NEW ZEALAND BANKERS ASSOCIATION

Submission

to the

Finance and Expenditure Select Committee

on the

Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill

9 September 2016

NEW ZEALAND BANKERS ASSOCIATION
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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 that contribute to a strong and stable banking system that benefits New Zealanders and the New Zealand economy.

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

   - ANZ Bank New Zealand Limited
   - ASB Bank Limited
   - Bank of China (NZ) 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
   - Westpac New Zealand Limited.

Background

3. NZBA welcomes the opportunity to provide feedback to the Finance and Expenditure Select Committee (**Committee**) on the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill (**Bill**), and commends the work that has gone into developing it.

4. NZBA understands and supports the commitment that New Zealand has made to global initiatives for greater tax transparency. We also appreciate the steps taken by Inland Revenue (**IR**) to provide opportunities for feedback on how New Zealand might best implement the Common Reporting Standard (**CRS**) for the Automatic Exchange of Information (**AEOI**), and IR's ongoing consideration to minimise compliance costs for affected Financial Institutions (**FIs**) to the extent it does not undermine the policy intent.

5. NZBA would appreciate the opportunity to make an oral submission to the Committee on this Bill. Please contact Richard Bicknell, Government Relations Director at NZBA on 04 802 3350 regarding times for appearing before the Committee.

6. If you have any questions about this submission, or would like to discuss any aspect of the submission further, please contact Antony Buick-Constable, NZBA Policy Director & Legal Counsel on 04 802 3351.

Executive Summary

7. NZBA's key submissions are:

   a. We broadly support the inclusion of the "wider approach" provided in the Bill, however:

      i. Have some concerns this approach has not been endorsed by the Office of the Privacy Commissioner (**OPC**); and

      ii. Recommend that FIs report all foreign tax resident accounts to IR, implementing the 'wider approach' for both collection and reporting.

   b. We strongly recommend aligning reporting with general CRS and FATCA timelines.

   c. We strongly support transition rules that mean an FI is not liable for penalties if the FI made reasonable efforts to meet the requirements, and corrects any failures within a reasonable timeframe. However, we submit this relief should be extended in certain circumstances and that the time limit on the reasonable efforts defence should be removed.

   d. We recommend that IR engage with the banking industry further on specific record-keeping rules that will be set to ensure that they align with those currently imposed under FATCA.

   e. We recommend expanding the definition of undocumented accounts in the Bill to include both new and pre-existing accounts.

   f. We recommend that determinations should be applied prospectively with a staged transition, and that IR engage with the banking industry on transition periods when making changes.

   g. We submit that the list of excluded entities and accounts should be published as soon as possible, and that this list should include those entities and accounts that are excluded under FATCA.

   h. We submit that the current penalties provisions in the Bill create uncertainty and concern for FIs, as there is no cap or limitation on the penalties that can be applied, and several penalties can be applied for the same offence.

   i. We submit that there needs to be a comprehensive Government-led educational programme targeting the public, informing them of these legislative changes and their CRS obligations.

   j. We submit that, should FIs elect to avail of the CRS option to resolve controlling persons based on the timing of distributions, they would be unable to comply with new section 185N(10), as currently drafted.

k. We suggest that FIs should not have to file ‘nil returns’ as this adds to compliance costs. Instead, we recommend that FIs must evidence ‘nil returns’, if required by IR.

l. We recommend alignment of the FI definition to that contained in the CRS, together with clarification of the specific types of entities in New Zealand that meet the “Non-Reportable FI” definition.

m. We fully support the amendments to section 59B of the Tax Administration Act 1994 related to foreign trust registration and disclosure as outlined in Clause 10 of the Bill.

8. Please see our substantive submissions below.

Substantive submissions

Wider Approach

9. NZBA broadly supports the inclusion of the "wider approach" provided in the Bill.

Privacy concerns

10. However, NZBA members, like other industry participants, still have some concerns that the “wider approach” has not been endorsed by the OPC. NZBA submits that IR should consider, and confirm with OPC, that FIs will not be in breach of the Privacy Act 1993 if they elect to take the “wider approach” and report information under new section 185N(8). Should this amount to a breach of privacy this may render the relevant provisions of the Bill inoperative.

11. These privacy issues are causing concerns for industry participants, given they are in the solution design phases and need to close these phases out in the very near future to ensure that due diligence procedures can be implemented on 1 July 2017 and reporting engines can be developed.

Extension of the wider approach

12. NZBA strongly supports the adoption of the wider approach for CRS implementation across both due diligence ‘collection’ and ‘reporting’ requirements.

13. Under the Bill, an FI must review all accounts held or controlled by foreign tax residents. The FI can report all accounts held by foreign tax residents or choose to only report accounts held by those tax residents in countries on the reportable jurisdiction list which the Commissioner will publish.

14. NZBA is concerned that allowing FIs the choice of which foreign tax resident accounts to report may lead to account holders moving to those FIs that choose only to report accounts on the reportable jurisdiction list, creating an unfair competitive advantage for some FIs.

15. NZBA is also concerned that allowing FIs the choice to limit reporting will not reduce compliance costs as intended, but will simply spread them over a much longer period. The reportable jurisdiction lists will change over time and FIs will need to constantly update processes and reporting requirements to meet those changes.

16. NZBA recommends that FIs report all foreign tax resident accounts to IR, implementing the ‘wider approach’ for both collection and reporting. NZBA notes this is the approach taken in most other countries to reduce compliance costs and inconsistencies.

Reviewing pre-existing accounts

17. NZBA strongly recommends aligning reporting with general CRS and FATCA timelines — requiring FIs to report accounts the year after confirming the tax residency status of the account.

18. An alternative is to allow FIs to report pre-existing accounts later, with new accounts reported as proposed in the Bill.

19. Requiring FIs to complete due-diligence and report pre-existing account holders within compressed timeframes is unreasonable.

20. Our members' FATCA experience, involving smaller numbers and generally less-complex account holders, shows due diligence and reporting compliance was extremely challenging.

21. With CRS, FIs will need to come to grips with the new regime within condensed timeframes. FIs will also need to review and report on much larger volumes, with more complex account holders. Our view is that the compliance costs and effort will be significantly higher in the first reporting year under CRS. This should be taken into consideration when setting the first reporting period.

22. Under the Bill, FIs have a three-month grace period until 30 June 2018 and 30 June 2019, respectively, to complete due-diligence reviews for the first reporting year. FIs must review and report to IR:

    a. pre-existing high-value individual accounts by 30 June 2018, for the reporting period ending 31 March 2018, and

    b. pre-existing lower-value individual and entity accounts by 30 June 2019, for the reporting period ending 31 March 2019.

23. In NZBA's view, FIs will need the three-month grace period simply to work through large volumes of data collected and prepare reporting. Likewise, NZBA submits FIs will not be able to report any accounts identified during the grace-period for the reporting period ending 31 March 2018, as established through our members' experience with FATCA.

24. NZBA believes there will be a risk that, if the provisions remain unchanged, customer experience will suffer due to the pressure to complete due diligence. NZBA is concerned more customers will likely be reported simply because FIs will be unable to completely assess customers within the required period.

Transition to the new rules — making reasonable efforts

25. NZBA strongly supports transition rules that mean an FI is not liable for penalties if the FI made reasonable efforts to meet the requirements, and corrects any failures within a reasonable timeframe.

26. NZBA believes the transition rules are consistent with the approach taken when implementing FATCA, and reflect significant changes FIs will need to make to their businesses.

27. NZBA notes however that no transitional relief is provided where an FI fails to take reasonable care to meet a requirement of the FI under Part 11B and the CRS applied standard for financial accounts (new section 142H(5)). NZBA suggests applying the same transitional relief, so that an FI is not liable for penalties if the FI has made reasonable efforts to meet the requirements, and corrects any failures within a reasonable timeframe.

28. Furthermore, under new section 142H the reasonable efforts defence is available for occurrences prior to 1 April 2019. NZBA submits that the time limit on the reasonable efforts defence should be removed. As currently proposed, FIs would be liable for penalties post 30 March 2019 for failure to comply with due diligence and reporting requirements or obtaining self-certifications even where the FI made substantial efforts to comply with these requirements.

Align record-keeping rules with FATCA

29. The Bill proposes that, as well as the rules in the AEOI standards, specific record-keeping rules will be set. IR will use FIs' records to determine compliance. NZBA recommends that IR engage with the banking industry further on specific record-keeping rules that will be set to ensure that they align with those currently imposed under FATCA.

30. The Bill takes a more comprehensive enforcement approach than the international AEOI obligations require, specifically around the requirement to keep records about the failure to collect a self-certification. NZBA strongly recommends that the appropriate mechanism is through reporting of undocumented accounts, both new and pre-existing, and removing the requirement to keep a record of self-certificate failure.

Undocumented accounts

31. The Bill adopts the CRS definition of undocumented accounts. NZBA suggests expanding the definition of undocumented accounts in the Bill to include both new and pre-existing accounts. The United Kingdom and Cayman Islands have already adopted this approach.

32. Extending the definition ensures the CRS intent is not frustrated or undermined, and also aligns with FATCA record-keeping processes.

33. NZBA also notes that if an FI is unable to determine the status of a pre-existing account it generally must report it as an "undocumented account". However the CRS provides that "undocumented account" only relates to particular situations and there is conflict between the CRS and the OECD Commentary. Accordingly this requires clarification.

Determinations and updates

34. The Bill contains provisions for the Commissioner to make determinations (new sections 91AAU to 91AAW), which are broadly supported by NZBA. This removes the need for returning to the legislative process for matters which are administrative in nature and can be attended to sooner than a legislative fix.

35. NZBA would however like to ensure that as a matter of principle, when the Commissioner issues such determinations they are prospective with a staged transition, as opposed to being framed as retrospective in application (unless it is identified that general practice applied to AEOI is at odds with the tax administration and the Commissioner is comfortable to back-date a determination). However, most NZBA members agree that for systems and process changes, determinations with prospective application dates are favoured.

36. Under the Bill, the Commissioner may issue updates within 30-days of making changes. NZBA requests that IR engage with the banking industry on transition periods when making changes. In particular, the scope or complexity of the change should be considered in deciding when new rules become effective. The banking industry will need to adjust technology and processes to comply, which will require suitable transition periods in order to implement any updates, including lists of participating jurisdictions, reportable jurisdictions, and excluded accounts.

Excluded entities and accounts

Timeframe for guidance from Inland Revenue

37. NZBA understands that IR intends publishing an initial list of entities and accounts that can be excluded from due diligence and reporting in early to mid-2017.

38. NZBA is concerned that publishing the list of exclusions as late as 2017 may lead to unnecessary compliance costs and may adversely impact customer experience. Given the condensed timeframes for compliance, FIs could unnecessarily report excluded customers. If the list is released as late as 2017, NZBA is concerned FIs will have insufficient time to establish the systems needed to analyse the tax status of complex individuals and entities who may be excluded from due diligence and reporting and could potentially report higher volumes of customers.

39. NZBA requests that officials issue a draft determination or other guidance describing the categories of entities and accounts that will be excluded as soon as possible. NZBA requests that this guidance be made available at least six months prior to the collection start date of such information (1 July 2017).

Alignment with FATCA

40. NZBA further submits that this guidance should include those entities and accounts that are excluded under FATCA.

41. The following accounts are currently excluded under FATCA but are currently not excluded under the CRS (although could be excluded by a Determination):

    a. KiwiSaver and other superannuation scheme accounts.

    b. Debt interests issued by FIs which is not solely an Investment entity (for example, Covered Bonds, European Commercial Paper, and Medium Term Notes).

42. NZBA submits that these types of accounts pose a low risk of being used for offshore tax evasion and therefore should be exempt from the due diligence and reporting obligations in the Bill.

Penalties on Financial Institutions

43. NZBA submits that the current penalties provisions in the Bill create uncertainty and concern for FIs. There are three penalties that can be applied to a FI, and there is no cap or limitation on the penalties that can be applied. For example, a $300 penalty can be applied for an FI's failure to comply with its CRS "due diligence and reporting" requirements, but in addition a $20,000 or $40,000 penalty could also be applied for the same offence.

44. In terms of the $300 penalty, this could apply per account in the case of failure to obtain self-certification on account opening (account opening being undefined). If an FI had failed to correctly undertake due diligence on 1000 accounts, then the penalty could be $300,000, and in addition the imposition of the $20,000 or $40,000 penalty. Furthermore, a knowledge offence penalty may also apply.

45. NZBA submits that the penalty provisions should be amended to ensure that double imposition/liability will not occur and that there are clear limitations imposed on the Commissioner in both applying and capping penalties for offences of a similar type or nature.

Penalties on Information Providers or Account Holders – Need for Public Education

46. While NZBA supports the concept of penalties on providers of information to FIs, in practice we believe that this is somewhat of a double edged sword which has the potential to impact the business of FIs.

47. There are and will always be disputes over the provision of information between a business and its client. These disputes form part of the day-to-day realities of any business, including banks and other FIs. They are usually managed by reference to a legally binding contract entered into at the start of the relationship.

48. With the introduction of a regulatory penalty for failing to provide certain information, one anticipates that when a customer or account holder (information provider) is faced with the potential for a penalty after the fact, they are likely to point to the FI and impress upon the Commissioner that they have met their obligations and shift

the focus for failure onto the FI claiming that, for example, the FI has misplaced the customer data. Whether that be true or not the customer relationship will likely be soured and the customer will potentially move to another FI.

49. There have been examples of this in practice over a number of years with respect to withholding tax and incorrect withholding tax rates, legislative changes to withholding taxes and end of year certificate issues. While FIs strongly support penalties on information providers as a driver of documentation provision, there is legitimate concern that there may be ongoing unintended impact on customer relationships, businesses and brands as a result. In order to avoid this potential impact, NZBA proposes a comprehensive educational programme (as indicated below) to ensure those impacted understand the penalties and processes resulting from New Zealand IR Competent Authority obligations.

50. To that end, NZBA submits there needs to be a comprehensive educational programme targeting the public, informing them of these legislative changes and their CRS obligations. This approach was requested for FATCA but was not implemented, other than minor information placed on IR's website. Given the potential for the implementation of the CRS to impact on significantly more customers (estimates are between 16-60 times the number of those impacted by FATCA), this need is more pressing.

51. Such a programme could take the form of a high-profile communications strategy aimed at the general public to inform them about their foreign tax obligations (i.e. both FATCA and CRS).

Trusts

52. NZBA submits that should FIs elect to avail of the CRS option to resolve controlling persons based on the timing of distributions, they would be unable to comply with new section 185N(10), as currently drafted. It provides that an FI that chooses to treat a discretionary beneficiary as not being a controlling person of a trust until they receive a distribution must have in place reasonable safeguards and procedures for determining when a distribution is made to the beneficiary. NZBA submits that an FI electing to adopt such a process would be effectively unable to determine when such distributions are made, and as a result, would not be able to avail of this option.

53. Most trusts will not have established if they have a beneficiary distribution as at 31 March and in fact under New Zealand current tax settings they have up to 6 months following balance date to make such an election.

54. So for example a Trust with a balance data aligned to AEOI i.e. 31 March will have up to 30 September to elect to treat its income as beneficiary income and distribute accordingly. That distribution is technically from the same AEOI year ended 31 March.

55. This distribution could be known by the Trustees at any time in that 6 month window but the window for filing will have ceased on 30 June so many Trusts would not have

furnished the necessary information because they would not have determined their position regarding beneficiary distributions.

56. The due diligence work effort for trusts is significant (regardless of which option is adopted). One NZBA member bank has indicated that it has over 84,000 account holders with the word "trust" in their title. That means it will have to contact at least 84,000 account holders each year, advising the information required from them, collecting that information, and then reviewing and reporting it as appropriate. The reporting deadline (30 June) is only three months following the close of an AEOI year (31 March). To achieve this within the timeframe is just not feasible.

57. NZBA submits this issue is already addressed in new section 185P as the persons providing the information to FIs are best placed to ensure this information is captured.

58. But even if they had complied, NZBA queries how an FI can comply with the law when it has so many of these accounts to address. The fact that one bank has 84,000 accounts means that it needs to have in place an entire team to deal with its Trust accounts for AEOI purposes let alone undertaking its own business.

59. A discretionary beneficiary who moves overseas (temporarily or permanently) and becomes a tax resident of another jurisdiction could also result in a change of status for the trust under AEOI. This means that there could easily be a breach of information flows regarding trusts to overseas jurisdictions because that information will just not be available until well after the due date for submission.

60. It is likely that the area of Trusts and reporting will test the penalty provisions. The compliance burden is expected to be significant and will likely be one of the most difficult areas for FIs to comply with.

61. NZBA submits the Government (and indeed on a global basis, all CRs Participating Governments) must consider finding an alternative solution for obtaining AEOI information from trusts. IR must explore building on the information it receives regarding Trusts and collecting any additional information required as part of the trust's annual tax return process.

Nil returns

62. The Bill is silent on whether FIs must file 'nil returns'. NZBA suggests that FIs should not have to file 'nil returns' as this adds to compliance costs. Instead, NZBA recommends that FIs must evidence 'nil returns', if required by IR.

Definition of Financial Institution

63. Due to the differences in the definition of FI between the FATCA and CRS regimes, we recommend alignment of the FI definition to that contained in the CRS, together with clarification of the specific types of entities in New Zealand that meet the "Non-Reportable FI" definition.

Amendments to section 59B

64. NZBA fully supports the amendments to section 59B of the Tax Administration Act 1994 related to foreign trust registration and disclosure as outlined in Clause 10 of the Bill, and as recommended by the recent Government Inquiry into Foreign Trust Disclosure Rules. NZBA considers the proposed changes promote increased transparency which will discourage the use of New Zealand trusts for illicit purposes by offshore parties.