

# Regulatory Impact Statement

## Implementing New Zealand's commitment to Automatic Exchange of Information (AEOI)

### Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by Inland Revenue.

It provides an analysis of options to determine how best to give effect to New Zealand's commitments to implement the G20/OECD standard for *Automatic Exchange of Financial Account Information in Tax Matters*. The AEOI standard is a global framework for cooperation between countries in the detection and prevention of tax evasion. Specifically, the AEOI standard responds to international concerns that individuals and entities can relatively easily evade their tax obligations by concealing their wealth in 'off-shore' financial accounts.

New Zealand's international commitments to implement the AEOI standard were made in 2014 and in 2016 Cabinet supplemented those commitments with a decision to commence AEOI obligations from 1 July 2017. For this reason, this RIS is concerned solely with implementing AEOI and detailed design matters.

Three implementation options and the status quo are assessed in this RIS. The exact form that these options will take in practice depends on the specific design features that are ultimately decided upon. Given this and the fact that there is limited data about who may be impacted and how they may be affected by AEOI it is not possible to accurately estimate some of the costs involved (such as compliance costs) and benefits associated with each of the options. Even so, we have undertaken several rounds of consultation with financial institutions and their representative bodies (the most affected by AEOI), government agencies, and the general tax community, and the feedback from consultation has helped to inform our high-level assessment of the nature and extent of the costs and benefits.

It is acknowledged that implementing the AEOI will involve potentially significant compliance costs on financial institutions and administrative costs on Inland Revenue.

Additionally, the AEOI initiative will only be successful if jurisdictions implement AEOI on the same timeline and with consistent rules. If some jurisdictions are allowed to lag behind or implement to a lesser standard, the off-shore tax evasion problem is likely to simply relocate to those jurisdictions.

There are no other significant constraints, caveats or uncertainties concerning the analysis undertaken.

The preferred option is to adopt a balanced approach to implementation that seeks to minimise compliance costs and administrative where possible, provided those choices do not result in New Zealand failing to meet international expectations.

None of the policy options considered would restrict market competition, impair property rights, reduce incentives for small businesses to operate, or override fundamental common law principles.

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## STATUS QUO AND PROBLEM DEFINITION

1. This Regulatory Impact Statement (RIS) deals with the question of how best to give effect to New Zealand's commitments to implement the G20/OECD standard for *Automatic Exchange of Financial Account Information in Tax Matters* (in short, Automatic Exchange of Information, or AEOI).
2. New Zealand's international commitments to implement the AEOI standard were made on:
  - 7 May 2014, by joining in a general declaration of support for the AEOI initiative issued at the OECD Ministerial Council Meeting;
  - 3 June 2014, by signing an administrative instrument<sup>1</sup> that sets out the terms for AEOI exchanges (the jurisdictions we will exchange with are still to be specified<sup>2</sup>); and
  - 16 November 2014, by reiterating our commitment at the November 2014 G20 Leaders Summit in Brisbane.
3. These commitments were general in nature. In February 2016, Cabinet supplemented the commitments with a decision that the start date from which AEOI obligations will apply in New Zealand will be 1 July 2017. From this date, financial institutions must start collecting the information needed for subsequent exchange. Although 1 July 2017 is later than the start date adopted by most other jurisdictions, it aligns with Australia's start date.

### International considerations

4. AEOI is a global framework for cooperation between jurisdictions in the detection and prevention of tax evasion.<sup>3</sup> Specifically, AEOI responds to international concerns that individuals and entities can, with relative ease, evade their tax obligations by concealing their wealth in 'off-shore' financial accounts.
5. Jurisdictions implementing AEOI must:
  - enact legislation that will impose obligations on financial institutions to collect and report information to their local tax authority on accounts held or (in certain circumstances) controlled by non-residents; and
  - establish the legal mechanisms (primarily tax treaties) necessary for exchanging that information with other jurisdictions.
6. The exchanged information will be used by the receiving jurisdiction to ensure that their tax residents have correctly reported off-shore income for tax purposes.

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<sup>1</sup> The OECD *Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information* (MCAA)

<sup>2</sup> Determining these jurisdictions will be subject to a separate process, as explained at paragraphs 120 and 121 below.

<sup>3</sup> AEOI forms part of the wider picture of a focus on cross-border tax compliance, both internationally (for example, the G20/OECD Base Erosion and Profit Shifting (BEPS) initiative which primarily relates to multinational enterprises) and domestically (for example, GST and online shopping).

7. This RIS pertains solely to the above requirement to enact legislation. It contains only passing references to certain necessary associated processes (for example, the publishing of New Zealand-specific lists of exchange partners and excluded entities/accounts) and legal mechanisms for exchange.
8. The AEOI initiative will only be successful if jurisdictions implement AEOI on the same timeline and with consistent rules. If some jurisdictions lag behind or implement to a lesser standard, the off-shore tax evasion problem is likely to simply relocate to those jurisdictions.
9. Accordingly, the G20 has taken a strong stance on ensuring that jurisdictions implement AEOI on a consistent and timely basis. Similar to the global standard for Anti-Money Laundering/Countering the Financing of Terrorism (AML/CFT), the AEOI standard constitutes ‘soft law’ (that is, international recommendations that are effectively mandatory, rather than just ‘best practice’).
10. As regards consistency, the *Global Forum on Transparency and Exchange of Information for Tax Purposes* (the Global Forum) has been tasked by the G20 with conducting peer reviews and on-going monitoring to ensure that jurisdictions implement the standard as it is set out in the OECD documentation.
11. As regards timing, the G20 and OECD have identified a target group of 101 countries that must implement AEOI on a timeline that will enable first exchanges to be completed by 30 September 2018. The target group includes all G20 and OECD member countries, and any other jurisdictions that have been identified as having or operating as an international finance centre are expected to implement AEOI on a similar timeline. As an OECD member country, New Zealand is included in the target group.
12. To clarify, 1 July 2017 will be the start date from which New Zealand financial institutions are to begin collecting information for subsequent reporting to Inland Revenue. Inland Revenue must then exchange that information with tax treaty partners by 30 September 2018.
13. All 101 jurisdictions in the above target group have committed to implement AEOI according to the G20 requirements. A small number of these, referred to as ‘early adopters’, have committed to complete their first exchanges a year earlier than the September 2018 deadline.
14. Jurisdictions outside of the target group do not face implementation deadlines as they are not considered to pose a significant risk in the context of off-shore tax evasion.<sup>4</sup>

### **Domestic considerations**

15. The principal benefit for New Zealand in implementing AEOI lies in the information we will receive reciprocally from our treaty partners. This information will be available to

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<sup>4</sup> Many of these jurisdictions may nevertheless implement AEOI. In the main, they are smaller developing countries. International organisations concerned with implementing the global *Post-2015 Development* and *Financing for Development* agendas are factoring AEOI implementation into their work programmes, as a key aspect of the ‘domestic resource mobilisation’ element of that agenda.

Inland Revenue to verify that its tax residents are correctly reporting off-shore financial assets and/or income.

16. To the extent that this facilitates a reduction in tax evasion (either through evasion actually detected, or more generally by deterring such activity), New Zealand will derive fiscal benefits. AEOI can generally also be expected to enhance voluntary tax compliance, through improved taxpayer perceptions that everyone is paying their fair share of tax.
17. New Zealand has been a strong supporter of all international initiatives to improve transparency and international cooperation in tax matters. There will be reputational benefits for New Zealand from being seen to be compliant with international standards.
18. It is acknowledged that AEOI implementation will impose potentially significant compliance costs on financial institutions and administrative costs for Inland Revenue. However, failure to implement AEOI, or to implement AEOI to a lesser standard so as to reduce compliance costs and administrative costs would damage New Zealand's international reputation.

### **The Common Reporting Standard (CRS)**

19. New Zealand's enabling legislation will largely involve imposing obligations on financial institutions. These obligations are set out in a key element of the AEOI standard referred to as the *Common Reporting Standard (CRS)*.
20. The rules set out in the CRS (as clarified and supplemented in the accompanying OECD commentary) are complex. In broad terms, incorporating the CRS into New Zealand domestic law will involve imposing *due diligence* and *reporting* obligations on New Zealand financial institutions in respect of their financial accounts.
21. Due diligence will be undertaken to identify the *tax residence* of:
  - the account holders; and
  - the controlling persons of accounts held by certain passive entities.
22. The due diligence procedures are highly prescriptive. In very generalised terms:
  - in respect of *pre-existing accounts* (accounts already open as at 1 July 2017), financial institutions will generally be allowed to rely on documentation already held for other purposes (particularly that collected for AML/CFT or other 'know-your-customer' purposes) to determine the tax residence of each account holder and (where relevant) controlling person;
  - in respect of *new accounts* (accounts opened on or after 1 July 2017), financial institutions will generally determine tax residence by obtaining a *self-certification* from each account holder and (where relevant) controlling person; and
  - the *passive entity* account holders to be 'looked through' to determine their controlling persons are those that (i) are not themselves financial institutions, and (ii) have assets that primarily produce or are held for the production of *passive*

*income* (such as interest or dividends) – entities that meet these criteria are referred to as passive non-financial entities (*passive NFEs*).

23. Financial institutions will be required to report (on an annual basis) the following information to Inland Revenue:
  - In respect of account holders or controlling persons that have been identified as tax residents of jurisdictions that have implemented AEOI,<sup>5</sup> they must generally report:
    - *identity information* such as name, address, and (in defined circumstances) date of birth and tax identification number; and
    - *financial account information* such as account balances and interest, dividends and other income earned.
  - If they have been unable to determine the status of an account, they are required to report the account as an ‘*undocumented account*’ in defined circumstances.
24. The CRS also requires implementing jurisdictions to have rules and procedures in place to ensure compliance and address non-compliance. This includes appropriate anti-avoidance rules, document retention requirements, auditing programmes, and sanctions to deal with identified non-compliance. Jurisdictions are specifically required to follow up on any undocumented accounts that are reported.
25. The CRS contains exclusions for certain categories of financial institution and financial account that are considered to pose a low risk of facilitating or being used for tax evasion. However, in some cases the criteria for exclusion are not automatic, and require submissions to be made by the financial institutions concerned. These criteria are very stringent. The application of the criteria in such cases will be dealt with as a stage two implementation matter. The process will involve Inland Revenue calling for submissions, and if possible making the necessary determinations before the end of 2016.

### **New Zealand’s precedents and existing mechanisms**

26. New Zealand has had an active exchange of information programme for many years. This primarily operates on the basis of responding to specific requests for information, but certain categories of information are subject to automatic exchange. As yet, we only automatically exchange *financial account* information with one country – the United States (US), pursuant to their 2010 *Foreign Account Tax Compliance Act* (FATCA) initiative.
27. FATCA operates on a similar basis to AEOI, in that New Zealand financial institutions are required to identify accounts held or controlled by US tax residents or citizens<sup>6</sup>

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<sup>5</sup> Note that the option of a ‘wider approach’, which would capture non-residents from all jurisdictions, not just those in jurisdictions we will exchange information with is elaborated on below in this report.

<sup>6</sup> The reference here to ‘citizens’ is a key point of difference from AEOI. AEOI only applies to tax residents, reflecting the fact that most countries only tax the worldwide income of persons who are tax resident. The US, however, also applies this approach to citizens, regardless of whether they are also tax residents of the US.

Financial account information on those accounts is then reported to Inland Revenue, which automatically exchanges the information with the US.

28. The framework legislation for FATCA in New Zealand is contained in Part 11B of the Tax Administration Act 1994. The detailed rules are set out in an Intergovernmental Agreement (IGA) with the US that has been given legislative effect in New Zealand by Order in Council.
29. Part 11B of the Act contemplates entering into similar arrangements with other countries. Strictly, therefore, New Zealand legislation already provides for automatic exchange of financial account information with countries other than the US. However, the legislation as currently framed requires entering into further arrangements through treaties similar to the US IGA. This does not match the approach taken by the G20 and OECD for AEOI.
30. FATCA and AEOI rely in part on information already required to be collected by financial institutions from account holders, particularly under AML/CFT ‘know-your-customer’ requirements. However, the overlap between the AML/CFT requirements is not an exact match for those applying under the CRS. For example, under New Zealand’s AML/CFT laws a financial institution may not collect all of the information required by the CRS in respect of discretionary trusts. Accordingly, in some areas, the AEOI due diligence obligations will require information to be obtained that is not required under AML/CFT laws.
31. Although AEOI exchanges can be made under other tax treaties, international expectations are that most, if not all, AEOI exchanges will take place under the OECD/Council of Europe *Multilateral Convention on Mutual Administrative Assistance in Tax Matters* (the Multilateral Convention). New Zealand signed the Multilateral Convention in 2012.

## OBJECTIVES

32. The policy options considered in this RIS will be assessed against the following objectives:
  - (a) To implement AEOI in a way that ensures **consistency with the requirements of the CRS** and its accompanying commentary so as to enable New Zealand to:
    - (i) meet international expectations;
    - (ii) comply with the international deadline of 30 September 2018 for completing first exchanges; and
    - (iii) successfully undergo Global Forum peer review.

(This objective reflects the aim of achieving sustainability and fairness in an international environment that is focused on establishing a global level playing field through implementation consistency.)

- (b) To implement AEOI in a manner that **maximises the opportunity for New Zealand to derive domestic and international benefits**. (This objective is primarily concerned with efficiency and sustainability.)
- (c) To implement AEOI in a manner that **minimises the compliance costs** that will be imposed on financial institutions. (This objective is primarily concerned with fairness and efficiency.)
- (d) To implement AEOI in a manner that **minimises the administrative costs** that will be imposed on New Zealand regulatory agencies. (This objective is primarily concerned with efficiency.)
33. These objectives are listed in descending order of importance.
34. Objective (a) is the overarching consideration, given that New Zealand's implementation of the AEOI standard will be subject to peer review and other international scrutiny. The identification of deficiencies would damage New Zealand's international reputation and result in international and domestic pressure to take immediate remedial action. More generally failure to implement AEOI correctly could result in suspicion of New Zealand's motives, potentially leading to greater scrutiny of the off-shore activities of New Zealand tax residents and adding to the cost for New Zealanders of doing business internationally.
35. Objective (b) reflects the objective of the AEOI standard, which is to facilitate the detection and prevention of off-shore tax evasion. Implementation is not just about compliance with an international imperative. The ultimate purpose of AEOI is to improve tax compliance and provide fiscal benefits to jurisdictions. It is important that this objective be viewed as a key focus.
36. Objectives (c) and (d) reflect acknowledgement that implementing AEOI will impose potentially significant compliance costs on financial institutions and administrative costs on New Zealand regulatory agencies. However, implementation decisions to reduce compliance and/or administrative costs should only be made if that is achievable without lowering the overall effectiveness of the standard in New Zealand or being seen as undermining the multilateral initiative.

## REGULATORY IMPACT ANALYSIS

37. Four policy options have been considered for implementing the AEOI standard described above:
- Option 1: Maintain the **status quo** – that is, do not implement AEOI.
  - Option 2: A **low cost approach** – that is, to implement AEOI on the basis of design decisions that favour minimising compliance costs for financial institutions and administrative costs for Inland Revenue over meeting international expectations.
  - Option 3: A **balanced approach** – that is, to implement AEOI on the basis of implementation decisions that strike a balance between minimising compliance



costs for financial institutions and minimising administrative costs for New Zealand regulatory agencies and meeting international expectations.

- Option 4: A **high cost approach** – that is, to implement AEOI on the basis of implementation decisions that favour meeting international expectations over minimising compliance costs for financial institutions and administrative costs for Inland Revenue.

38. The ‘Implementation’ section of this RIS discusses key design features of AEOI. Some of these features are specifically referred to in the analysis of the options below in order to highlight key differences between the options.

### **Option 1: Maintain the status quo**

39. Option 1 would not meet any of the objectives and is not considered to be tenable. A decision not to implement AEOI would mean New Zealand defaulting on commitments and result in international (and domestic) criticism and reputational damage.

### **Option 2: Low cost approach**

40. This option would involve making design decisions that would favour minimising compliance costs for financial institutions and administrative costs for Inland Revenue over meeting international expectations.

41. Examples would involve lenient phase-in options (as discussed in paragraphs 120 to 121) not contemplated by the CRS and limiting due diligence for CRS purposes to existing due diligence requirements under AML/CFT laws (as discussed in paragraphs 115 to 117).<sup>7</sup>

42. Option 2 has been measured against the objectives listed in paragraph 32 above.

#### ***Objective (a) – Consistency with the requirements of the CRS and its accompanying documentation***

43. Design decisions that favour minimising compliance costs as described above would in most cases fall short of the CRS requirements, and would result in failed peer review.

44. The consequences of failing peer review have not been articulated by the G20 or OECD. At a minimum New Zealand would face reputational damage. At the extreme, it is possible that we could face international sanctions. In any case, New Zealand would come under intense pressure to rectify any deficiencies, effectively meaning that any damage incurred will have been for little gain.

45. Therefore, option 2 does not meet this objective.

#### ***Objective (b) – Maximise the opportunity for New Zealand to derive domestic and international benefits***

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<sup>7</sup> As noted, AEOI due diligence depends to a significant degree on information obtained for AML/CFT purposes. However, there are gaps where AEOI due diligence obligations go beyond AML/CFT requirements.

46. The benefits to New Zealand from implementing AEOI primarily lie in the reciprocal information other jurisdictions will provide to Inland Revenue about New Zealand tax residents. Lowering the standard and quality of the information New Zealand provides to other jurisdictions will not directly affect this benefit.
47. However, it is possible that some jurisdictions might respond by refusing to provide information to New Zealand.
48. Aside from the benefit of reciprocal information, AEOI implementation will provide other benefits such as reputational benefits and enhancing voluntary compliance in tax matters. These benefits would be adversely compromised.
49. Therefore, this option partially meets the objective.

***Objective (c) – Minimise the compliance costs to be imposed on financial institutions***

50. As noted above, this option would be aimed at minimising compliance costs for financial institutions so meets the objective.

***Objective (d) – Minimise the administrative costs to be imposed on Inland Revenue***

51. This option would be aimed at minimising administrative costs for Inland Revenue so meets the objective.

**Option 3: A balanced approach**

52. Option 3 recognises that it is possible to implement AEOI in a way that enables New Zealand to meet international expectations while making choices that seek to minimise compliance costs and administrative costs.
53. The CRS is set by the OECD, and implementation will largely involve incorporating its rules (as clarified and supplemented by the OECD commentary) directly into domestic law. However, the CRS itself provides implementing jurisdictions with a number of options that can be taken. Adopting these options may assist in reducing compliance costs and administrative costs.
54. Outside of the options specifically contemplated by the CRS, other decisions could be taken under option 3 which would bear a low risk of exposure to international criticism. Key examples include:
  - the timing for phasing in certain due diligence obligations (such as allowing 24-months to complete due diligence of pre-existing entity accounts, rather than the 12-months provided by Australia – see paragraphs 106 to 109), and
  - allowing a transitional period in respect of enforcement – during which financial institutions identified as not complying with their obligations could mount a ‘reasonable endeavours’ defence and be allowed a reasonable period of time to rectify any errors (see paragraph 121).
55. Option 3 has been measured against the objectives listed in paragraph 32 above.

***Option (a) – Consistency with the requirements of the CRS and its accompanying documentation***

56. Design decisions under this option would be made on the basis of mitigating compliance costs and administrative costs wherever possible. In some cases, this may involve a judgement call whether CRS requirements would or would not be met.
57. The transitional approach to enforcement demonstrates this point. Although the CRS generally leaves the design of an effective enforcement regime up to jurisdictions, the terms of reference and methodology for peer reviews have not yet been set by the Global Forum.
58. Decisions made on the basis of option 3 would therefore involve some potential risk that peer review will determine that CRS requirements have not been met. However, the risk of reputational damage arising from the identification of deficiencies in peer review would be low, given that the decision was made on the basis of a judgement call that CRS requirements were met.
59. Therefore, this objective is met.

***Option (b) – Maximise the opportunity for New Zealand to derive domestic and international benefits***

60. The balanced approach to implementation should have no adverse implications in terms of the benefits likely to accrue to New Zealand from AEOI implementation so meets the objective.

***Option (c) – Minimise the compliance costs to be imposed on financial institutions***

61. The balanced approach to implementation would represent an attempt to minimise compliance costs to the extent possible so this objective is met.

***Option (d) – Minimise the administrative costs to be imposed on Inland Revenue***

62. The balanced approach to implementation would represent an attempt to minimise administrative costs to the extent possible, so meets this objective.

**Option 4: High cost approach**

63. Option 4 would carry the least risk of international criticism. In contrast to option 3, which involves making some judgment calls as to whether CRS requirements have been met, option 4 would involve a greater focus on meeting those requirements. However, this approach would result in the imposition of some compliance costs on financial institutions that could otherwise have been mitigated.
64. For example, under this approach, the transitional approach to enforcement would not be contemplated.
65. Option 4 has been measured against the objectives listed in paragraph 32 above.

***Option (a) – Consistency with the requirements of the CRS and its accompanying documentation***

66. Under this option, all design decisions would be made on the basis of meeting CRS requirements, so this objective would clearly be met.

***Option (b) – Maximise the opportunity for New Zealand to derive domestic and international benefits***

67. The high cost approach to implementation will have no adverse implications in terms of the benefits likely to accrue to New Zealand from AEOI implementation. Therefore, this objective is met.

***Option (c) – Minimise the compliance costs to be imposed on financial institutions***

68. The high cost approach to implementation would not attempt to minimise the compliance costs to be imposed on financial institutions so this objective is not met.

***Option (d) – Minimise the administrative costs to be imposed on Inland Revenue***

69. The high cost approach to implementation would not attempt to minimise the administrative costs to be imposed on financial institutions so this objective is not met.

**Administrative impacts**

70. In order to implement AEOI, a secure technology platform capable of receiving, storing and aggregating information from financial institutions in accordance with the CRS and exchanging it with other tax authorities is needed. Additionally, guidance and support must be provided to financial institutions to enable them to meet their obligations in full. Inland Revenue will also be responsible for the effective enforcement of AEOI.

**Social, environment or cultural impacts**

71. There will be no negative social, environmental or cultural impacts associated with any of the options identified above.

**CONSULTATION**

72. Several rounds of consultation were undertaken with affected parties including financial institutions and their representative bodies, the umbrella groups such as the New Zealand Law Society and Chartered Accountants of Australia and New Zealand and a number of Government agencies, including those concerned with New Zealand's privacy laws and anti-money laundering/countering the financing of terrorism (AML/CFT) laws.
73. In February 2016, an Officials' issues paper entitled *Implementing the global standard on automatic exchange of information* was released for public consultation. 21 submissions were received on the paper.

74. None of the submissions received on the issues paper proposed that New Zealand not proceed with implementation. This suggests that there is widespread acceptance of the need to implement AEOI to meet international expectations and to carry through with the commitment New Zealand has already made to implement AEOI.
75. The submissions often expressed a wide divergence of views as to how AEOI should be implemented. However, some common themes emerged, including:
- A strong preference for New Zealand to align its implementation decisions, where possible, with those taken internationally – and in particular with Australia.
    - Alignment with Australia seems particularly relevant in the context of New Zealand banks that are owned by Australian parents. But it is also relevant for financial institutions that have trans-Tasman financial products or an Australian client base.
  - A strong preference that, where the CRS permits implementing jurisdictions to provide financial institutions with a choice of due diligence and reporting procedures, that choice should be available to institutions.
  - A strong preference that financial institutions should not be required to obtain or report information about accounts unless the information is specifically required under the CRS or because of a choice that they have made.
    - This point essentially responds to an OECD suggestion that implementing jurisdictions could consider going further than the CRS requirements in certain areas – for example by making it mandatory to collect tax identification numbers or date of birth information in all cases (whereas the base expectation under the CRS is that for pre-existing accounts financial institutions do not need to go beyond reasonable endeavours to obtain this information). A further example is whether to require reporting of controlling persons of passive NFEs that are New Zealand residents.
    - The one exception to this point is the proposed application of the ‘wider’ approach to CRS due diligence (and reporting), outlined below. As will be noted, there was strong support for adopting the wider approach, to due diligence in particular.
  - A strong preference that New Zealand should, where possible look to align the entities and accounts that will be excluded from CRS obligations with the entities and accounts that are excluded for FATCA. Some submitters noted that this alignment should also apply to entities and accounts that are excluded under New Zealand’s AML/CFT regime.
  - A strong preference that New Zealand should, where possible, look to align CRS due diligence procedures with those carried out under FATCA and New Zealand’s AML/CFT regime, so that any additional AEOI due diligence is minimised. (There was widespread acceptance that the information that needs to be reported under AEOI will be different from that reported under these other regimes.)

- A strong preference that New Zealand should adopt a ‘soft landing’ approach to addressing any non-compliance with CRS. (Essentially, that is, to take a light or transitional approach to penalising non-compliance.)
76. All of the points raised in submissions and in consultation discussions have been considered.
77. Those that would lead to a high risk of international criticism and failing peer review have generally been ruled out. In this regard, it is worth reiterating that the AEOI standard is a global standard and its success depends on consistent application across jurisdictions.
78. However, some submissions have helped to shape key design decisions. A notable example is the proposed transitional approach to enforcement. Other examples include decisions to allow optionality, to align with the FATCA reporting period, and to align with the Australian wider approach for due diligence and reporting<sup>8</sup>.
79. A number of public sector agencies were consulted including the Treasury. Given the strong links with New Zealand’s AML/CFT laws, additional consultation was held with AML Regulators (the Department of Internal Affairs, the Financial Markets Authority, and the Reserve Bank of New Zealand). The Ministry of Justice and the Office of the Privacy Commissioner were specifically consulted in respect of privacy concerns.

## CONCLUSIONS AND RECOMMENDATIONS

80. Inland Revenue supports the adoption of option 3 (the balanced approach) on the basis that it meets all of the objectives.

	Consistency with the CRS	Maximise the benefits for NZ	Minimise compliance costs	Minimise administrative costs
Low cost approach	✘	✓✘	✓	✓
Balanced approach	✓	✓	✓	✓
High cost approach	✓	✓	✘	✓✘

Key: ✓ = meets, ✓✘ = partially meets, ✘ = does not meet

81. Option 1 (the status quo) is not supported because it is not tenable. Options 2 and 4 are not supported because they do not meet all of the objectives. In particular, option 2 would result in New Zealand failing to meet international expectations, whereas option 4 would meet international expectations but impose compliance costs and administrative costs that could otherwise be mitigated.

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<sup>8</sup> We note, however, that although Australia has opted to make the wider approach mandatory in all cases, New Zealand will allow the wider approach to be optional in the case of reporting.

## IMPLEMENTATION

82. Option 3 would involve implementing AEOI on the basis of balanced implementation decisions that reduce compliance costs for financial institutions and administrative costs for Inland Revenue where possible, but only to the extent that those decisions would not jeopardise New Zealand's ability to meet international expectations.

### Key design features

83. The key design features of the preferred option are outlined below.

### *Optionality*

84. As noted above, the CRS is set by the OECD, and implementation will largely involve incorporating its rules directly into domestic law. However, the CRS itself provides implementing countries with a number of options that can be taken.
85. For the most part it is proposed to leave these options open to the financial institution, so that they can choose the option that best suits their particular circumstances.
86. For example, for consistency the CRS sets certain default due diligence thresholds in US currency, such as a threshold of US\$1,000,000 for distinguishing between high value and lower value individual accounts<sup>9</sup>. However, the CRS allows jurisdictions to substitute their local currency. Many financial institutions might find compliance cost savings in not having to convert NZ\$ balances to US\$ equivalents to determine if the threshold has been exceeded (and simply treating the high value threshold as being NZ\$ 1,000,000). Other financial institutions, particularly those that operate in several jurisdictions, might prefer the consistency of applying the same threshold amount in the same currency in all the jurisdictions in which they operate. The proposed approach, in such cases, is to allow each financial institution to choose their threshold. Submissions strongly endorsed this approach.
87. In certain other cases, where consistency is important or is required by the CRS, the taking of an option will need to be mandated in legislation (that is, not left to financial institutions to decide). Two key examples of this are the *reporting period* and *wider approach to due diligence*, discussed below.
88. In deciding on what option to take in this regard (which all financial institutions would be required to apply) it is proposed that the decision is taken that results in the least compliance costs for financial institutions as a whole and that is consistent with CRS obligations (and in accordance with New Zealand's international obligations).
89. Public submissions generally endorsed this approach to optionality.
90. There are also a number of parts of the CRS where implementing jurisdictions have the option of requiring financial institutions to obtain and report certain information beyond the CRS base due diligence and reporting expectations. It is proposed for the most part (with the exception of the *wider approach to due diligence*) that financial institutions should not be required to obtain information about accounts unless the information is

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<sup>9</sup> In broad terms, financial institutions need to carry out more extensive due diligence procedures for high value accounts.

specifically required under the CRS or because of a choice that they have made. Submissions strongly supported this approach to optionality

### ***Reporting period***

91. The CRS due diligence and reporting obligations operate on the basis of annual ‘reporting periods’. Jurisdictions may choose whether to adopt a calendar year or other appropriate period for this purpose.
92. Australia and most other countries have adopted the calendar year (for both CRS and FATCA). The reporting period New Zealand adopted for FATCA purposes was the tax year (that is, the year ending 31 March).
93. The majority of submitters considered that New Zealand should adopt the tax year for CRS due diligence and reporting, to align with both the New Zealand tax year and the period used for other reporting and regulatory purposes, especially FATCA.
94. Some submitters proposed that this period be ‘optional’. However, it is implicit in the CRS that each jurisdiction will have one period governing due diligence, reporting and exchanging.
95. On balance, the tax year (that is, the period ended 31 March), would provide better domestic alignment, including with FATCA. This will allow financial institutions to better integrate their CRS systems with other existing reporting systems, so overall should assist in minimising compliance costs.
96. Moreover, when combined with the New Zealand start date of 1 July 2017, a 31 December reporting period end date would result in a first reporting period of only six months. A 31 March reporting period end date would result in a first reporting period of nine months, giving financial institutions more time to complete the due diligence reviews required by the CRS in that first period. (See below under ‘initial reporting period’.)
97. For reasons of certainty, consistency and simplicity, it is proposed to mandate the tax year as the reporting period, rather than allowing financial institutions the choice.
98. It is also proposed that financial institutions be required to report CRS information to Inland Revenue by 30 June in line with the FATCA reporting deadline. This will help ensure that Inland Revenue has sufficient time to then process the information for exchange by the 30 September deadline.
99. In this regard note that Australia allows until 31 July rather than 30 June. Aligning with Australia’s 31 July date would allow New Zealand financial institutions more time to report. However, it would shorten the time available for Inland Revenue to prepare the information for exchange from three months to two months. Given the possible need for Inland Revenue to identify and clarify irregularities or deficiencies with financial institution reports (particularly in the initial years of implementation), two months would pose material risks.



### ***Initial reporting period***

100. The CRS contemplates due diligence reviews of pre-existing high value individual accounts being undertaken within the first reporting period.
101. Most jurisdictions implementing AEOI will have a start date of 1 January and will operate on the basis of a calendar year reporting period, allowing a full 12 months to conduct these reviews. In contrast, the proposed New Zealand start date of 1 July 2017 and reporting period end date of 31 March will prima facie only allow New Zealand financial institutions nine months (that is 1 July 2017 to 31 March 2018) to complete these initial reviews. This potentially disadvantages New Zealand financial institutions as compared with financial institutions of other countries.
102. Australia has the same 1 July start date as New Zealand, but has a reporting period end date of 31 December. Therefore Australia's first reporting period will only be six months. As this would prima facie only allow six months for completing due diligence of pre-existing high value individual accounts, Australia has adopted a compromise approach that involves allowing additional time to complete the reviews of pre-existing high value individual accounts, albeit still reporting the required information (such as account balances) in the first report.
103. The mechanism is complex, but in essence Australia will allow financial institutions to carry out due diligence on pre-existing high value individual accounts until 31 July 2018 (essentially allowing 13 months for due diligence on such accounts) provided that such accounts are reported in the first report.
104. It is proposed to adopt a similar approach for New Zealand. The 30 June deadline will apply for the purposes of completing due diligence reviews of pre-existing high value individual accounts and reporting the information to Inland Revenue. Under this approach, financial institutions can continue conducting due diligence on high value accounts past the 31 March reporting period end date, provided they report the information about any reportable high value accounts identified in this review to Inland Revenue by 30 June.
105. The same approach will apply for the following year, for the due diligence reviews of pre-existing low value individual accounts and pre-existing entity accounts (that is, allowing review and reporting by 30 June 2019).

### ***Time for completing due diligence reviews of pre-existing entity accounts***

106. The OECD documentation is (slightly) ambiguous on the expected time-frame for completing due diligence for pre-existing entity accounts. Most countries appear to be reading the documentation as generally allowing 24 months for these reviews. Australia initially proposed 24 months, but in their implementation legislation enacted in March 2016, ultimately only allowed 12 months.
107. The due diligence for pre-existing entity accounts is expected to be more challenging for financial institutions than due diligence for accounts held by individuals, particularly given that look-through rules apply to accounts held by passive NFEs. In this context, allowing 24 months rather than 12 months to complete these reviews would seem appropriate and broadly aligns with FATCA due diligence time-frames for reviewing such accounts.

108. Although submissions generally call for alignment with Australia where possible, alignment with the Australian 12 month period for entity accounts may be a step too far, particularly given the tight time-frames for New Zealand's implementation.
109. It is proposed to retain the 24 month due diligence period for completing due diligence reviews of pre-existing entity accounts, and not to follow the Australian approach to this issue.

### ***Wider approach***

110. During the development of the CRS, private sector interests raised concerns with the OECD that the number of jurisdictions participating in the AEOI initiative can be expected to increase over time. Each new country joining the initiative would trigger a requirement for financial institutions to conduct a new round of due diligence reviews of accounts. This could be prevented by treating all jurisdictions as reportable jurisdictions for due diligence purposes. This approach would have a significant compliance cost saving, and we are not aware of any jurisdiction not adopting the *wider approach to due diligence*. Submissions strongly endorsed this approach.
111. For consistency, to prevent confusion for customers, and to avoid putting financial institutions that adopt the wider approach at a competitive disadvantage, it is proposed to make the wider approach for due diligence mandatory rather for all financial institutions. Submissions generally endorsed this approach.
112. The wider approach to due diligence raises the question of what then happens to the additional information collected that does not need to be exchanged ('the residual information').
113. The residual information could be held by the financial institutions. However, the greatest compliance cost saving would arise from financial institutions simply being allowed to report all of the information they collect (including the residual information) to the local tax administration, even though it will not be exchanged. Under this approach, financial institutions would not be constantly required to keep track of the jurisdictions New Zealand has entered into AEOI relationships with. Instead, financial institutions would merely report all of the information about non-residents to Inland Revenue. This is referred to as the *wider approach to reporting*. Some countries, including Australia, have adopted this option. Others, such as the United Kingdom, require the residual information to be retained by financial institutions.
114. The general preference in submissions is to align with Australia, and adopting the wider approach to reporting would also be consistent with the approach of minimising compliance costs wherever possible. Moreover, the pool of residual information could be used by Inland Revenue to assist in, for example, confirming that the non-residents have the correct non-resident withholding rate (similar to the way that the information to be exchanged can be used) to the extent that such use is consistent with legal obligations and responsibilities. This is a delicate matter that involves balancing benefits against privacy concerns. For consistency with New Zealand's privacy laws, it is proposed that the potential use of the residual information by Inland Revenue be subject to full transparency.

### *Alignment with existing regimes*

115. The CRS due diligence and reporting procedures leverage off FATCA and AML/CFT procedures in a number of ways. For example, CRS uses a number of FATCA terms and concepts (such as what constitutes a financial institution and the types of accounts that are subject to due diligence and reporting). Financial institutions are also sometimes able to use AML/CFT information to assist with CRS due diligence. However, the CRS and supporting OECD documentation are clear that there are a number of areas where CRS due diligence and reporting procedures diverge from FATCA and AML/CFT procedures.
116. One consistent theme of the submissions is that New Zealand should look to align CRS due diligence with FATCA and AML/CFT procedures where possible with a view to minimising compliance costs for financial institutions.
117. Although this approach has been adopted where possible (for example in aligning the AEOI and FATCA reporting periods) it is not possible in all situations. To the extent that there are any differences between regimes, the CRS must drive CRS due diligence and reporting obligations. This is because CRS is a global standard that needs to be implemented consistently worldwide. New Zealand's compliance with this global standard will be internationally reviewed.

### *Enforcement*

118. The CRS requires effective anti-avoidance and enforcement rules to ensure compliance. This includes a specific expectation that implementing jurisdictions will have robust rules in place that will ensure self-certifications are always obtained for new accounts. However, it leaves the design of those rules up to each country.
119. In terms of an anti-avoidance rule, we propose a similar rule to that introduced for FATCA. This would be modified (as required by the CRS) to ensure that in addition to financial institutions it applies to account holders, intermediaries, and certain other persons (in recognition of the fact that such persons often control the information that institutions are required to obtain and report, so could take steps to circumvent CRS due diligence and reporting). The rule could apply, for example, in the case of a financial institution that advises a customer to maintain an account with a related entity in a non-participating jurisdiction (where there is no scope to link the accounts for due diligence purposes), so as to avoid reporting obligations while still offering services to the customer as if the account was maintained by the financial institution itself. It is proposed that this modification will also apply for FATCA purposes.
120. In terms of enforcement rules, we propose a regime broadly based on civil penalties (rather than criminal penalties, as is the case for FATCA). We are not aware of any other implementing country imposing specific criminal penalties for AEOI.
121. Penalties (for example, for failure to conduct due diligence or reporting) would primarily apply at the financial institution level (including a specific penalty for failure

to obtain a self-certification when opening a new account)<sup>10</sup>. However, as a transitional measure, we propose allowing a grace period through to 31 March 2019 during which time a ‘reasonable endeavours’ defence could be mounted and a reasonable period of time allowed to rectify identified errors. After the transitional period, the penalties would be applied on a more rigorous basis. It is also proposed that undocumented new accounts are reported to be used as a tool to review and monitor compliance by financial institutions with their CRS due diligence obligations.

122. In some cases, financial institutions may experience difficulty in obtaining responses from account holders, intermediaries and other persons to requests for documentation (particularly self-certification of tax residence). It is therefore proposed to supplement the penalties imposed on financial institutions with penalties on account holders, intermediaries, or other persons for either providing a false self-certification or (where the person fails to provide a self-certification (or material information about a change of circumstances relating to a self-certification) with the intention of circumventing CRS reporting. There would also be a requirement of persons that hold accounts or funds on behalf of another person to take reasonable steps to provide (on request) CRS information to that financial institution, with a penalty for non-compliance.
123. It is proposed that these penalties on account holders, intermediaries, and other persons, will be extended to apply to FATCA, as there is currently a gap in these areas.

### ***Stage two implementation issues***

124. The AEOI standard requires implementing jurisdictions to publish a number of lists. These are:
- *Reportable jurisdictions.* An implementing jurisdiction must list the countries that it intends providing AEOI information to.
  - *Participating jurisdictions.* An implementing jurisdiction must also list the countries that it has an arrangement to receive AEOI information from.<sup>11</sup>
  - *Excluded Entities and Accounts.* An implementing jurisdiction must list the specific financial institutions and accounts that it has excluded from AEOI obligations on the basis that they pose a low risk in the context of tax evasion.
125. These lists do not need to be finalised in parallel with the implementation legislation, but will need to be in place prior to the 1 July 2017 start date, with sufficient lead time for financial institutions to develop their systems and processes.
126. The issue of reportable jurisdictions raises potential privacy issues, given that the information to be disclosed to jurisdictions is of a highly sensitive personal and financial nature. Frameworks for confidentiality and data safeguards are a key element of AEOI implementation for all jurisdictions, and are the subject of separate Global Forum reviews. However, submissions proposed that a degree of caution should be

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<sup>10</sup> The CRS commentary is clear that there is an expectation that implementing jurisdictions will have robust provisions in place to ensure that self-certifications are always obtained for new accounts.

<sup>11</sup> Note that, during the global implementation phase, a transitional period will apply during which jurisdictions that have committed to implementing AEOI will be treated as participating jurisdictions.

exercised in the case of jurisdictions such as those that have no previous experience in exchange of information. Submissions strongly proposed that selection of New Zealand's reportable jurisdictions be subject to a robust and transparent process, and Government oversight.

127. In acknowledgement of the concerns raised in these submissions, it is proposed that the list of reportable jurisdictions be selected by a process that will involve Inland Revenue disseminating the outcome of Global Forum reviews and calling for submissions on genuine reasons why a jurisdiction should not be included on the list. Inland Revenue's decisions will be subject to Government oversight through an Order in Council process for announcing and maintaining the list.
128. The issue of determining excluded entities and accounts will also necessarily involve Inland Revenue receiving and considering submissions. However, it is proposed that the Commissioner of Inland Revenue be authorised to announce, and maintain, the lists of excluded entities and accounts, by Commissioner's determination.
129. Similarly, it is proposed that the Commissioner of Inland Revenue be authorised to announce, and maintain, the lists of participating jurisdictions, by Commissioner's determination.

## **MONITORING, EVALUATION AND REVIEW**

130. New Zealand's implementation will be subject to international peer review and on-going monitoring by the Global Forum. The peer review schedule has not yet been determined.
131. As the AEOI standard is determined internationally, future changes at the international level are likely – particularly as countries identify issues and concerns, and make consequential adjustments to the rules to address these issues. New Zealand will need to monitor and respond to these changes.
132. Domestically, an internal review of the AEOI legislation is also proposed 18 to 24 months after enactment. This will primarily be to evaluate if the rules are working as intended or if adjustments are needed. In particular, New Zealand's CRS anti-avoidance and enforcement provisions will be evaluated to determine if they are effective. In addition, it may be possible to use this opportunity to further align FATCA legislation with the AEOI legislation, as we obtain information about how the regimes (particularly the penalties provisions) are working in practice.
133. It is not appropriate to make changes to the FATCA rules as part of the initial AEOI implementation, as AEOI consultation did not specifically seek information on this point.