Regulatory Impact Statement

Legislation to enable compliance with an intergovernmental agreement between the United States and New Zealand

Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by Inland Revenue.

It provides an analysis of:

- Whether it is appropriate for New Zealand to enact legislation that will enable financial institutions to comply with their obligations under any intergovernmental agreement (IGA) with the United States of America. The IGA will be an agreement that sets out how New Zealand is to assist in the implementation of United States law commonly referred to as the Foreign Accounts Tax Compliance Act (FATCA).
- If it is appropriate, what form that should legislation take.

The issues have been consulted on with the relevant Government agencies, including The Treasury, Ministry of Justice and the Office of the Privacy Commissioner. Public consultation on these issues has been limited, but a working group of representative from the financial services sector has been actively engaged and are supportive of New Zealand legislation that reduces the compliance costs imposed by FATCA on the sector.

FATCA and any IGA are also of broader public interest, particularly amongst United States taxpayers that are resident in New Zealand. It is understood this group generally opposes both FATCA and New Zealand entering into an IGA with the United States. However, it is important to differentiate the IGA from the proposal to introduce enabling legislation. The decision to negotiate an IGA has already been taken by Cabinet; this legislation is simply the mechanism by which New Zealand financial institutions will be able to comply with its terms.

The preferred option would allow any IGA to be incorporated into domestic legislation and would require financial institutions to comply with any information gathering and reporting obligations contained in it. It is also designed to allow future agreements of a similar nature to the IGA to be added into domestic legislation with minimal additional legislative amendments.

There are no significant gaps, dependencies, constraints or caveats concerning the regulatory analysis undertaken. We do however note that the economic costs of not enacting the legislation proposed are unable to be accurately estimated. Similarly, any fiscal gains from the reciprocal nature of any IGA cannot currently be estimated because Inland Revenue is not currently aware of the number of unreported US accounts held by New Zealand tax residents. Nevertheless, it is concluded that the benefits of enacting this legislation greatly outweigh the costs. Without the ability to comply with FATCA (i.e. if the necessary enabling legislation is not in place), New Zealand financial institutions may be faced with a choice of:

- not investing in the United States (either directly or indirectly); or
- investing in the United States and facing a 30% withholding penalty on any profits derived.

Because it will require financial institutions to collect data on customers and pass relevant information onto Inland Revenue, the proposed option will impair the privacy rights of the customers concerned. There is also an argument that, because the first people likely to be impacted by the legislation are United States taxpayers, the legislation will enable discrimination against this group. To this end, the proposals have been discussed with the Office of the Privacy Commissioner and the Ministry of Justice, both of whom understand the need for legislation in this instance.

Other than as stated above, the policy options do not impair private property rights, restrict market competition, or override fundamental common law principles.

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STATUS QUO AND PROBLEM DEFINITION

1. The United States of America, as part of the Hiring Incentives to Restore Employment Act of 2010, enacted a set of rules commonly referred to as the Foreign Accounts Tax Compliance Act (FATCA). Under FATCA financial institutions, regardless of their location, are required to report on certain United States account-holders (known as "US persons") directly to the Internal Revenue Service (IRS) or face a withholding on United States sourced income of 30%. Financial institution is broadly defined to include (subject to certain exceptions) banks, life insurers and managed funds.

2. As recognition of the fact that compliance with FATCA would impose a significant compliance burden on financial institutions, the United States has developed a system whereby foreign governments can enter into intergovernmental agreements (IGA) with the United States. There are two main types of IGA, known as Model 1 and Model 2.

3. A Model 1 IGA would require financial institutions to supply the relevant information through their own tax authority. That tax authority would then exchange the information with the United States in accordance with existing protocols set out in any double tax agreement between that country and the United States. A Model 2 IGA would require the relevant country to compel its financial institutions to enter into agreements directly with the IRS.

4. Entering into an IGA has a number of benefits, the main ones being:

- Financial institutions in the relevant country would not be required to carry out some of the more compliance-heavy aspects of FATCA.
- In the case of a Model 1 IGA, the financial institutions would not have to enter into separate agreements with the IRS – they would instead be automatically covered by the national agreement.
- Financial institutions would be deemed compliant unless they demonstrated serious non-compliance with the IGA.
- The IGA clarifies a number of exemptions from FATCA reporting for financial institutions considered to be of low-risk from a United States tax perspective.

5. In November 2012, Cabinet agreed to enter into negotiations with the United States with a view to concluding a Model 1 IGA.

6. IGA negotiations with the United States are ongoing. However, this statement is focussed on the desirability of enabling domestic legislation that would require and allow New Zealand financial institutions to comply with the terms of any IGA, on the assumption that one will be agreed in the near future. Financial institutions in New Zealand see significant risk in not having domestic legislation in place.

7. For the purposes of this statement, it is worth noting that the United States is one of the very few countries that taxes individuals on a "citizenship" basis. This means that a United States citizen remains liable to file tax returns (and pay tax if necessary) in the United States irrespective of how long they have been living abroad. In practice, this may mean that a New Zealand resident that is also a United States citizen/taxpayer may be caught by FATCA reporting, even if they have been living in New Zealand for many years and maintain no links to the United States (apart from continuing to be a United States citizen). People in this position that have not consistently complied with their United States reporting and payment obligations are therefore likely to be concerned that being reported on to the IRS may potentially expose them to significant tax and penalty charges.

8. Because they are also New Zealand residents, any impact on this group will be a social impact. The interests of this group are therefore an important consideration in reviewing the alternative options. However, it is also important to note that New Zealand respects the sovereign rights of the United States to impose taxes and penalties as it sees fit.

9. Finally, Inland Revenue notes that the international trends towards countering tax evasion make it likely that other countries may look to adopt FATCA-style reporting at some stage in the future. This means that agreements similar to the IGA may become more commonplace in the international community.

OBJECTIVES

10. The objective of the review is to ensure that:

- New Zealand financial institutions comply with their reporting obligations under any IGA; and
- can do so without violating any domestic law.

REGULATORY IMPACT ANALYSIS

11. Given that approval for IGA negotiations has been provided by Cabinet, this statement proceeds on the assumption that an IGA will be agreed between the United States and New Zealand prior to the date that FATCA information gathering requirements commence on 1 July 2014. We consider there are two main options regarding enabling legislation:

i) *Option 1: Status quo:* No specific legislation be introduced and financial institutions would be required to work within existing legislative frameworks.
ii) *Option 2: Legislation:* Legislation be introduced that would require financial institutions to comply with IGA reporting obligations and explicitly over-ride domestic legislation likely to impede with that.

12. Within option 2, there are two further sub-options:

iii) The legislation could be prescriptive and effectively reproduce any IGA within domestic legislation.
iv) The legislation could be broad, incorporating any IGA by reference only.

13. "Broad", in this context, refers to legislation that applies to any IGA but also any similar agreements that may be entered into in the future with other countries. It would incorporate such agreements by reference and provide a general framework in which they operate by setting out rules that apply to all such agreements.

14. Officials consider there are strong economic arguments for favouring option 2 (introducing legislation) and also consider that legislation should be broad. These options are also favoured by the financial services sector.

15. The table on the following pages analyses the 2 options discussed above against the objectives of the review. It also takes into account the position of United States taxpayers that are likely to be the subject of any reporting.

	Objectives (Met/Not met)		Impacts		
	Require financial institutions to comply with any IGA requirements	Can comply without breaching domestic legislation	Costs	Benefits	Net Impact
Option 1: Status quo – Not preferred	Not met – Although any IGA is likely to be a "double tax agreement" for domestic law purposes, this does not in itself authorise financial institutions to comply with its terms. Compliance with any IGA would therefore be optional for a financial institution.	Not met – It seems likely that any effort to transmit information to Inland Revenue, as contemplated by any IGA, would constitute a breach of the privacy of the persons concerned (under the Privacy Act 1993). It may be possible to circumvent this by obtaining the permission of each customer, but it is unlikely that this permission would ever be obtained for all customers. Taking action against uncooperative customers could open financial institutions to claims of discrimination under the Human Rights Act or the New Zealand Bill of Rights Act.	**Government:** New Zealand's commitment to assisting the fight against tax evasion by entering into an IGA would be contradicted by a lack of legislation authorising compliance with its terms. This could result in broader reputational damage and may also damage the bilateral relationship between New Zealand and the United States. **Financial institutions:** Industry uncertainty as to whether they could comply with the IGA within existing frameworks. Deadweight costs on legal advice are likely to be significant, as would any attempts to get universal consent of customers to collect and share personal information. Failure to comply could expose the institutions to FATCA penalties, which could impact on their broader customer base. The alternative option of not investing into the United States would deny access to the world's largest financial market and would likely result in lower returns for their broader customer base. Would impose a significant compliance cost onto industry. This cost may be reflected in lower returns to the financial services sector and those costs being passed onto consumers. **US persons:** None, other than possible lower returns from investment as a result of financial institutions being subject to FATCA withholding or not investing in the United States. This would be a cost to all New Zealand customers.	**Government:** Existing rights of United States taxpayers that are resident in New Zealand will be protected. **Financial institutions:** None. **US persons:** United States taxpayers would be allowed to challenge the sharing of their information under existing legislation.	Negative – Any benefits to United States persons are outweighed by: (1) the potential reputational impact to New Zealand (2) financial institutions incurring significant deadweight costs (3) financial institutions either suffering FATCA penalties or denying themselves access to the United States financial market.

	Objectives (Met/Not met)		Impacts		
	Require financial institutions to comply with any IGA requirements	Can comply without breaching domestic legislation	Costs	Benefits	Net Impact
Option 2: Specific legislation – Preferred	Met – Legislation would require financial institutions to comply with the requirements of any IGA. Failure to comply would result in penalties, either through becoming subject to the FATCA 30% withholding penalty or through sanctions in domestic legislation or both.	Met – Domestic legislation can over-ride the Privacy Act, Human Rights Act and New Zealand Bill of Rights Act to the extent it is inconsistent with those Acts.	**Government:** Inherent undesirability of promoting legislation that may be contradictory to Privacy, Human Rights and Bill of Rights legislation. **Financial institutions:** None in addition to those that would be incurred under option 1. **US persons:** Any avenues they may have to take action against financial institutions for breaches of the Privacy Act or Bill of Rights Act may be extinguished. For those reported on, there may be the imposition of tax and penalties from the IRS. While the IGA does not alter any substantive taxing rights, it may have the effect of making the IRS aware of existing non-compliance. However, this is consistent with the aims of FATCA.	**Government:** Consistent with the message that the Government will cooperate with international efforts to reduce tax evasion. **Financial institutions:** Provides certainty that they can comply with any IGA reporting obligations, which in turn should mean they can avoid FATCA withholding penalties and can continue to invest in the United States. **US persons:** None.	Positive – Legislation would enhance New Zealand's reputation as an active member of the international community attempting to counter tax evasion. Enabling financial institutions to comply with IGA reporting obligations would allow them means to continue to invest in the United States without penalty. Costs to US persons resident in New Zealand do not appear to outweigh these benefits.

Broad or prescriptive legislation

16. Having established that legislation is desirable, it is necessary to consider whether that legislation should be broad in nature or prescriptive and IGA-specific.

	Advantages	Disadvantages
Option 1: Prescriptive – Not preferred	• It would bring any IGA into domestic legislation in an unambiguous manner. • It would provide a single legislative reference point for interested parties.	• It would be relatively cumbersome to effectively reproduce the requirements of the IGA into domestic legislation. • The legislation would either repeat the IGA (if it were an exact copy) or paraphrase it. There is a risk that paraphrasing would introduce unintended ambiguity between the IGA text and the content of any legislation. • It would be inflexible in that it would only apply to any United States IGA. In the event that New Zealand enters into agreements in the future with other countries which are of similar effect to any IGA, these future agreements would similarly need to be incorporated in a comprehensive manner. • Any future changes to the IGA itself are likely to result in domestic legislation needing to be amended.
Option 2: Broad - Preferred	• It would be simple. It would cross-refer to any IGA and allow interpretation of that document to determine a person's obligations. In doing so, the risk of 'gaps' between any IGA and enabling legislation could be managed and theoretically eliminated. • It could more easily accommodate New Zealand entering into similar agreements in the future. If agreements of this type were their own defined category, future agreement could be included within the regime by amending the relevant definition. Any agreement-specific legislative changes would also be able to be included at that time. • Broad legislation is consistent with the way New Zealand currently legislates for agreements to eliminate double taxation and prevent fiscal evasion (double tax agreements, or DTAs) entered into with other jurisdictions.	The major disadvantage would be that the agreement would not be contained in the same place as other substantive tax laws. Any reader would therefore have to locate both the enabling legislation and the relevant agreement to obtain the full legal picture. People unfamiliar with the workings of DTAs may therefore have trouble locating the relevant legislation. We consider this is mitigated considerably by the ability to search and access legislation online and Inland Revenue will attempt to publically disseminate the relevant legislative references through the FATCA pages on its website.

Fiscal impacts

17. It is not considered that this legislation will have any direct fiscal impacts. Any fiscal effects will instead come from entering into the IGA.

18. Inland Revenue does not consider it is possible to estimate the fiscal costs/benefits of entering into an IGA with the United States. However, it is considered that not entering into an IGA and promoting enabling legislation would have a significant impact on the New Zealand economy. Without the ability to comply with FATCA (i.e. if the necessary enabling legislation is not in place), New Zealand financial institutions may be faced with a choice of:

- not investing in the United States (either directly or indirectly); or
- investing in the United States and facing a 30% withholding penalty on any profits derived.

19. The Model 1 IGA that New Zealand is negotiating is a reciprocal agreement. This means that, in time, Inland Revenue will also receive information from the United States on New Zealand taxpayers with accounts in United States financial institutions. Any financial benefits from this arrangement cannot be estimated at this stage because it is not known how many New Zealand residents have undeclared accounts in United States financial institutions.

Social, environment and cultural impacts

20. The social impacts of the options are largely related to their impact on US persons that are also New Zealand residents. Inland Revenue does not consider there are any environmental or cultural implications for any of the options.

Recommended option

21. Inland Revenue considers that option 2 is preferable and, within the sub-options of broad or prescriptive legislation, broad legislation is also preferable. These choices appear to provide the maximum possible benefits to New Zealand, by clarifying that financial institutions must comply with their IGA obligations and enabling them to do so in a way that avoids unnecessary confusion while also catering for the possibility of future similar agreements being entered into.

Legislation before an IGA

22. It is recognised that recommending legislation be passed before an IGA has been signed is unusual. However, we note that:

- FATCA takes effect from 1 July 2014 irrespective of any action taken by New Zealand. The October 2013 tax bill containing these changes is the last chance that New Zealand will have to implement enabling legislation before that date, unless urgency is used. Urgency would reduce the ability of affected US persons to contribute to the process at the select committee stage.
- As set out above, without enabling legislation, New Zealand financial institutions are unlikely to be able to comply with their FATCA/IGA obligations.

- There is no reason to suspect that an IGA will not be agreed well before 1 July 2014.

CONSULTATION – POLICY FRAMEWORK

Private sector

23. Options for legislation have not been broadly consulted on, on the basis that the decision is simply whether or not specific legislation is required. This is considered to be more of a technical legal question than one that would greatly benefit from public input. However, a working group of representatives from the financial services sector has been actively engaged and are broadly supportive of the aims of the legislation.

24. It is recognised that FATCA is a matter of public interest, particularly amongst New Zealand residents that are likely to be reported on under any IGA. However, public dissatisfaction is likely to be centred around:

- whether an IGA should be agreed in the first place; and
- the United States model of citizenship taxation.

25. The Cabinet decision to enter into IGA negotiations has already been made. The content of any IGA agreed between officials of the United States and New Zealand will be subject to scrutiny in the appropriate manner. Only after this scrutiny has taken place and the IGA brought into force will any domestic enabling legislation take effect.

26. It is recognised that the United States model of individual taxation will result in the application of any IGA being broader than it would have been if New Zealand had entered into a similar agreement with a country that did not adopt this model. However, it is considered inappropriate for New Zealand to comment on this. New Zealand respects the United States' sovereign rights to impose taxes and penalties as it sees fit.

Public sector

27. Inland Revenue has discussed enabling legislation with The Treasury, the Ministry of Business, Innovation and Employment (MBIE), the Office of the Privacy Commissioner, the Ministry of Foreign Affairs and Trade and the Ministry of Justice.

28. MBIE is supportive of enabling legislation on the basis that it will significantly lower compliance costs for financial institutions and enable financial institutions to continue to have access to the United States market.

29. The Office of the Privacy Commissioner considers that New Zealand financial institutions would be unable to comply with FATCA or any IGA without breaching some of the privacy principles set out in the Privacy Act. It has recommended that the only way financial institutions could comply would be through the enactment of legislation that clearly authorises the collection and transmission of the relevant information.

30. The Ministry of Foreign Affairs and Trade is assisting Inland Revenue with any relevant aspects of the IGA negotiations and will further assist in bringing the officials' text of any IGA to Cabinet for approval.

31. The Ministry of Justice has been kept abreast of developments and will vet the proposed legislation for Bill of Rights Act implications in the usual manner.

CONCLUSIONS AND RECOMMENDATIONS

32. For the reasons set out in the "Regulatory Impact Analysis" section of this statement, we recommend specific legislation be introduced to enable and require New Zealand financial institutions to comply with reporting requirements under any IGA (option 2). We also recommend that such legislation be broad, in that it incorporates any IGA (and any other future similar agreements) by reference and provides a broad legislative framework in which such agreements can operate.

IMPLEMENTATION

33. It is proposed that the revised rules apply to affected parties from 1 July 2014. This is the date that the first FATCA information-gathering requirements are due to take effect. As FATCA implementation more generally is driven by the United States, we consider there is little scope to change this application date. To bring it forward may subject affected US persons to unnecessary reporting. To delay it would leave financial institutions in a situation where they were required by the United States to commence FATCA information-gathering but would have no explicit domestic legislative authority to do so.

34. It is anticipated that there will be some compliance costs for financial institutions. These will be necessary to ensure compliance with any IGA, such as systems changes necessary to identify the relevant customers and increased customer contact to establish whether a customer is a US person. However, these will be considerably less than they would be if no enabling legislation were introduced.

35. Receiving information from financial institutions and passing it onto the United States IRS will have systems implications for Inland Revenue. This is particularly due to the volume of information it anticipates receiving as well as catering for the fact that the United States will set the technical specifications for the data exchange. Inland Revenue is currently preparing a single stage better business case for funding of this initiative for consideration by Cabinet. As required by the business case process, a range of options are being considered. These options range in cost, over a five-year whole of life cost, and are currently estimated at between $5.667 million and $8.543 million.

MONITORING, EVALUATION AND REVIEW

36. Monitoring the effect of these changes will fall under Inland Revenue's responsibilities under the generic tax policy process (GTTP). The GTTP is a multi-stage process that has been used to design tax policy in New Zealand since 1995. The final stage of this process is the implementation and review stage, which involves Inland Revenue conducting a post-implementation review and identifying any remedial issues. Opportunities for external consultation are built into this stage.