NEW ZEALAND BANKERS ASSOCIATION

Submission

to the

Inland Revenue Department

on the

Draft Guidance on the Automatic Exchange of Information

2 March 2017

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 sixteen 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
   - Industrial and Commercial Bank of China (New Zealand) 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 NZBA welcomes the opportunity to provide feedback to the Inland Revenue Department (**IRD**) on the Draft Guidance on the Automatic Exchange of Information (**Draft Guidance**) in relation to the implementation of the OECD Standard for Automatic Exchange of Financial Account Information in Tax Matters (**AEOI**).

4. For convenience, where relevant in this submission we have adopted the terminology used in the Draft Guidance and/or the Common Reporting Standard (**CRS**), as the context requires. Paragraph and page references are to the Draft Guidance, unless otherwise stated. CRS section references (other than to Section VIII) are to the sections set out in Appendix 5 of the CRS, which have been amended for the wider approach.

5. If you would like to discuss any aspect of the submission further, please contact:

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Executive summary

6. NZBA's key submission points relate to the following matters covered in the Draft Guidance:

6.1 Meaning of “account holder” - Look-through of non-Financial Institution intermediaries;

6.2 Determining the Controlling Persons of an entity – Reliance on AML/KYC information;

6.3 Determining the Controlling Persons of a trust – Discretionary beneficiaries and classes of beneficiaries’;

6.4 Timing for obtaining self-certifications from controlling persons;

6.5 Account holders that are financial institutions by virtue of assets being managed by a DIMS provider;

6.6 Reasonableness testing as a “day two” process;

6.7 Acceptable Documentary Evidence for entities;

6.8 Meaning of “Active NFE” – Charitable organisations and donee organisations;

6.9 Meaning of “debt interest”;

6.10 Meaning of “passive income”;

6.11 Options permitted by the CRS (including option to use service providers);

6.12 Currency;

6.13 Penalties on information providers;

6.14 Public education campaign; and

6.15 Miscellaneous typographical errors.

7. The submission points at paragraphs 6.1 to 6.4 are considered high priority issues for NZBA’s members because they have significant implications for systems design. We would therefore be grateful if IRD could please consider those submissions points first and respond at its earliest convenience.

8. Although there are some differences in opinion amongst our members on some of the submission points, this submission is made with majority support from our members.

High priority issues

Meaning of “account holder” - Look-through of non-Financial Institution intermediaries

9. NZBA and its members have been in discussions with IRD and the New Zealand Law Society for some time about the application of FATCA to solicitors’ trust accounts. IRD’s current view, based on their interpretation of the “account holder” definition (discussed at paragraph 1.8 on page 13 of the Draft Guidance), is that the solicitors’ clients are to be treated as “account holders” of interest bearing deposit accounts where those accounts are sufficiently “designated” in the name of the underlying

clients. This interpretation applies also to the CRS and is likely to have impact beyond solicitors' trust accounts to other accounts that are of a similar nature.

10. As those underlying persons that are required to be treated as "account holders" for FATCA/CRS purposes are not actually bank customers, significant changes to the banks' systems (at significant cost and time) are necessary to allow information capture and reporting in relation to those underlying persons. We have raised concerns with IRD about their ability to have the required systems in place by 1 July 2017. We therefore seek assurance from IRD that, as long as Reporting NZFIs make those systems changes as quickly as they can, they would be considered to have made reasonable efforts to meet their obligations within the meaning of proposed section 142H of the Tax Administration Act 1994 (**TAA**).

Determining the Controlling Persons of an entity – Reliance on AML/KYC information

11. The CRS provides that, in respect of both Pre-existing Entity Accounts and New Entity Accounts, "for the purposes of determining the Controlling Persons of an Account Holder, a Reporting Financial Institution may rely on information collected and maintained pursuant to AML/KYC Procedures" (see CRS Section V.C.2(b) and Section VI.A.2(b)).

12. It is unclear whether that means that a Reporting NZFI can:

    12.1 treat the persons who have been identified as Controlling Persons for AML purposes as the entity's Controlling Persons for CRS purposes; or

    12.2 use the information collected for AML, but separately apply the "Controlling Persons" definition in the CRS to identify the entity's Controlling Persons for CRS purposes.

13. The CRS Commentary at page 199 paragraph 137 provides that:

> *"Where a Reporting Financial Institution relies on information collected and maintained pursuant to AML/KYC Procedures for purposes of determining the Controlling Persons of an Account Holder of a New Entity Account…such AML/KYC Procedures must be consistent with Recommendations 10 and 25 of the FATF Recommendations (as adopted in February 2012), including always treating the settlor(s) of a trust as a Controlling Person of the trust and the founder(s) of a foundation as a Controlling Person of the foundation. For purposes of determining the Controlling Persons of an Account Holder of a Preexisting Entity Account…a reporting Financial Institution may rely on information collected and maintained pursuant to the Reporting Financial Institution's AML/KYC Procedures".*

14. The requirement in the CRS Commentary above as regards New Accounts (i.e. that the AML/KYC Procedures must be consistent with the 2012 FATF Recommendations) suggests that the phrase "for the purposes of determining the Controlling Persons of an Account Holder, a Reporting Financial Institution may rely on information collected and maintained pursuant to AML/KYC Procedures" means that AML/KYC determination of Controlling Persons is also used for CRS. We ask that this be confirmed in guidance for both New Entity Accounts and Pre-existing Entity Accounts (see Draft Guidance at paragraph 5.5.3 on page 75 and paragraph 5.6.3 on page 83).

Determining the Controlling Persons of a trust - Discretionary beneficiaries and classes of beneficiaries

15. It is clear from the Draft Guidance (see paragraph 1.9 on page 16, paragraph 5.1 on page 51, and paragraph 5.5.3 on pages 76-77) and CRS Commentary (see page 198 at paragraph 134) that beneficiaries of a trust are to be treated as "controlling persons" of the trust for CRS purposes, irrespective of whether they actually exercise control over the trust.

16. However, significant practical issues arise for Reporting NZFIs in identifying:

    16.1 discretionary beneficiaries, i.e. specified/named beneficiaries that are only entitled to discretionary distributions from the trust; and

    16.2 class beneficiaries, i.e. beneficiaries that are not specified/named but are designated by characteristics or class.

17. In relation to discretionary beneficiaries, Reporting NZFIs have the option of treating them as controlling persons of the trust only when they receive a distribution (or such distribution becomes payable to them). The Draft Guidance states that a Reporting NZFI that adopts that option must have "reasonable safeguards and procedures in place to determine when such a distribution has been made" and that "[t]his could include the Reporting NZFI having an arrangement with the trustee (possibly in terms and conditions) that the trustee will inform the Reporting NZFI when it has made such a distribution". We seek confirmation from IRD in guidance that requiring a trustee to notify the Reporting NZFI of any change of circumstance during a reporting period, including a distribution paid or planned to a discretionary beneficiary, would satisfy the requirement to have reasonable safeguards and procedures in place.

18. In relation to class beneficiaries, a Reporting NZFI is required to obtain sufficient information concerning those beneficiaries to satisfy itself that it will be able to establish the identity of the beneficiaries at the time a distribution is paid out to them or when the beneficiaries intend to exercise vested rights. The Draft Guidance does not specify what information IRD would consider sufficient for this purpose. It would be helpful if IRD could provide examples of information that Reporting NZFIs are required to obtain. In particular, we consider that the comment at page 77 of the Draft Guidance that "[t]his could include the Reporting NZFI having an arrangement with the trustee (possibly in terms and conditions) that the trustee will inform the Reporting NZFI when it has made such a distribution" should be extended to cover the identification of class beneficiaries. We therefore seek confirmation that the requirement in relation to the identification of class beneficiaries would be satisfied where a Reporting NZFI requires the trustee to notify it of any change of circumstance during a reporting period, including the payment of a distribution or intention of beneficiaries to exercise vested rights.

Timing for obtaining self-certifications from controlling persons

19. In respect of New Entity Accounts, a Reporting NZFI must obtain a self-certification to determine whether a Controlling Person of a Passive NFE is a foreign tax resident. However, it is unclear what the timeframe for collecting such self-certification is and it is not addressed in the Draft Guidance (see paragraph 5.6.3 on page 83).

20. Unlike New Individual Accounts, the CRS itself does not expressly state that the self-certifications for New Entity Accounts must be obtained "upon account opening"

(compare Section VI.A to Section IV.A). Although the CRS Commentary clearly states that a self-certification to determine the entity's jurisdictions of tax residence must be obtained "upon account opening" (see page 143, para 4), it is silent as to when the self-certification of the entity's controlling persons must be obtained.

21. We submit that that collection of controlling persons self-certification as part of a "day two" process, rather than "upon account opening", is permitted by the CRS and that this should be reflected in the guidance:

21.1 Section VI.A.2 states that in determining whether a New Entity Account is held by a Passive NFE with one or more Controlling Persons that are Reportable Persons, the FI must follow the guidance in the order most appropriate under the circumstances. This implies that the determination of whether a Controlling Person of an entity is a foreign tax resident could be undertaken after the FI has first determined whether the entity is a Passive NFE and identified its Controlling Persons.

21.2 In relation to both the determination of whether an entity is a Passive NFE and the identification of its Controlling Persons, the CRS allows the FI to review and rely on other information before seeking a self-certification (see Section VI.A.2(a) which allows an FI to reasonably determine that the entity is an Active NFE or a financial institution based on publicly available information or information in the FI's possession, and Section VI.A.2(c) which allows the FI to rely on AML/KYC information in identifying the entity's Controlling Persons).

21.3 To require a Reporting NZFI to obtain the controlling persons self-certification "upon account opening" would be inconsistent with the above.

Other issues

Account holders that are financial institutions by virtue of assets being managed by a DIMS provider

22. The Draft Guidance states (at paragraph 3.1.3 on pages 24-25) that an entity will be regarded as "managed" by another financial institution that performs specified investment activities for it, where that financial institution has discretionary authority to manage the entity's assets, either in whole or in part. It is clear from Example 3 on page 25 that an entity (such as a trust) could be a financial institution by reason of having its assets managed by a DIMS provider.

23. In respect of a Reporting NZFI that provides DIMS services to an entity customer, can IRD please address/confirm in guidance:

23.1 the circumstances in which the Reporting NZFI can reasonably determine, based on its DIMS relationship with the entity, that the entity is a Financial Institution (other than a managed investment entity that is not a Participating Jurisdiction Financial Institution) under CRS Section V.C.2(a) or Section VI.A.2(a) (For example, to what extent is the Reporting NZFI required to identify whether the entity's income is from financial assets?);

23.2 that, if the Reporting NZFI is not able to make the reasonable determination referred to above, the Reporting NZFI is required to obtain a self-certification from the entity as to its status and to presume the entity is a Passive NFE if it is

not able to determine its status (as per CRS Commentary page 140 paragraph 20 and page 147 paragraph 18); and

23.3 that the Reporting NZFI is not required to notify the entity that the entity could be a financial institution by reason of its assets being managed under the DIMS relationship.

24. The potential for entities being treated as a managed investment entity financial institutions by reason of having their assets managed by a DIMS provider could affect many family trusts. It is therefore important that the IRD address this in its public education campaign to ensure that such entities are adequately informed.

Reasonableness testing as a "day two" process

25. It should be clarified that the Reporting NZFI in Example 4 on page 68 of the Draft Guidance has chosen not to undertake reasonableness testing of self-certifications as a "day two" process. As currently drafted, the Example suggests that an account cannot be opened if a self-certification fails the reasonableness test, but that is only the case if the Reporting NZFI undertakes the test as a "day one" process. It is clear from OECD materials (some of which are quoted in the Draft Guidance) that the reasonableness testing can be undertaken as a "day two" process. This should be confirmed in the guidance.

Acceptable Documentary Evidence for entities

26. We seek IRD clarification on whether documentary evidence for entities will be expanded to include non-government issued documentation to align with the recently updated FATCA final and temporary regulations (TD9809) as follows:

> *"iv. Requirements for Documentary Evidence—Foreign Status—Entity Government Documentation - Under the 2013 final regulations, acceptable documentary evidence supporting a claim of foreign status includes, with respect to an entity, official documentation issued by an authorized government body. However, some common types of organizational documentation may not be considered "issued" by a governmental body (for example, articles of incorporation and partnership agreements). Therefore, these final regulations revise the 2013 final regulations to provide that acceptable documentary evidence supporting a claim of foreign status includes any documentation that substantiates that the entity is actually organized or created under the laws of a foreign country".*

Meaning of "Active NFE" – Charitable organisations and donee organisations

27. The Memorandum of Understanding to the Intergovernmental Agreement between New Zealand and the United States in relation to FATCA (**FATCA IGA**) states that:

> *"It is understood that organizations registered under the Charitable Trusts Act 1957 and the Charities Act 2005, and donee organizations as defined in the Income Tax Act 2007, would be treated as NFFEs that satisfy subparagraph B(4)(j) of section VI of Annex I."*

28. Section VI.B(4)(j) in Annex I of the FATCA IGA sets out the requirements to be an Active NFFE for FATCA purposes. The requirements are identical to those set out in

Section VIII.D.8(h) of the CRS to be an Active NFE. Accordingly, an entity that is an Active NFFE for FATCA purposes under Annex I section VI.B(4)(j) of the FATCA IGA should be an Active NFE for CRS purposes under Section VIII.D.8(h). We therefore ask that IRD confirm in guidance that organisations registered under the Charitable Trusts Act 1957 and the Charities Act 2005, and donee organizations as defined in the ITA are Active NFE for CRS purposes.

Meaning of "debt interest"

29. The Draft Guidance states at paragraph 4.5.1.2 on page 41 that a debt interest would cover amounts loaned to a financial institution and securities and bonds that are not equity interests. This definition is too broad. We seek confirmation that for the purpose of applying the CRS "debt interest" does not include accounts that are "Depository Accounts". This can be achieved by adding "or Depository Accounts" after "equity interests" in the sentence above.

Meaning of "passive income"

30. A new definition of "passive income" will be added to section 3(1) of the TAA for CRS purposes. That definition refers to "income". The term "income" is not defined in the TAA, but section 3(2) of the TAA provides that unless the contest requires otherwise, undefined terms used in the TAA have the same meanings as they have in the Income Tax Act 2007 (**ITA**). Accordingly, "income" in the "passive income" definition means income under section BD 1(1) of the ITA. It would be helpful if this could be explained in the guidance (see paragraph 5.5.2, page 74).

Options permitted by the CRS (including option to use service providers)

31. It is clear from the Draft Guidance (at paragraph 1.4 on page 10) that Reporting NZFIs are permitted, as an option, to use service providers to carry out due diligence and reporting obligations on their behalf. This, together with other options available to Reporting NZFIs, is set out in Appendix 2 of the Draft Guidance. For completeness and ease of reference, it would be helpful for the guidance to refer to the specific legislative provision (i.e. section 185O(5) and (6) of the TAA), once it is enacted, that allows such optionality

Currency

32. We request that a reference to currency be made upfront in the guidance, along the lines of the following which is modelled on the ATO's guidance materials for Australia: "Dollar values stated in the guidance should be read for CRS purposes as referring to either New Zealand Dollars or US Dollars according to the election by the relevant Reporting NZFI".

Penalties on information providers

33. Proposed section 142I of the TAA imposes penalties on persons or entities that are required to provide information (including a self-certification) in relation to a financial account (referred to as "information providers"). Under that section, penalties apply in various situations including (but not limited to) providing false information, signing a false self-certification, and failing to provide a self-certification within a reasonable time after a request.

34. To ensure that information providers are aware of their obligations and the potential penalties that apply if they fail to comply, those should be covered in IRD's planned public education campaign. In addition, we would like IRD to clarify in guidance that Reporting NZFIs are not obliged to separately advise information providers of such penalties.

Public education campaign

35. We understand that IRD will undertake a public education campaign to enhance awareness of AEOI. Such a campaign is critically important to ensure that a consistent message is provided to account holders and other affected persons about AEOI and to enable Reporting NZFIs to refer customers to official "plain language" information on AEOI.

36. We consider that, as a minimum, the public education campaign should:

    36.1 provide comfort that customer information will be safe and that the appropriate safeguards for confidentiality will be in place (both when the information is held by IRD and when it is exchanged with other jurisdictions);

    36.2 clarify that IRD may use the information for non-AEOI purposes and specify all of the purposes for which the IRD intends to use the information (including, for example, the verification of NRWT rates);

    36.3 explain the meaning of "effective place of management" and how an entity account holder that has no residence for tax purposes should apply the term in determining its jurisdictions of tax residency;

    36.4 explain the meaning of "account holder" and how account holders should determine their tax residency (this is particularly important in the context of trusts);

    36.5 explain the concept of dual/multiple tax residency and what this means in the context of the self-certifications that account holders and controlling persons are required to provide;

    36.6 explain the meaning of "financial institution" and in particular that entities could be a financial institution for AEOI by virtue of being managed by a financial institution such as a DIMS provider (this is particularly important in the context of family trusts); and

    36.7 set out the obligations of customers in respect of AEOI and the penalties that could apply if they do not comply.

37. We recommend that IRD consider a printed campaign in addition to an online campaign so that Reporting NZFIs can provide printed materials to customers that contain all the relevant facts (or references for further information). We also request that Reporting NZFIs be permitted to use official excerpts from such publications when communicating with customers.

Miscellaneous

38. Could IRD please correct the following apparent typographical errors in the Draft Guidance as follows:

38.1 page 178, para (h)(iv):

> *"…(iv) the applicable laws of the NFE's jurisdiction of residence or the NFE's formation documents do not permit any income or assets of the NFE to be distributed to, or applied for the benefit of, a private person or ~~liquidation or dissolution, all of its assets be distributed to a Governmental Entity or other non-profit organisation, or escheat to~~ non-charitable Entity other than pursuant to the conduct of the NFE's charitable activities, or as payment of reasonable compensation for services rendered, or as payment representing the fair market value of property which the NFE has purchased; and…"*

38.2 page 179, para (v):

> *"…(v) the applicable laws of the NFE's jurisdiction of residence or the NFE's formation documents require that, upon the NFE's liquidation or dissolution, all of its assets be distributed to a Governmental Entity or other non-profit organisation, or escheat to the government of the NFE's jurisdiction of residence or any political subdivision thereof."*