borrower in excess of the amount determined under New Zealand's interest limitation rules, known as the restricted

[2] Section YA 1 defines a "non-cash dividend" as "a dividend to the extent to which it does not consist of an unconditional payment in money". An excess amount paid under a transfer pricing arrangement will generally be a non-cash dividend as it is a conditional payment, in the sense that it was made in relation to a transaction for the provision of something by the other party. This can be contrasted with a normal dividend, which is not conditional or paid in relation to any transaction.

transfer pricing (RTP) rules will also give rise to a transfer of value and a deemed dividend.[3] This dividend is also subject to NRWT withholding obligations.

Examples

Example 1 – interest payments

13. A New Zealand subsidiary enters into an agreement to borrow an amount from its non-resident parent. For the year in question, the New Zealand subsidiary pays interest of $1.5m to the non-resident parent. The arm's length amount is $1m, and an adjustment would be made under the transfer pricing rules treating this amount as the amount payable for the purposes of calculating the New Zealand subsidiary's income tax liability.

14. The excess $0.5m is a transfer of value from the New Zealand subsidiary to the non-resident parent, resulting in a deemed dividend subject to NRWT. Interest NRWT previously paid in relation to this excess amount could be refunded or offset against the dividend NRWT liability provided the applicable provisions in the Act are satisfied.

Example 2 – royalty payments

15. A New Zealand company pays a royalty of $1.5m to a non-resident Group Intellectual Property Holding Entity in relation to a trademark licence, but the arm's length amount is $1m.[4] An adjustment would be made under the transfer pricing rules treating the arm's length amount as the amount payable for the purposes of calculating the New Zealand company's income tax liability.

16. The excess $0.5m is a transfer of value from the New Zealand company to the Group Intellectual Property Holding Entity, resulting in a deemed dividend subject to NRWT. Royalty NRWT previously paid in relation to this excess amount could be refunded or offset against the dividend NRWT liability provided the applicable provisions in the Act are satisfied.

[3] An amendment was made to section CD 38(2)(b)(i) by the Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Act 2022 with effect from 1 April 2022 to confirm that the deemed dividend arising when interest is disallowed under the interest limitation rules is calculated based on the amount disallowed under those rules.

[4] The non-resident is an upstream associated person, so s CD 27(3) does not have application.

Example 3 – purchase of goods

17. A New Zealand company purchases trading stock from a non-resident parent for $1.5m, but the arm's length amount is $1m. An adjustment would be made under the transfer pricing rules treating the arm's length amount as the amount payable for the purposes of calculating the New Zealand company's income tax liability.

18. The excess $0.5m is a transfer of value from the New Zealand company to the non-resident parent, resulting in a deemed dividend subject to NRWT.

Example 4 – sale of goods

19. A New Zealand company sells goods to a non-resident parent for $1m, but the arm's length value of the goods is $1.5m. An adjustment would be made under the transfer pricing rules treating this $1.5m amount as the amount receivable for the purposes of calculating the New Zealand company's income tax liability.

20. The $0.5m difference is a transfer of value from the New Zealand company to the non-resident parent, resulting in a deemed dividend subject to NRWT.

Example 5 – provision of services

21. A New Zealand company provides management services to its non-resident parent. The management fee charged for the year is $1.5m, but the arm's length value of the management services is $2m. An adjustment would be made under the transfer pricing rules treating the arm's length amount as the amount receivable for the purposes of calculating the New Zealand company's income tax liability.

22. The $0.5m difference does not result in a deemed dividend subject to NRWT pursuant to the application of section CD 5(3), unless the close company exception in section CD 5(4) applies. This is because section CD 5(3) provides that a transfer of company value does not occur to the extent to which the money's worth provided by the company is only the provision of services.

Example 6 – interest limitation

23. A New Zealand subsidiary enters into an agreement to borrow $15m from its non-resident parent. For the year in question, the New Zealand subsidiary pays interest of $1.2m to the non-resident parent. Following the application of the interest limitation rules, the appropriate amount of interest is limited to $0.9m. An adjustment would be

made treating this amount as the amount payable for the purposes of calculating the New Zealand subsidiary's income tax liability.

24. Section CD 38(2) provides that the $0.3m difference is a transfer of value from the New Zealand subsidiary to its non-resident parent, resulting in a deemed dividend subject to NRWT. Interest NRWT previously paid in relation to this excess amount could be refunded or offset against the dividend NRWT liability provided the applicable provisions in the Act are satisfied.

Application

25. This Statement sets out the Commissioner's position and operational approach in relation to withholding obligations arising from transfer pricing arrangements. The Commissioner will continue to apply this position to all cases.

26. If you have concerns about your compliance with the position set out in this Commissioner's Statement, you should discuss this matter with your tax advisor or contact Inland Revenue to make a voluntary disclosure.

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About this document

The purpose of a Commissioner's Statement is to inform taxpayers of the Commissioner's position and the operational approach being adopted on a particular tax matter.

The examples provided in this Commissioner's Statement are intended to illustrate the Commissioner's position. They are not intended to illustrate any other position by the Commissioner on any other areas of the law.