

A special report from
Policy and Strategy, Inland Revenue

Automatic exchange of information

This special report provides early information on changes that have been made to the Income Tax Act 2007 (ITA) and Tax Administration Act 1994 (TAA) to incorporate the G20/OECD standard for *Automatic Exchange of Financial Account Information in Tax Matters* into New Zealand domestic law.¹

The standard is usually referred to as “Automatic Exchange of Information”, “AEOI”, or the “AEOI standard”.

AEOI is a global initiative, led by the G20 and OECD, to address the international problem of “offshore tax evasion” (that is, evading tax by hiding wealth in offshore accounts).

Broadly, a jurisdiction implements the AEOI standard by enacting legislation that requires financial institutions to:

- conduct **due diligence** on their financial accounts to identify those held or (in certain circumstances)² controlled by non-residents; and
- **report** specified identity information (including tax residence) and financial information (such as account balances and interest earned) in respect of those accounts to their local tax administration.

Implementing jurisdictions must also have an appropriate network of tax treaties in place to **exchange** the reported information with applicable participating jurisdictions.

Although different types of tax treaty can be used for this purpose, AEOI exchanges will predominantly be made under the joint OECD/Council of Europe *Multilateral Convention on Mutual Administrative Assistance in Tax Matters*.³

The exchanged information will be used by tax administrations to verify compliance with tax obligations.

¹ For information on the standard see <http://www.oecd.org/tax/automatic-exchange/>.

² Certain entity account holders must be “looked through” to identify the ultimate natural persons who have effective control or deemed control of the financial account.

³ For information on the Convention see <http://www.oecd.org/tax/automatic-exchange/international-framework-for-the-crs/>.

This special report outlines and explains the legislative changes at a relatively high level. Inland Revenue is supplementing this report with comprehensive guidance that will deal with the application of the AEOI standard and this implementation legislation at a detailed technical level. (The guidance was issued in draft form in December 2016, and submissions were called for by 28 February 2017. After the submissions are reviewed the guidance will be finalised and published on Inland Revenue’s website.)

Key features

The AEOI implementation legislation focuses on imposing the necessary due diligence and reporting obligations on financial institutions. (Exchanging the reported information is primarily a tax treaty matter and generally does not require implementation legislation.)

The due diligence and reporting obligations to be imposed are set out in an element of the AEOI standard known as the *Common Standard On Reporting And Due Diligence For Financial Account Information* (in short, the “Common Reporting Standard” or “CRS”).⁴

The CRS is also supplemented by a comprehensive official OECD Commentary (the “OECD Commentary”).

The approach adopted in the legislation is essentially to incorporate the CRS directly into New Zealand law by reference, and to require the application of the CRS to be consistent with the OECD Commentary.

Because of similarities between the CRS and the related United States Foreign Account Tax Compliance Account (“FATCA”) initiative, the CRS implementation legislation has primarily been located (and merged) with the FATCA framework legislation at Part 11B of the Tax Administration Act 1994.

The general scheme of Part 11B has been retained. Section 185E, which sets out the purpose of Part 11B, has been updated to include references to the CRS and to outline the new structure. Some provisions in Part 11B (namely sections 185F to 185M) apply solely to FATCA, some (sections 185N and 185O) apply solely for CRS purposes, and some (sections 185P to 185R) apply for both FATCA and CRS purposes.

A number of other amendments have been made to the Income Tax Act 2007 and the Tax Administration Act 1994, to support the operation of Part 11B. These include:

- new definitions (in both Acts);
- new record-keeping provisions (in subsection 22(2) of the Tax Administration Act);
- new penalty provisions (at sections 89C, 142H and 142I of the Tax Administration Act);
- new determination and Order in Council-making powers (at new sections 91AAU, 91AAV, 91AAW, 226D and 226E of the Tax Administration Act); and
- a new Schedule 2 to the Tax Administration Act (modifying the application of the CRS to New Zealand).

⁴ For information on the CRS see <http://www.oecd.org/tax/automatic-exchange/common-reporting-standard/>.

All of these amendments are detailed and explained in this special report.

Terminology

Given that the focus of the legislation is on incorporating CRS obligations into New Zealand law, this report will primarily refer to the CRS rather than AEOI or the AEOI Standard.

The CRS contains numerous definitions that are potentially confusing. Examples include:

- The term “entity” includes legal arrangements such as trusts, which would not normally be the case under New Zealand law.
- The terms “financial institution” and “financial account” have wider application than might normally be expected. For instance, a professionally managed investment trust that meets specified criteria will be a financial institution for CRS purposes. Moreover, a settlor or beneficiary of such a trust will be deemed to hold a financial account with the trust.

New Zealand start date

The start date to which the New Zealand Government has committed internationally, and from which the legislation provides that CRS obligations are to apply in New Zealand, is 1 July 2017.

Due diligence

The legislation specifies due diligence procedures that financial institutions must undertake in order to determine if any of their accounts are held or (if “look-through” rules apply) controlled by non-residents.

- From 1 July 2017, the due diligence procedures must be conducted in respect of all **new accounts**.⁵
 - Due diligence for new accounts will generally involve obtaining, on account opening, **self-certifications** that contain the required identity and tax residence information.
- From 1 July 2017, financial institutions must also begin due diligence reviews in respect of all **pre-existing accounts**.⁶
 - Different due diligence procedures are specified for different types of pre-existing accounts. In general, however, financial institutions will often be able to rely on documentation and/or information that they have already obtained for other regulatory or customer relationship purposes.⁷
 - The due diligence for pre-existing **high value**⁸ **individual** accounts must be completed by 30 June 2018.

⁵ A new account will generally be one opened on or after 1 July 2017.

⁶ A pre-existing account will generally be one already open at 30 June 2017.

⁷ In particular, this includes information obtained from compliance with anti-money laundering/countering the financing of terrorism “know-your-customer” laws.

⁸ Generally, high value accounts are those with an account balance exceeding US\$1 million.

- The due diligence for **all other** pre-existing accounts (that is pre-existing lower value individual accounts⁹ and all pre-existing entity accounts) must be completed by 30 June 2019.

Reporting

The legislation also imposes an annual reporting requirement on a financial institution that determines, pursuant to the above due diligence procedures, that it has one or more “reportable accounts”. (That is, an account that is held or (if the “look-through” rules apply) controlled by non-residents.)

The New Zealand **reporting period** for CRS purposes will align with the New Zealand tax year (that is, the 12-month period ending 31 March).¹⁰

The annual **reporting deadline** for financial institutions for each reporting period will be 30 June following the end of the reporting period. The information that must be reported for each reportable account for each reporting period is:

- **identity information** (including the tax residence) for each non-resident account holder and (if applicable) controlling person; and
- **financial information**, including the account balance or value as at the end of the reporting period, and specified income earned (such as interest) and distributions made during the reporting period.

If a financial institution is unable to determine the status of a pre-existing account, in specified circumstances it will be required to report the account as an “**undocumented account**”.

Grace periods for due diligence

Each annual CRS reporting period ends on 31 March. Accounts identified as reportable during a reporting period are to be reporting on to Inland Revenue by the following 30 June.

However, to provide financial institutions with as much time as possible for conducting due diligence of pre-existing accounts, a grace period of three months applies beyond the 31 March reporting period end date for the first two years of CRS reporting.

- The deadline for completing due diligence of pre-existing high value individual accounts is 30 June 2018 (rather than 31 March 2018).
- Similarly, the deadline for completing due diligence of all other pre-existing accounts (that is, lower value individual accounts and all entity accounts) has been set at 30 June 2019 (rather than 31 March 2019).

Crucially, however:

- the 30 June reporting deadline still applies, meaning that due diligence and reporting to Inland Revenue must **both** be completed by 30 June; and

⁹ Generally, lower value accounts are those with an account balance that does not exceed US\$1 million.

¹⁰ However, by virtue of the 1 July 2017 start date, the duration of the first period (from 1 July 2017 to 31 March 2018) will be nine rather than 12 months.

- accounts identified as reportable during each grace period must be included in the reporting period to which the grace period relates (this is referred to as a “**carry-back rule**”).

Thus, due diligence reviews of pre-existing high value individual accounts and all reporting for these accounts must be completed by 30 June 2018. The carry-back rule means that the account balance or value to be reported will be as at 31 March 2018, and income to be reported will be income earned in the period ending 31 March 2018.

Similarly, due diligence reviews of all other pre-existing accounts (lower value individual accounts and all entity accounts) and reporting for these accounts must be completed by 30 June 2019. The carry-back rule means that the account balance or value to be reported will be as at 31 March 2019, and income to be reported will be income earned in the period ending 31 March 2019.

An exception to the carry-back rule applies if the account would not have been reportable before 31 March. This could happen, for example, if the account holder’s status changed from non-reportable (for example, New Zealand resident) to reportable (for example, non-resident) after 31 March. In such a case, if the account was identified as reportable in the period from 1 April to 30 June, it would not need to be reported until the following 31 March (rather than the previous 31 March).

CRS optionality

Some optionality is contemplated under the CRS and OECD Commentary. For example, the CRS provides that pre-existing entity accounts should not be reviewed unless the account balance or value exceeds US\$250,000. However, the OECD Commentary provides implementing jurisdictions the option of ignoring this de minimis threshold.

The implementation legislation generally allows financial institutions the discretion to adopt the option that best suits their circumstances.

However, the legislation withholds some options for New Zealand. These are the two key “**excluded choices**”:

- The reporting period to be used by all New Zealand financial institutions is the year ending 31 March.
- The CRS “wider approach” to due diligence will be mandatory for all New Zealand financial institutions.

These excluded choices are explained further below.

Compliance framework

The CRS requires implementing jurisdictions to introduce rules for ensuring compliance. These include anti-avoidance rules and effective sanctions for addressing non-compliance. To meet this requirement, the implementation legislation includes a compliance framework with an anti-avoidance rule and certain penalties.

The compliance framework applies to financial institutions and also extends to other persons and entities that hold or control accounts with such institutions, or that otherwise act as intermediaries in relation to accounts.

This reflects the fact that effective implementation of the CRS requires a chain of information effectively flowing from account holders, controlling persons and intermediaries, to financial institutions and then to Inland Revenue (for international exchange).

Background

International context and New Zealand's commitment to implement AEOI

To date, 101 jurisdictions have committed to implement AEOI with a view to completing first exchanges by 30 September 2018 at the latest. This includes:

- all G20 and OECD member countries; and
- all other jurisdictions identified by the G20 or OECD as having or operating as an international finance centre.

Jurisdictions other than those identified above can also implement the AEOI standard, but will not be subject to implementation deadlines (unless they are subsequently identified by the G20 or OECD as an emerging tax risk).

As an OECD member, New Zealand has made an international commitment to implement AEOI and to complete its first international information exchanges by the 30 September 2018 deadline.

Of the 101 committed jurisdictions, 55 have committed to complete their first exchanges by 30 September 2017. These are generally referred to as early adopters. The other 46 jurisdictions (which includes New Zealand and Australia) are working towards the 30 September 2018 deadline.

The success of the global AEOI initiative depends on jurisdictions implementing consistent rules, to a similar implementation timeline. Otherwise there is a high risk of the offshore tax evasion problem merely relocating to jurisdictions that lag behind or implement to a lesser standard.

To ensure consistency and timeliness, the OECD's global tax body, the Global Forum on Transparency and Exchange of Information for Tax Purposes ("Global Forum"), will lead peer reviews and other forms of monitoring to ensure that jurisdictions correctly implement the AEOI standard in a timely manner. The Global Forum will report the outcome of its reviews to the G20, which is positioned to apply possible sanctions against non-complying jurisdictions, if necessary.

Relation to other international initiatives

AEOI is a stand-alone initiative, but is related to other international developments aimed at improving transparency frameworks and tax compliance. In particular, the CRS reflects (and is largely based on) the US FATCA initiative, which New Zealand implemented in 2014.

The CRS builds off the FATCA initiative in a number of ways. For example, both regimes have broadly similar types of entities, financial institutions, financial accounts, due diligence procedures (including sometimes allowing financial institutions to rely on anti-money laundering/countering the financing of terrorism "know your customer" ("AML") procedures and other account information that they already hold), and reporting requirements.

However, there are some differences between the regimes. Below are some key examples.

- FATCA due diligence is focused on identifying “US persons” (which includes US citizens as well as residents). CRS due diligence applies only to **non-residents** and not **foreign citizens**.¹¹
- FATCA contains a number of de minimis exclusions from due diligence and reporting. The CRS generally does not have such exclusions. The one exception to this is for pre-existing entity accounts, where the threshold exemption is US\$250,000, unless the financial institution chooses to opt out of the threshold.
- FATCA compliance is buttressed by a 30% withholding tax to apply to US-sourced income for non-compliance. This does not apply to the CRS. The CRS therefore requires implementing jurisdictions to have a legal and operational compliance framework in place to verify compliance, penalise non-compliance and counter potential CRS avoidance arrangements.

In addition, FATCA implementation involved the incorporation of the necessary due diligence and reporting rules (which are set out in a treaty-level instrument)¹² into New Zealand law by regulations.¹³ The CRS is not a treaty-level instrument, and incorporation into New Zealand law therefore requires specific legislation.

Other elements of the AEOI standard

As noted, the CRS is the element of the overall AEOI standard that sets out the due diligence and reporting obligations for financial institutions of participating jurisdictions.

The other elements of the AEOI standard generally relate to the exchange of AEOI information between jurisdictions. This includes model competent authority agreements and the data schema to be used for exchanges.

A common IT solution for encrypting and transmitting data between jurisdictions, referred to as the Common Transmission Standard, is also being developed by the OECD.

All exchanges of information with other jurisdictions will be made under New Zealand’s tax treaties.

The legal instruments for exchange

Any form of tax treaty can potentially be used to make AEOI exchanges. However, the G20 and OECD have promoted the joint *OECD/Council of Europe Multilateral Convention on Mutual Administrative Assistance in Tax Matters* (“Multilateral Convention”) as the principal treaty to be used for this purpose.

¹¹ As explained in the detailed analysis section, the legislation makes the CRS option of the “wider approach” to due diligence mandatory for all New Zealand financial institutions. This means CRS due diligence in New Zealand will focus on identifying all foreign tax residents, rather than only the residents of implementing jurisdictions.

¹² An Intergovernmental Agreement between New Zealand and the US. The agreement is available on Inland Revenue’s tax policy website at <http://taxpolicy.ird.govt.nz/tax-treaties/united-states-america#iga>.

¹³ The Double Tax Agreements (United States of America-FATCA) Order 2014.

New Zealand signed the Multilateral Convention in 2012. It was given legal effect in New Zealand on 21 October 2013 by an Order in Council made under section BH 1 of the Income Tax Act 2007.¹⁴

Section BH 1 authorises the making of an Order in Council to give legal effect to a “double tax agreement”. As that term is defined, and under statutory legal principles, the reference to double tax agreement in section BH 1 can apply to a wide range of tax treaty types, including multilateral treaties. However, this was not immediately obvious from the wording. This has led to some claims that the Multilateral Convention was not correctly given legal effect in New Zealand.

Although a legal challenge to the validity of the Order in Council giving effect to the Multilateral Convention is unlikely to be successful, any uncertainty is undesirable. Moreover, additional multilateral treaties may need to be given effect under section BH 1 in the future.

Accordingly, the legislation includes a retrospective amendment to section BH 1 to put the matter beyond doubt, by clarifying that it also applies to multilateral treaties.

The definition of “foreign account information-sharing agreement”, in section YA 1 of the Income Tax Act 2007, has also been amended to specifically include the Multilateral Convention. This supports the change made to section BH 1 with a reference to the Multilateral Convention being brought into force by an Order in Council made under section BH 1. It also clearly links the Multilateral Convention (and other applicable tax treaties) to the agreements to which Part 11B of the Tax Administration Act 1994 applies.

Article 6 of the Multilateral Convention authorises automatic exchanges of information (as opposed to other forms of exchange, such as on request). It provides that automatic exchanges must be subject to detailed terms as agreed between “competent authorities”.

To give effect to the Article 6 requirement for competent authorities to agree the detailed terms of automatic exchanges for AEOI, the OECD developed an administrative instrument referred to as the *Multilateral Competent Authority Agreement* (“MCAA”). New Zealand signed the MCAA in 2015.¹⁵

Competent authorities are generally specific persons or authorities nominated by each treaty partner to administer the treaty. The competent authority under New Zealand’s tax treaties is the Commissioner of Inland Revenue.¹⁶

In addition to other important details, such as the manner of exchanges and rules, and procedures around maintaining confidentiality of exchanged data, the MCAA specifies the actual information to be exchanged between the parties.

The MCAA also has a notification mechanism, which enables each party to confirm the actual jurisdictions that it will exchange with (see explanation of “reportable jurisdictions” below), and the timing of exchanges with each of those jurisdictions. This notification mechanism is administered by the OECD, and will be publicised online on the OECD’s AEOI portal.¹⁷

¹⁴ Details about the Multilateral Convention are available on Inland Revenue’s tax policy website at <http://taxpolicy.ird.govt.nz/tax-treaties/convention-mutual-administrative-assistance-tax-matters>.

¹⁵ For information about the MCAA see <http://www.oecd.org/tax/automatic-exchange/international-framework-for-the-crs/>.

¹⁶ The Commissioner may delegate competent authority status.

¹⁷ See <http://www.oecd.org/tax/automatic-exchange/international-framework-for-the-crs/>.

New Zealand will provide notifications on reportable jurisdictions when its list of reportable jurisdictions is finalised.¹⁸

Application dates

The legislative amendment to section BH 1, clarifying that the section applies in the case of multilateral treaties, has retrospective application from 21 October 2013. As noted above, this is to put beyond doubt that section BH 1 applies to the Multilateral Convention (which has had legal effect in New Zealand since 21 October 2013).

Otherwise, the legislative amendments come into force from the date of Royal assent.

Detailed analysis

This special report outlines and explains the legislative changes at a relatively high level. Inland Revenue is supplementing this report with comprehensive guidance that will deal with the application of the AEOI standard and this implementation legislation at a detailed technical level.

Incorporating the CRS and OECD Commentary into New Zealand law

The due diligence procedures and reporting requirements set out in the CRS are supplemented by a comprehensive OECD Commentary.

Rewriting the CRS's rules into domestic law in a way that ensures consistency with the OECD Commentary could risk inadvertent differences and gaps between the CRS/OECD Commentary and the domestic implementation legislation. Moreover, the CRS and OECD Commentary will almost certainly be subject to future change, as deficiencies and improvements are identified, and in response to possible changes in future taxpayer behaviour.

To ensure that the CRS is correctly incorporated into New Zealand law, and reduce the risk of deficiencies being identified during international peer review, the AEOI standard has been incorporated into domestic law by direct reference to the CRS and the OECD Commentary, as published.

To facilitate the incorporation of the CRS by reference, three key definitions have been inserted into section 3(1) of the Tax Administration Act 1994:

- “**CRS publication**”, which refers to the official OECD publication that includes the full AEOI standard (the *Standard for Automatic Exchange of Financial Account Information in Tax Matters*);¹⁹
- “**CRS standard**”, referring to Part IIB of the CRS publication, which is where the CRS is located; and

¹⁸ The mechanism for confirming New Zealand's reportable jurisdictions is covered further below.

¹⁹ This publication is available on the OECD website at <http://www.oecd.org/ctp/exchange-of-tax-information/standard-for-automatic-exchange-of-financial-account-information-for-tax-matters-9789264216525-en.htm>. Inland Revenue will issue a New Zealand version of the CRS on its website, with all domestic law modifications (such as key dates and the wider approach to due diligence) included.

- “**CRS applied standard**”, meaning the CRS standard as modified by section 185O and Schedule 2 of the Tax Administration Act 1994.²⁰

As noted, the CRS must be interpreted and applied consistently with the official OECD Commentary, which is in Part IIIB of the CRS publication. New section 185O(3) of the Tax Administration Act 1994 incorporates that requirement into New Zealand law.

Importantly, the definition of CRS standard includes the words “as amended from time to time”. This means that future changes to the CRS will generally flow through into New Zealand legislation automatically.

The CRS is an international standard, and New Zealand’s compliance with it will be peer reviewed by the OECD’s Global Forum. The G20 has stated its intention to apply sanctions, when appropriate, in response to identified non-compliance. This applies equally to any future changes to the CRS. Therefore, the automatic flow-through of future changes into New Zealand law is considered to be appropriate.

As a safeguard, however, new section 226E allows Orders in Council to be made, if necessary, to facilitate, block or defer particular CRS changes.

Note that section 185O(3)(b) also states “as amended at the time”, thereby ensuring that future changes to the OECD Commentary also automatically apply.

Other definitions

The approach of incorporating the AEOI implementation legislation into existing Part 11B of the Tax Administration Act 1994 involves merging the AEOI rules into the concept of a **foreign account information-sharing agreement**, on which Part 11B is based. To achieve this, the definition of “foreign account information-sharing agreement” (in section YA 1 of the Income Tax Act 2007) has been amended to include the Multilateral Convention (which, as noted above, will be the tax treaty predominantly used for AEOI exchanges).

The CRS itself contains a large number of specific definitions. Generally, the approach of incorporating the CRS into New Zealand law by reference will ensure that these definitions will automatically apply in the application of the CRS in New Zealand.

However, in case of a conflict between a CRS definition and a defined term in the Inland Revenue Acts, a rule has been inserted at new section 185O(4) of the Tax Administration Act 1994 to ensure that when applying the CRS standard, the CRS definition will generally take precedence.

The OECD Commentary specifies that two terms (“**passive income**” and “**maintain**”) are to take their domestic law meaning, but they must also include certain things. To ensure that the full meaning set out in the OECD Commentary will apply in New Zealand, specific definitions of these terms have been included in section 3(1) of the Tax Administration Act 1994.

²⁰ The legislation modifies the CRS to clarify the application of options, dates (such as the dates that are to apply for due diligence and reporting purposes) and other items as necessary.

Other amendments in section 3(1) to ensure the legislation works correctly include new definitions of “information” (to clarify that it includes a self-certification) and “taxpayer identification number” (to clarify the application to a functional equivalent number in a foreign jurisdiction).

A new term “**FATCA agreement**” has also been introduced in section 3, as a means of differentiating between FATCA and AEOI in Part 11B.

Framework for CRS obligations

Because the CRS due diligence and reporting obligations are incorporated into New Zealand law by reference, the legislation generally does not need to detail specific obligations. Rather, the AEOI implementation legislation is primarily concerned with establishing the framework under which the CRS obligations will apply in New Zealand.

Section 185O sets out the specific modifications to be made to the CRS standard for application in New Zealand (as the CRS applied standard).

Section 185N of the Tax Administration Act 1994 applies the obligations to financial institutions.

Section 185P of the Tax Administration Act 1994 applies the obligations to persons or entities other than financial institutions (such as account holders, controlling persons or intermediaries).

Some complexity arises from the fact that the CRS treats certain legal arrangements (particularly trusts and partnerships) as entities. As this does not match New Zealand law, section 185Q provides that any obligations in the CRS that apply to an entity are to apply to the relevant natural person in the New Zealand context. (For example, for trusts, the obligations will apply to the trustees, and for partnerships, each partner.)

The framework is supplemented by amendments to section 22 of the Tax Administration Act 1994 that insert specific record-keeping requirements in relation to compliance with Part 11B of the Act.

This includes a specific requirement for financial institutions that are subject to Part 11B to:

- keep a record of any failure to obtain a self-certification; and
- keep a record of the steps taken and evidence relied upon in meeting obligations under Part 11B relating to the CRS applied standard.²¹

Modifications to the CRS

Section 185O(2) of the Tax Administration Act 1994 provides that a number of specific modifications are set out in new Schedule 2 to the Tax Administration Act 1994. (These are detailed further below.)

²¹ This is required each CRS reporting period, irrespective of whether or not the financial institution has any CRS information that is required to be reported to Inland Revenue.

Section 185O(3) of the Tax Administration Act 1994 provides that the CRS is to be applied consistently with the OECD Commentary, as amended at the time.

Section 185O(4) of the Tax Administration Act 1994 effectively provides that a CRS definition will prevail in any conflict with a domestic law definition.

Section 185O(5) of the Tax Administration Act 1994 generally permits financial institutions to make elections contemplated in and consistent with the CRS and OECD Commentary. Section 185O(6) provides that after making an election, the person or entity must meet the requirements of the CRS applied standard consistently with that election.

Schedule 2 of the Tax Administration Act 1994

New Schedule 2 makes the following specific modifications to the CRS:

- Item 1 clarifies that references in the CRS to reporting period and calendar year should generally mean a 12-month reporting period ending 31 March.
- Items 2 and 3 mandate the use of the wider approach for due diligence. This is an important compliance minimisation option offered to implementing jurisdictions in the CRS. It is explained below, in the section “The wider approach”.
- Item 4 withdraws a choice available in the CRS to allow a transitional period for the introduction of a requirement to report gross proceeds from the sale or redemption of financial assets. The reasons for this are explained below under “Excluded choices”.
- Items 5 to 10 set out various due diligence timeframes that apply for the different types of pre-existing accounts.
- Item 11 provides an option relating to certain employer-sponsored group insurance contracts or annuity contracts.
- Item 12 provides that dollar amounts referred to in the CRS (which are in US currency), can be treated as being in New Zealand dollars.
- Items 13 and 22 to 24 all link to the lists of New Zealand’s participating jurisdictions, reportable jurisdictions, non-reporting financial institutions and excluded accounts, which will need to be published. This is explained below.
- Item 14 sets out the date at which a credit card issuer is required to implement various defined policies and procedures in order to be a “qualified credit card issuer” as defined in the CRS.
- Items 15 and 16 set out various dates from which collective investment vehicles must no longer issue physical shares in bearer form and by which they must have policies in place to ensure that such shares are redeemed or immobilised in order to be an “exempt collective investment vehicle” as defined in the CRS.
- Items 17 and 18 define “pre-existing account” and “new account”. The definition of pre-existing account incorporates the option in the CRS to apply the due diligence procedures for pre-existing accounts to new accounts opened by pre-existing customers in circumstances permitted in the CRS.
- Items 19 and 20 set out dates that apply for determining whether a pre-existing individual account is a “lower value account” or a “high value account”.

- Item 21 sets out a deadline date by which a financial institution is required to implement defined policies and procedures in order for a type of overpaid depository account to be an “excluded account”.
- Item 25 replaces the definition of the term “related entity” in the CRS with the optional definition (at paragraph 82 of Section VIII) in the OECD Commentary. The replacement definition of related entity generally refers to whether an entity is controlled by another entity, or whether two entities are under common control, or whether two managed investment entities are under common management.

Much of new Schedule 2 is concerned with inserting the key CRS implementation dates and timeframes that are to apply in New Zealand. These include the date on which CRS obligations begin, dates for determining whether a financial account is a new account or a pre-existing account, and the deadlines for financial institutions to complete due diligence and reporting.

In the CRS and OECD Commentary, these dates have generally been left open for each implementing jurisdiction to insert via domestic implementing law (subject to meeting international expectations).

In addition, because New Zealand’s reporting period is different from the default calendar year reporting period in the CRS, a rule is included to ensure that all references to reporting period and calendar year are to be read in the context of the New Zealand tax year (unless the context requires otherwise).

Obligations of financial institutions

The CRS provides that a financial institution that is resident (as that concept applies for CRS purposes) in a jurisdiction will be subject to CRS obligations in that jurisdiction.

However, a branch of a New Zealand-resident financial institution located outside of New Zealand is excluded from the rules. Conversely, a branch of a non-resident financial institution located in New Zealand is subject to the New Zealand rules.

These fundamental rules are repeated in section 185N(1) and (2).

The CRS also includes a complex series of definitions that set out the actual criteria for identifying financial institutions.

For CRS purposes, the term “**financial institution**” is broadly defined. It extends beyond traditional financial institutions (such as banks) to a wide range of entities that would not normally be considered to be financial institutions (for example, it will include some professionally managed trusts).

However, the CRS also specifies a number of categories of financial institution that pose a low risk of being used to facilitate offshore tax evasion, and which therefore are excluded from the due diligence and reporting obligations. These are defined as “**non-reporting financial institutions**”.

Section 185N(3) provides that a financial institution must comply with the due diligence and reporting obligations set out in the CRS applied standard.

Section 185N(4) imposes an annual reporting deadline for financial institutions of 30 June following the 31 March reporting period end date.

Consistent with the timeframes in the CRS and OECD Commentary for completing due diligence of pre-existing accounts, section 185N(5) sets a deadline of 30 June 2018 for due diligence and reporting on pre-existing high value individual accounts, and 30 June 2019 for due diligence and reporting for all other pre-existing accounts. Otherwise, section 185N(5) includes a general rule for the timing of reports in respect of an account identified as reportable during a particular reporting period.

Section 185N also includes other supplementary rules that clarify the application of certain options in the CRS.

Obligations of persons other than financial institutions

Section 185P extends CRS obligations to persons other than financial institutions.

This reflects the fact that financial institutions will often be required to collect documentation and information directly or indirectly from account holders (and sometimes the controlling persons of the account) in order to comply with their CRS obligations. This includes circumstances when the institution has a customer relationship with an intermediary that holds an account for the benefit of an account holder and, potentially, other controlling persons.

This requires an efficient transfer of information from those account holders and other persons directly or indirectly to the financial institution.

Financial institutions are required to obtain documentation and information from customers on account opening.²² However, they may face challenges in obtaining necessary documentation and information from customers in other circumstances. For example, a pre-existing customer may not respond to a written request for information. There may also be difficulties obtaining documentation and information from persons connected with particular types of accounts, such as trust accounts.

To assist compliance, section 185P imposes an obligation on such customers and other persons or entities, to obtain and provide any information that the financial institution requests from them, directly or indirectly, that is needed to satisfy the institution's CRS due diligence obligations.

Section 185P also requires customers and other relevant persons or entities to provide updates on any material change in circumstances that they are aware of that may affect their status as a reportable person. For example, if a customer has provided a self-certification to a financial institution that they are a New Zealand resident, and they subsequently become non-resident, that change of residence status should be notified to the financial institution.

Record-keeping obligations

The CRS specifically requires implementing jurisdictions to have rules in place that require financial institutions to keep records of the steps undertaken, and any evidence relied upon, in meeting their CRS obligations.

²² Inland Revenue's technical guidance will contain specific guidance on this point.

This requirement is covered by the introduction of specific rules in section 22 of the Tax Administration Act 1994. These include a requirement for a financial institution to keep a record if they cannot obtain a required self-certification. The new record-keeping requirements will assist Inland Revenue in verifying compliance with the CRS and addressing any non-compliance (including considering penalties).

Optionality

Although the success of the AEOI global initiative depends on jurisdictions implementing similar rules, the CRS provides implementing jurisdictions with a number of options. These options have been developed with a view to minimising compliance costs for financial institutions in areas that are not considered likely to compromise the effectiveness of the CRS.

The circumstances of each financial institution can differ markedly, meaning that financial institutions may have different preferences as to whether these options should be adopted. Accordingly, the implementation legislation generally allows each financial institution to decide whether to adopt any particular option offered in the CRS.

Some of the specific choices available to financial institutions are set out in section 185N. Otherwise, subsections 185O(5) and 185O(6) generally provide that a financial institution may make an election that is expressed as being available to them (under the CRS and the Inland Revenue Acts).

Excluded choices

Section 185N(11) provides that the optionality in the CRS for alternative reporting periods, and in the OECD Commentary for the use of average balances rather than period-end balances, will not be available to financial institutions. In these two cases, a particular choice will be mandated for all financial institutions:

- **CRS reporting period** – the reporting period to be used in New Zealand will be the 12-month period ending 31 March.²³ This is consistent with the New Zealand tax year and the reporting period adopted by New Zealand for FATCA purposes. The period ending 31 March must be adopted by all financial institutions.
- **Average balances** – the OECD Commentary provides that jurisdictions that already require financial institutions to report average account balances can permit their financial institutions to maintain this approach for CRS, rather than reporting period-end balances. This does not apply in New Zealand. However, for clarity, the implementation legislation expressly provides that this option is not available to New Zealand financial institutions.

An additional excluded choice is set out at item 4 of Schedule 2. This relates to an option available in the CRS to allow a transitional period for the introduction of a requirement to report gross proceeds from the sale or redemption of financial assets in relation to a custodial account. On this point there is a mismatch between the CRS and the exchange commitments set out in the MCAA, where this is not allowed as an option. Therefore this has been specifically set out as an excluded choice.

²³ Given New Zealand's 1 July 2017 start date, the first CRS reporting period will be a nine-month transitional period from 1 July 2017 to 31 March 2018.

The wider approach

The wider approach to CRS due diligence

An important option offered in the CRS is use of the wider approach to CRS due diligence. This option addresses the practical issue that the CRS prima facie requires financial institutions to only identify persons that are tax-resident in reportable jurisdictions (that is, jurisdictions that New Zealand has a commitment to provide CRS information to). Over time, additional jurisdictions will join the initiative and become reportable jurisdictions. Without specific rules, each new jurisdiction joining could trigger a new round of due diligence reviews of accounts by financial institutions.

To avoid this problem, and to minimise compliance costs, the CRS includes an option for implementing jurisdictions to adopt a wider approach to due diligence. Under this approach, a jurisdiction's financial institutions would collect and retain CRS information for all non-residents identified, rather than just for residents of reportable jurisdictions.

The CRS implementation legislation adopts the wider approach to due diligence. To ensure consistency, and to prevent a competitive disadvantage for any financial institution, this approach will be mandatory for all financial institutions.

This modification to the CRS standard is made at item 2 of the new Schedule 2.

The wider approach to CRS reporting

The wider approach to due diligence means that financial institutions will prima facie need to sort the collected data to determine which non-resident accounts need to be reported to Inland Revenue.

However, for CRS reporting, the implementation legislation allows a wider approach option for financial institutions to report *all* of the information to Inland Revenue. That is, financial institutions may choose to report information for all financial accounts held or controlled by a non-resident, not just those that are residents of reportable jurisdictions.

Financial institutions that adopt the wider approach reporting option will effectively pass the responsibility for sorting their non-resident data on to Inland Revenue, potentially saving compliance costs. Inland Revenue will be responsible for determining the information to be exchanged with reportable jurisdictions.

The wider approach to reporting option is set out in section 185N(7).

Section 185N(8) effectively provides that, once a financial institution elects to adopt the wider approach for a reporting period, it must report on that basis for that period. This "permitted choice" rule is consistent with the approach adopted for FATCA.

Determinations and regulatory powers

The terms "participating jurisdiction" and "reportable jurisdiction" are key concepts in the application of the CRS. The CRS requires New Zealand to publish lists of its participating jurisdictions and reportable jurisdictions.

The CRS also provides carve-outs from due diligence and reporting obligations for “non-reporting financial institutions” and “excluded accounts” that pose a low risk of being used for tax evasion purposes. Some generic categories of these are set out in the CRS. However, the CRS also provides that certain other financial institutions and accounts can be subject to the carve-outs, provided they are approved by Inland Revenue as meeting specified criteria.

New Zealand’s lists of participating jurisdictions, reportable jurisdictions, approved non-reporting financial institutions and excluded accounts will be published by a mix of Commissioner’s determinations and regulations.

Participating jurisdictions

A participating jurisdiction is generally one that has implemented AEOI and that will provide CRS information to other jurisdictions. More specifically, New Zealand’s participating jurisdictions will be those with which an exchange agreement is in place for that jurisdiction to provide CRS information to New Zealand.

The CRS contains rules that require a financial institution to look through prescribed entities (referred to in the CRS as “passive NFEs”) to determine the natural persons that are its ultimate controlling persons. This look-through rule extends to certain investment entities that are not from participating jurisdictions.

This means that New Zealand’s list of participating jurisdictions will impact on the entity account holders that New Zealand financial institutions will need to look through to identify any ultimate controlling persons.

New section 91AAU of the Tax Administration Act 1994 provides that the Commissioner of Inland Revenue may make a determination about whether a particular jurisdiction is a participating jurisdiction. The provision authorises the Commissioner to limit, amend, suspend or withdraw a determination.

It will take time to confirm whether all jurisdictions that have committed to implementing AEOI have correctly carried through with their commitments. As a transitional measure, the OECD has permitted jurisdictions to tentatively treat all jurisdictions that have made international commitments to implement AEOI/CRS as participating jurisdictions. New Zealand will adopt this approach.

However, the transitional measure is only to apply for a limited time, and jurisdictions are required to publish final lists by 30 June 2017. Given that New Zealand’s start date is 1 July 2017, the intended approach is to publish a transitional list that will apply for the first reporting period (1 July 2017 to 31 March 2018) and then a final list by 30 June 2017 that will apply from the beginning of the second reporting period (that is, from 1 April 2018).

Reportable jurisdictions

A participating jurisdiction is one that provides CRS information. A reportable jurisdiction is one that also wants to receive CRS information. Not all participating jurisdictions will be reportable jurisdictions. For example, some participating jurisdictions may not have a tax system²⁴ and therefore have no need to receive information.

²⁴ For example, some smaller economies that are international finance centres.

In general, international expectations are that AEOI/CRS information will be provided to all jurisdictions that have signed the MCAA on the basis that they wish to receive such information. However, the OECD acknowledges that this raises potential concerns about confidentiality and data security.

AEOI/CRS exchanges will comprise sensitive personal and financial information. The terms of the legal instruments under which the information will be exchanged require this information to be used only for specified (tax) purposes and disclosed only to specified persons for such purposes.

Many jurisdictions have been exchanging such sensitive information for many years, have robust laws, processes and systems in place for ensuring exchanged data is kept secure and is only used for legitimate purposes, and have a track record of maintaining confidentiality in respect of exchanged information. However, some jurisdictions that are implementing the AEOI standard have had little, or no, prior experience in exchange of information for tax purposes.

Implementing jurisdictions may decide not to provide information to a particular jurisdiction if they have genuine concerns about confidentiality and/or data security. However, such decisions cannot be used to frustrate the purposes of the CRS.

This is a difficult balancing act. To assist, the Global Forum is conducting specific reviews of jurisdictions' confidentiality and data safeguards, and is making its conclusions available to jurisdictions implementing the AEOI standard.

A new section 226D in the Tax Administration Act 1994 provides a regulation-making power for determining New Zealand's reportable jurisdictions. This will ensure that the New Zealand Government retains oversight and control over adding or removing jurisdictions from New Zealand's reportable jurisdictions list.

To ensure that, in the case of any serious breach, exchange of information with a particular jurisdiction can be swiftly suspended, the Commissioner of Inland Revenue will be authorised to make a determination to temporarily suspend that jurisdiction as a reportable jurisdiction. This determination-making power is contained in new section 91AAV (and its effect on the regulation, in section 226D(5)).

The section 91AAV determination power will only exist as a contingency to ensure that the time taken to make an Order in Council to suspend a jurisdiction does not result in a legal obligation to provide information despite a serious breach of confidentiality. Any determination made under section 91AAV will need to be subsequently confirmed by Order in Council or it will lapse.

Non-reporting financial institutions

As noted above, non-reporting financial institutions are not subject to CRS due diligence or reporting. The CRS provides for some generic categories of financial institution that will be non-reporting financial institutions. However, there is also a category of low risk financial institutions that an implementing jurisdiction can itself determine. These must meet certain specified criteria in the CRS, must be confirmed by the implementing jurisdiction in a published list, and must meet a final test of not frustrating the purposes of the CRS.

New section 91AAW of the Tax Administration Act 1994 provides for the Commissioner of Inland Revenue to make a determination as to whether a particular financial institution, or type of financial institution, is a non-reporting financial institution. The provision allows the Commissioner to limit, amend, suspend or withdraw a determination. All determinations made under this provision must be published.

Certain low risk excluded accounts

Similarly, excluded accounts are not subject to CRS due diligence or reporting. A number of generic categories of excluded account are set out in the CRS. There is also an additional category of low risk accounts that an implementing jurisdiction can determine. However, these must also meet specified criteria in the CRS, must be confirmed by the implementing jurisdiction in a published list, and must meet a final test of not frustrating the purposes of the CRS.

Section 91AAW of the Tax Administration Act 1994 also provides for the Commissioner of Inland Revenue to make a determination as to whether a particular financial account, or type of financial account, is an excluded account. The provision allows the Commissioner to limit, amend, suspend or withdraw a determination. All determinations made under this provision must be published.

Enforcement

The CRS requires implementing jurisdictions to have rules and procedures in place to ensure compliance and address non-compliance. This includes having appropriate anti-avoidance rules, record-keeping requirements, compliance programmes and effective sanctions to address identified non-compliance (including countering avoidance arrangements).

Accordingly, the legislation includes a comprehensive suite of enforcement rules and penalties.

The penalties that can be imposed on financial institutions for not complying with CRS obligations are as follows.

“Absolute liability” penalties

Under subsection 142H(1) of the Tax Administration Act 1994, a civil penalty of \$300 applies if a financial institution does not comply with any CRS due diligence or reporting requirement. However, subsection 142H(2) provides that this penalty will not be imposed if the failure was due to circumstances beyond a financial institution’s control.

Under subsection 142H(3) of the Tax Administration Act 1994, a civil penalty of \$300 applies if a financial institution does not obtain a self-certification on opening of a new account, when this is required by the CRS.

Under subsections 142H(2) and (4) of the Tax Administration Act 1994, a transitional period (until 30 June 2019) will apply during which penalties under subsections 142H(1) and (3) will not be imposed if the financial institution is able to demonstrate that it:

- made reasonable efforts to comply with its CRS due diligence and reporting obligations; and
- corrected the failure within a reasonable period of time after becoming aware of it.

Under subsection 142H(6) of the Tax Administration Act 1994, the penalties that may be imposed under sections 142H(1) and (3) must not exceed \$10,000 per reporting period.

“Negligence” penalties

Under subsection 142H(5) of the Tax Administration Act 1994, a civil penalty of \$20,000 for a first offence and \$40,000 for any subsequent offence, may be imposed when a financial institution fails to take reasonable care in complying with its CRS due diligence and reporting requirements.

Under subsection 142H(6) of the Tax Administration Act 1994, the penalties that may be imposed under section 142H(5) must not exceed \$100,000 per reporting period.

Intentional non-compliance

“Knowledge offences” by financial institutions will be subject to existing criminal penalties under section 143A of the Tax Administration Act 1994.

Under section 142H, civil absolute liability penalties and negligence penalties may not be imposed for the same offence.

Information providers

The penalties for financial institutions are also backed with specific obligations and penalties that apply to “information providers” who are account holders, controlling persons, or persons that otherwise hold accounts for the benefit of others (including trusts and intermediaries).

Under section 142I(2)(a)–(h) of the Tax Administration Act 1994, a civil penalty of \$1,000 can be imposed on an information provider for each offence relating to a request for information (such as providing a false self-certification or not providing a self-certification within a reasonable period of time).

Under section 142I(2)(i) of the Tax Administration Act 1994, a civil penalty of \$1,000 can also be imposed on an information provider for not informing Inland Revenue of a material change in circumstances within a reasonable time.

However, under subsections 142I(3) and (4) of the Tax Administration Act 1994, the imposition of the above penalties is subject to a “no fault” defence (for a failure to provide information or a self-certification within the control of the information provider) and a “reasonable efforts” defence (for a failure to provide information or a self-certification relating to another person or entity and not within the control of the information provider).

Other enforcement amendments

Section 89C of the Tax Administration Act 1994 has been amended to enable Inland Revenue to impose any of the civil penalties under sections 142H and 142I by issuing a notice of assessment (that is, without first having to issue a notice of proposed adjustment).

Section 143 of the Tax Administration Act 1994 has been amended to ensure that criminal “absolute liability” penalties cannot be imposed under that section for non-compliance with Part 11B of the Act. (This is because sections 142H and 142I of the Act provide for absolute liability penalties.)

In addition, section 143A of the Tax Administration Act 1994 has been amended to enable criminal “knowledge” penalties to be imposed for knowingly failing to provide information or a self-certification.

As advised, specific record-keeping obligations relating to compliance with Part 11B of the Tax Administration Act 1994 have been inserted into section 22(2) of the Act.

An anti-avoidance provision that will apply to CRS arrangements and practices entered into or by financial institutions, persons or intermediaries with “a main purpose” of avoiding an obligation under Part 11B of the Tax Administration Act 1994, has been inserted into the Act as new section 185R.

“Reasonable efforts” to comply

The mix of transitional measures and available defences included in the above rules reflects the fact that the rules are complex, that financial institutions face short implementation timelines, and that there is therefore a risk of inadvertent error by financial institutions and information providers.

The intended approach is that for the first two years, reasonable efforts by financial institutions to comply will be recognised. For that time, sanctions will generally only be imposed in cases of intentional non-compliance or lack of reasonable care.

FATCA-related amendments

For consistency, the legislation also extends certain CRS obligations to FATCA. These include:

- aligning the FATCA anti-avoidance rule with the AEOI/CRS anti-avoidance rule (with application to any person with an obligation under Part 11B of the Tax Administration Act 1994);
- extending the record-keeping obligations in respect of Part 11B to FATCA as well as AEOI/CRS; and
- providing for the imposition of the same obligations and penalties on persons other than financial institutions (information providers) under FATCA as for AEOI/CRS.