NEW ZEALAND BANKERS ASSOCIATION

Submission

to the

Finance & Expenditure Select Committee

on the

Taxation (Annual Rates, Employee Allowances, & Remedial Matters) Bill

5 February 2014

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Submission by the New Zealand Bankers' Association to the Finance and Expenditure Select Committee on the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill

About NZBA

1. NZBA works on behalf of the New Zealand banking industry in conjunction with its member banks. NZBA develops and promotes policy outcomes which contribute to a safe and successful banking system that benefits New Zealanders and the New Zealand economy.

2. The following fourteen registered banks in New Zealand are members of NZBA:

- ANZ Bank New Zealand Limited
- ASB Bank Limited
- Bank of New Zealand
- Bank of Tokyo-Mitsubishi, UFJ
- Citibank, N.A.
- The Co-operative Bank Limited
- Heartland Bank Limited
- The Hongkong and Shanghai Banking Corporation Limited
- JPMorgan Chase Bank, N.A.
- Kiwibank Limited
- Rabobank New Zealand Limited
- SBS Bank
- TSB Bank Limited, and
- Westpac New Zealand Limited.

Oral submission and contact details

1. NZBA would appreciate the opportunity to make an oral submission to the Committee on this Bill.

2. If the Committee or officials have any questions about this submission, or would like to discuss any aspect of it further, please contact:

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Executive Summary

3. NZBA appreciates the opportunity to submit on the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill.

4. Our submission is exclusively focused on the FATCA (Foreign Account Tax Compliance Act) related provisions of the Bill. These provisions primarily relate to FATCA enabling legislation which will allow New Zealand financial institutions lawfully to meet their international obligations under FATCA.

5. Overall we support the Bill. We also strongly support the prompt passage of the Bill into law.

6. Without the legal protection provided by the Bill, New Zealand financial institutions would be at risk of breaching the Human Rights Act 1993 and the Privacy Act 1993 if they perform the due diligence and provide the information required to comply with FATCA. Failure to comply with FATCA is not an option for the financial industry as significant penalties would be imposed.

7. We think the Bill adequately addresses the concerns that we have identified in relation to privacy and human rights laws insofar as the reporting obligations of New Zealand financial institutions are concerned.

8. However, we have identified a number of issues with the FATCA provisions in the Bill which we believe need to be addressed by the Committee before the Bill progresses.

9. Our submission outlines the six key problems that we have identified and our suggested remedies for addressing them.

Key points

Failure to register should not be a criminal offence or an absolute liability offence (Clauses 150 and 151, sections 143 and 143A)

10. The Bill proposes that a failure to register with a foreign competent authority be subject to criminal sanctions as an absolute liability offence under section 143(1)(ab) and a knowledge offence under section 143A(1)(ab). We consider the proposed penalties are unduly harsh for the following reasons:

    a. **Criminal penalties not required by FATCA:** From a policy perspective, the Government should not impose greater penalties than required under any foreign account information sharing agreement. The intergovernmental agreement (IGA) which the New Zealand government has agreed to enter with the US government only requires the Government to have domestic law (including penalties) in place

to address "significant non-compliance". There is no requirement that such penalties be criminal (see Article 5(2)).[1]

b. **Obligations carrying criminal penalties should not be unclear:** Given the seriousness of a criminal conviction, the criminalisation of conduct should not be taken lightly when there is a degree of uncertainty as to what the acceptable or unacceptable conduct is. As a result of its multi-jurisdictional nature and the fact it is untested, there are many interpretational difficulties with FATCA. These include, for example, the meaning and scope of "financial institution" which will determine whether an entity is required to register with the IRS. The uncertainty is exacerbated by the fact we currently have no visibility of the final form of the IGA under negotiation.

11. Accordingly, we do not consider it appropriate for a failure to register to be a criminal offence.

12. If, however, failure to register is to be a criminal offence, it should not be an absolute liability offence. As currently drafted, an entity would be liable under section 143(1)(ab) even if the failure to register was inadvertent and the entity was not aware of it, for example if after due enquiry an entity concluded that it was not required to register with the IRS but the IRS and/or Inland Revenue takes a different view.

13. Proposed section 143(2B) provides that a failure to register that occurs through no fault of the person would not be an absolute liability offence. However, it is unclear what the phrase "through no fault of the person" means and whether it covers the inadvertent non-compliance described above. We therefore suggest amending the exclusion in section 143(2B) along the lines of the following:

    *No person may be convicted of an offence against **subsection (1)(ab)** if the failure to register occurred through no fault of the person, for example because the person considers on reasonable grounds that it is not required to register with a foreign government agency.*

14. We also recommend that penalties should not be imposed until the breach has been notified and reasonable time has been given to remedy it. For example, if the IRS and/or Inland Revenue consider an entity should have been FATCA registered, then the entity should be notified of this conclusion and given a reasonable time to remedy the situation, either by registering the entity or establishing the basis upon which it claims to be exempt. We understand that this is consistent with Inland Revenue practice but it should be made clear in the legislation.

[1] For the purpose of these submissions we have assumed the IGA will be in materially the same form as the Model IGA released by the US on 4 November 2013.

Application of permitted choice provision should be limited to choice actually made (clauses 158, proposed section 185F)

15. The Commentary to the Bill clearly states that financial institutions should not be in a position where they are required to comply with **all** possible scenarios contemplated by a foreign account information-sharing agreement. Section 185F(3) is intended to achieve that result by providing that a person's obligations are modified to the extent necessary to give effect to the authorised "permitted choice".

16. As currently drafted section 185F does not achieve the intended result. This is because "permitted choice" is defined in section 185F(1)(a) as a choice or a course of action or inaction described or contemplated in the agreement in relation to the person, i.e. it refers to all of the possible available options under the agreement, and is not limited to the one actually made by the person.

17. We recommend amending the definition of "permitted choice" in section 185F(1) and making consequential amendments as follows:

    *This section applies for a person, as described in a foreign account information-sharing agreement (the **agreement**), if –*

    (a) *the agreement describes or contemplates a choice or a course of action or inaction in relation to them and they make that choice or take that course of action or inaction (a **permitted choice**):*

    (b) *a choice made by the New Zealand government under the agreement allows, as described or contemplated in the agreement, the person a choice or course of action or inaction and the person makes a permitted choice.*

There should be a distinction between information that a person is required to provide to IRD and information that they are authorised to provide (clause 158, proposed section 185I)

18. The commentary to the Bill states (at page 57) that section 185I is intended to:

    a. *require* financial institutions to obtain and provide to Inland Revenue information that the New Zealand Government is obliged to exchange with the United States; and

    b. *allow* the provision of information that is not required for exchange purposes as long as the obtaining and providing of that information is contemplated in the agreement.

19. As currently drafted proposed section 185I does not draw the necessary distinction between information that financial institutions are required to provide to Inland Revenue on the one hand and information that they are allowed (but not required) to provide on the other. Under subsection (1), a person must obtain and provide information to Inland Revenue as long as it is described or contemplated in the

agreement. On its face, subsection (1) appears to require the provision of information to Inland Revenue even if the agreement allows the person a choice as to whether or not to provide that information, thereby effectively eliminating that choice.

20. We do not believe this is intended, and suggest amending proposed section 185I(1) as follows:

> *A person, as described in a foreign account information-sharing agreement (the **agreement**) must obtain and provide to the New Zealand competent authority –*
>
> (a) *information, described in the agreement, that the New Zealand competent authority is obliged to obtain and exchange with a foreign competent authority:*
>
> (b) *other information, described or contemplated in the agreement, that the person is authorised under section 185F to obtain and provide to the New Zealand competent authority because they have exercised a permitted choice.*

Excluded choices should be limited to the reporting of accounts that meet the threshold exemptions (clause 158, proposed section 185F)

21. Section 185F(6) of the Bill introduces the concept of an "excluded choice". Excluded choices are expressly excluded from being a "permitted choice" that is authorised under section 185F.

22. A list of "excluded choices" is set out in section 185F(7) and currently means an election under Annex I, paragraphs II.A, III.A, IV.A and V.A of the IGA. It is clear from the Commentary to the Bill (at page 56) that the reason these are excluded is to give effect to the Government's view that only information relating to accounts that are actually required to be reported on should be submitted to Inland Revenue, and to prevent financial institutions from choosing to ***report*** on accounts that fall below the reporting thresholds set out in those paragraphs.

23. However, the definition of "excluded choice" is broader than intended. The elections referred to in paragraphs II.A, III.A, IV.A and V.A extend beyond the mere reporting of accounts to include the reviewing and identification of accounts. Accordingly, by referring generally to an election under those paragraphs without specifying that only the election to report is to be excluded, section 185F(7) could prevent a financial institution from reviewing and identifying accounts that fall below the reporting thresholds.

24. As a practical matter, it would be unworkable if financial institutions were prevented from reviewing and identifying an account until such time as the account exceeds reporting thresholds. Generally, financial institutions will not know whether an account falls below the reporting thresholds until the end of each reporting period (i.e.

31 March). If financial institutions had to wait until each 31 March before they can collect information on accounts and review them, it would:

a. significantly increase compliance costs and create inefficiency (because they would have to return to customers to request further information, potentially a long time after a customer had first opened an account), and

b. reduce the likelihood of obtaining the necessary information (because the time at which they are best placed to ask customers for information is at account opening, not subsequently).

The fact that there is only a limited amount of time between 31 March and when financial institutions have to review, identify and report FATCA information to Inland Revenue, further exacerbates the difficulties.

25. Accordingly, the enabling legislation should allow financial institutions to collect information and to determine whether an account is otherwise reportable provided that they do not actually report on the account until the account exceeds the reporting thresholds. This would reduce the practical difficulties for financial institutions while at the same time adequately addressing the Government's concerns around reporting accounts that do not meet reporting thresholds. We have discussed this issue with Inland Revenue officials and understand that they agree with us in principle.

26. This issue has significant implications for the design of financial institutions' account opening processes and requires legislative clarification. This could be achieved by amending subsection 185F(7) as follows:

*For the purposes of **subsection (6)**, the following are excluded choices:*

(c) an election to report on accounts under Annex I.II.A of the foreign account information-sharing agreement:

(d) an election to report on accounts under Annex I.III.A of the foreign account information-sharing agreement:

(e) an election to report on accounts under Annex I.IV.A of the foreign account information-sharing agreement:

(f) an election to report on accounts under Annex I.V.A of the foreign account information-sharing agreement.

Obligations under Part 11B should be subject to a reasonableness standard (clause 158, proposed sections 185G, 185H, 185I and 185J)

27. FATCA is a new, untested, regime. There are many uncertainties in relation to the meaning and scope of key concepts including "financial institutions" and "financial accounts" and, consequently, the precise obligations of financial institutions. These

are likely to become clearer over time as issues are identified and the US and other revenue authorities consider and reach a view on them. In the meantime, however, financial institutions are in a difficult position because they do not know what their precise obligations are and there is limited guidance is available from the US or Inland Revenue. In these circumstances, financial institutions should not be penalised for technical non-compliance provided they have used their best endeavours to comply with their obligations and adopted reasonable interpretations where there are any uncertainties.

28. As the operative sections 185G, 185H, 185I and 185J are currently worded, financial institutions could technically be in breach of their obligations under those sections if the US or Inland Revenue disagree with their interpretation. This would be the case even if their interpretation is reasonable and they have used their best endeavours to comply. For example, an entity may conclude after due enquiry and on reasonable grounds that it is not a "financial institution" and therefore not required to register with the IRS under section 185G, but the US or Inland Revenue may take a different view. In our view, the entity should not be penalised for non-compliance in these circumstances.

29. To overcome this, we recommend the operative provisions in Part 11B be subject to a "reasonableness" standard. This can be achieved for example by substituting "must" in each section with wording along the lines of "must take reasonable steps to".

Timeframe for provision of information to IRD should be extended to 4 months (clause 158, proposed section 185M)

30. Under proposed section 185M(2), financial institutions must provide the required information to Inland Revenue within two months of the end of the reporting period (i.e. by 30 May). Inland Revenue in turn has four months (i.e. by 30 September) before it then has to provide the information to IRS under the IGA.

31. Given the demands on resources and the significant amount of work and cost involved for financial institutions to collate and provide the information to Inland Revenue in the form required, we believe that the timeframe should be reversed so that financial institutions have four months to provide the information to Inland Revenue. This then leaves Inland Revenue with two months to carry out the relatively speaking simpler task of passing the information onto the IRS.