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Our ref 160331KPMGsubCRS(final)

31 March 2016

Dear Sir

KPMG submission - Implementing the global standard on automatic exchange of information

KPMG is pleased to make a submission on the implementation of the Common Reporting Standard ("CRS") to facilitate the Automatic Exchange of (Financial Account) Information ("AEOI").

AEOI will have significant implications for New Zealand Financial Institutions ("NZFIs") and their customers. It is important that the AEOI rules allow for as efficient compliance as possible.

We believe that existing mechanisms in the Income Tax Act, including the various withholding tax regimes, can be used to leverage and buttress AEOI implementation. AEOI customer due diligence requirements are essentially Know Your Client ("KYC") rules. New Zealand's existing withholding systems also assume knowledge of the status of account holders. The implementation of AEOI provides an opportunity to consider how those systems can be used to support AEOI due diligence. At the same time, it allows consideration of how AEOI can be used to support those systems.

We acknowledge that AEOI is a global project and a global standard. This limits New Zealand's flexibility. However, we consider there are good reasons to justify a departure from the detail of the CRS where the AEOI objectives can be delivered effectively and more efficiently.

Our submissions have these principles in mind.

Our detailed submissions and suggestions are attached. We note that we have not had the time to fully "road test" all of our suggestions. This means that Inland Revenue should consider a further round of consultation. We would be happy to facilitate client roundtables to assist.

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Further information

Please do not hesitate to contact us, John Cantin on 04 816 4518 or Darshana Elwela on 09 367 5940, if you require further information on this submission.

Yours sincerely

John Cantin	Darshana Elwela	Tim Goodrick
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Summary of our key submissions

Reliance on AML/CFT

- Reliance on AML/CFT rules is possible and in our view necessary to prevent duplication of systems and effort.
- As you will be aware, AEOI and Anti-Money Laundering ("AML")/Countering the Financing of Terrorism ("CFT") rules are based on the Financial Action Task Force ("FATF") recommendations. New Zealand's KYC requirements for AML/CFT have yet to be peer reviewed. However, those requirements are intended to meet New Zealand's FATF obligations and they have been approved by the United States for the purposes of its Qualified Intermediary ("QI") rules.
- AEOI rules should only require NZFIs to collect information, not already covered by the AML/CFT rules – i.e. tax residence and tax identification numbers ("TINs") – and to report relevant accounts to Inland Revenue. In all other respects, AEOI should rely on the AML rules and the choices already allowed and made by New Zealand for FATF compliance.
- Reliance on AML/CFT rules for AEOI compliance leads to the following further submissions:
  - AEOI auditing (of customer due diligence and reporting) should be included as an add-on to AML/CFT audits. It does not need to be a separate audit.
  - AEOI implementation for NZFIs should be at the same time as AML/CFT implementation is required for those NZFIs which will be subject to AML/CFT rules. That is, where a NZFI is not yet subject to AML/CFT requirements (e.g. lawyers), the introduction of AEOI should be phased to align with AML/CFT for those entities.
  - For non-AML/CFT NZFIs, AEOI implementation would still require AML/CFT customer due diligence rules to be applied. We acknowledge that this will be an additional compliance burden for those NZFIs.

Special AEOI rules for NZ trusts

- To assist in alleviating the compliance burden in respect of NZ trusts (which tend to be problematic when determining whether they are a Financial Institution and also who their controlling persons are), New Zealand should consider whether Inland Revenue's Business Transformation to deliver AEOI reporting in a better way.
- We note that with FATCA, trusts are problematic due to the uncertainty of application of the "Investment Entity" definitions under either the FATCA US – NZ Inter-Governmental Agreement ("IGA") or the US Treasury FATCA Regulations. Further, determining a controlling person is not necessarily straight-forward. A NZFI that has a NZ trust as an investor is not normally privy to the information necessary to determine either matter. Generally, a NZFI will need to rely on the NZ trust's self-certification.

- We consider that AEOI reporting for NZ trusts as part of the income tax return process would provide outcomes consistent with AEOI objectives. Under our suggested approach, trusts would need to report all distributions, disclose all recipient beneficiaries and their New Zealand or Foreign TINs, and all settlors on an annual basis. Inland Revenue would then exchange this information with other Revenue Authorities as appropriate. This approach effectively treats each NZ trust as a reporting NZFI, for AEOI purposes.
- We believe this is a better approach to due diligence as the trustee is in a better position to know what the trust invests in and who it distributes to. A trustee can be reasonably relied on to ensure that a beneficiary is who they say they are in order to be able to discharge their obligations.
- Further, practically, as a NZFI is likely to require self-certification, their due diligence of a trust is not likely to provide additional comfort to the process. (This suggestion would not take a trust outside the AML/CFT rules. Compliance with those rules by an NZFI would still be required.)

Encouragement to comply

Non-residents

- We suggest that New Zealand consider self-certification and provision of relevant foreign tax information as a pre-requisite to access tax treaty benefits (i.e. reduced withholding tax rates) and the Approved Issuer Levy ("AIL") where the payer is a reporting NZFI.
- An entity which is "properly" or "obviously" a reporting NZFI will in our experience attempt to comply with their AEOI due diligence obligations. Their difficulty will be getting pre-existing customers to confirm their status, and to provide relevant information, to ensure they are not an undocumented account.
- We understand that an undocumented account is reported to Inland Revenue but not to an offshore authority. Inland Revenue is then obliged to consider why an account is undocumented and take steps for remediation. This process is likely to impose costs on both the relevant NZFI and Inland Revenue.
- Our experience is that most offshore jurisdictions set bureaucratic hurdles for accessing tax treaty benefits. New Zealand's requirements, in contrast, are minimal.
- Our suggestion is to make New Zealand's requirements, to access treaty relief, more consistent with the offshore requirements. This should reduce the number of undocumented accounts. The current requirements should continue to apply in the case of non-NZFIs that have non-resident investors.

Resident entities controlled by non-residents

- Inland Revenue could consider requiring a higher withholding rate be applied where a self-certification is requested by a NZFI but is not provided. Alternatively, the existing knowledge offence penalty rules could be applied in this situation.

- This is because the same process for claiming a concessionary rate is not relevant for New Zealand resident entities, controlled by non-residents, as payments to them are subject to Resident Withholding Tax ("RWT"), unless exempt. Provided an IRD number and an appropriate election is made, there is less justification for applying a higher rate of RWT.
- This means that an NZFI may not be able to confirm that an entity is or is not non-resident controlled. A non self-certification rate for RWT may encourage a resident entity to complete the necessary documentation.

Penalties

- Inland Revenue guidance will be critical. This should be Inland Revenue's focus.
- We consider that any failure to comply is likely to be inadvertent due to the wide definitions (e.g. for an "Investment Entity") in the AEOI rules. As these are global definitions, there is little opportunity to clarify in the New Zealand legislation. We note that our suggestion for NZ trust reporting (that it be done via the tax return) would reduce the risk of inadvertent non-compliance for many likely affected entities.

Avoidance

- We submit that any avoidance rule should be targeted at the specific activities which cause concern.
- The general avoidance rule for FATCA is applicable if the intent is to avoid an obligation under the rules.
- We understand that avoidance in the AEOI context is focused on reporting, due diligence and NZFI qualification. It is difficult to distinguish potential AEOI avoidance from commercially rational decision-making. (For example, making multiple smaller investments with different FIs which are below review thresholds is readily explainable by a desire to spread the risk.)
- A broad anti-avoidance rule is difficult to apply and interpret. It may be misused.

Excluded accounts

- The objective is for a foreign Revenue Authority to be able to identify their taxpayers who may have avoided or evaded tax. New Zealand has a comprehensive withholding tax regime for passive income. Generally, either RWT, PIE tax, Non-Resident Withholding Tax ("NRWT") or AIL applies.
- If a nil rate applies for PIE income, that income is reported to Inland Revenue and must be returned by the investor. The investor will need to provide both their NZ IRD number and a 0% Prescribed Investor Rate ("PIR") election. Otherwise a default PIR of 28% applies.
- If the nil rate applies because the investor is treated as a Notified Foreign Investor ("NFI") in a Foreign Investment PIE, the PIE must collect the investor's details, including their country of tax residence and foreign TIN. This broadly mirrors the tax information required for AEOI reporting purposes.

- If a nil rate applies for RWT, this is generally due to an exemption certificate. The income is included in the investor's New Zealand tax return.
- The above features of the New Zealand tax system generally mean that there is a low risk of New Zealand Financial Accounts being used to evade foreign taxes. We acknowledge however that it is unlikely that all New Zealand Financial Accounts could be excluded accounts, for AEOI purposes.
- However, we believe that consideration should be given to excluding PIE accounts from the definition of Financial Account for AEOI purposes.
- Our logic is broadly that:
  - PIEs will remain subject to AML/CFT. This should address concerns about verifying investors' identities for those purposes. However, an exclusion from AEOI requirements will mean there is no additional due diligence or reporting to Inland Revenue.
  - A PIE is a regulated entity (i.e. will be subject to the Financial Markets Conduct Act and accompanying legislation). In the unlikely event it is not, its Financial Accounts should not be excluded.
  - A PIE investment has a low risk of being used to avoid tax:
    - PIE income will generally be attributed to an investor and taxed at their nominated PIR.
    - If the investor is NZ resident, this will be at a rate between 0% and 28% (with measures to ensure the correct rate is notified, such as provision of a NZ IRD number to elect a rate lower than 28%).
    - For a non-resident investor, tax will be deducted at 28% (the highest rate), or if a Foreign Investment PIE, at 0% but only if the investor can verify that they are a NFI. (A NFI notification contains the same tax information as that required under AEOI).
    - PIE income and tax deducted, for each investor, is reported to Inland Revenue annually.

Detailed submissions and comments

New Zealand's AEOI implementation date

New Zealand's AEOI implementation date has been brought forward to 1 July 2017, from the originally announced 1 January 2018. Paragraph 1.8 of the issues paper states this is so Inland Revenue can meet New Zealand's commitment to exchange Financial Account information by 30 September 2018. Chapter 3 states that the 1 July 2017 start date cannot be changed.

It is not clear to us why the original 1 January 2018 implementation date would mean New Zealand is non-compliant with its obligations. Financial Account information for the period 1 January 2018 to 31 March 2018, for example, could still be reportable to Inland Revenue and exchanged by September 2018.

This is relevant because bringing forward the start date for the CRS will require NZFIs to start updating their systems now.

The draft legislation is proposed to be introduced in July 2016 and passed by the end of the year. However, we understand that this will contain the broad framework only, not the detail. At the various Inland Revenue stakeholder meetings, it was suggested that the technical detail, including available options, will be confirmed via Order in Council in early 2017.

We do not believe this provides sufficient time for NZFIs to make the necessary updates to their on-boarding systems for 1 July 2017.

Submission

Therefore if:

- the current time frame is "hard wired", the CRS specification for NZFIs needs to be finalised as soon as possible.
- the current time frame can be revisited, it should be.

AEOI needs to be aligned with AML/CFT laws

FATF background and AML/CFT fit for AEOI purpose

AEOI was developed with an assumption that the FATF Recommendations would be implemented. This was to ensure consistency with the Customer Due Diligence ("CDD") requirements of the FATF Recommendations (Recommendation 10 and its Interpretive Note).

FATF undertook a mutual evaluation of New Zealand in 2009. It determined that New Zealand's CDD requirements were non-compliant with the FATF Recommendations. However, New Zealand has since implemented significant changes to the CDD requirements through the AML/CFT Act 2009 which commenced on 30 June 2013.

We recognise that the CDD requirements in the AML/CFT Act were largely developed prior to the changes to the FATF Recommendations in 2012. Nevertheless, the fundamentals remained the same. As a result, in our view, the CDD requirements in the AML/CFT Act are to a large extent consistent with the FATF Recommendations.

Further, we note that the United States has accepted New Zealand's KYC rules for the purposes of its withholding tax regime. The lack of adequate KYC rules in New Zealand had previously meant that New Zealand entities did not qualify for QI status under those rules.

Reliance on AML/CFT CDD for AEOI purposes

To a large extent, NZFIs that are subject to AEOI are also subject to AML/CFT. To mitigate compliance costs for NZFIs, we recommend reliance on AML/CFT laws for CDD requirements as far as possible. This should mean that the AEOI rules only cover additional matters, such as collection of foreign tax residence and TIN information, and AEOI reporting to Inland Revenue.

As both the AML/CFT and AEOI rules were drafted to comply with the FATF Recommendations, this should mean that New Zealand's AEOI implementation complies with the AEOI/CRS requirements.

Consequences of AML/CFT CDD for items raised in the issues paper

Our key submission would mean that items which are potentially inconsistent with existing AML/CFT processes would be dealt with as follows (these are also covered in our detailed comments on the Chapter 5 consultation questions):

- ***Date of birth***: A date of birth for pre-existing accounts would only be required for 'existing accounts' as defined in the AML/CFT Act, when there is a material trigger (e.g. a change in product or customer circumstances).
- ***Place of birth***: A place of birth would not be required. The benefits of obtaining this for AEOI purposes do not seem to outweigh the compliance cost impact, in our view.
- ***Pre-existing account threshold / new accounts by pre-existing customers***: The definition of pre-existing account would be expanded to include a new account that is opened by the same person.
- ***Trust beneficiaries***: There is no specific requirement for AML/CFT purposes to identify a beneficiary of a discretionary trust which receives a distribution from a discretionary trust. However, there is an obligation to perform AML/CFT due diligence on effective controllers which may include a beneficiary. In general, if the effective controller changes due to a distribution then a financial institution may be required to identify and verify additional persons. As New Zealand, to a large extent, implements the FATF standards with respect to beneficial ownership of trusts for AML/CFT purposes, this approach should be applied for AEOI as well. (Also note our specific suggestions in respect of NZ trust AEOI compliance.)

NZFIs not yet subject to AML/CFT and NZFIs never subject to AML/CFT

New Zealand's AML/CFT rules currently apply to "Wave 1" entities. New Zealand has not yet confirmed the start date for "Wave 2" entities. Given the extensive definition of "Investment Entity" for AEOI purposes it is possible that some NZFIs, for AEOI purposes, will never be subject to AML/CFT. These NZFIs will not have AML/CFT processes in place by 1 July 2017, or at any time thereafter.

We submit:

- The application of AEOI to "Wave 2" entities should be aligned to the start date of AML/CFT CDD requirements for those institutions;
- The application of AEOI to NZFIs which will never be subject to AML/CFT should still apply the AML/CFT rules for AEOI CDD requirements.

We acknowledge that this submission may:

- put pressure on the definition of "Wave 2" entities, as being a Wave 2 NZFI will likely defer the application of AEOI reporting beyond 2018. ("Wave 2" implementation for AML/CFT has not yet commenced.) However, we see merit in implementing AML/CFT and AEOI at the same time.
- impose compliance costs on those to whom AML/CFT will never apply. However, we can see no alternative for implementing AEOI than for those entities to complete CDD using AML/CFT procedures.

Phasing AEOI implementation consistent with AML/CFT phasing

The phased approach to AEOI implementation is discussed below. This could include entity, account and/or due diligence requirements phasing.

Entity phasing

As noted above, AML/CFT requirements were introduced in New Zealand in two phases.

Financial Institutions (and casinos) were targeted as part of Wave 1, with AEOI applying to these entities from 30 June 2013. The application of AML/CFT to non-financial entities, such as lawyers, accountants, real estate agents, etc. (the second phase) is still under consideration (these are the Wave 2 entities referred to above).

AML/CFT implementation within Wave 1 was itself phased. Full implementation was spread over a three year period. We submit that Wave 1 entities should be subject to AEOI in the same phased manner as they were for AML/CFT purposes.

We expect that financial entities already subject to AML/CFT (Wave 1 entities) will encompass the vast majority of Financial Institutions that will be subject to AEOI (on the basis that AEOI only applies to financial entities[1]) from 1 July 2017.

We have already noted that a 1 July 2017 start date is very tight. The ability to meet this deadline will depend on how quickly the AEOI rules are promulgated, what additional work is required to comply and the capability of the entity.

Our recommendation is for any entity-based phasing to focus on the capability of the entity to implement the CRS. On the assumption that there is likely to be some correlation between capability and entity size (i.e. measured by number of account holders and/or total funds under

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[1] The exception is third parties that handle funds, such as solicitors that operate trust accounts and some brokers.

management), we believe that smaller financial entities should be given more time to transition to the CRS than say a bank or other large NZFI.

In particular, we note that the broad definition of "Investment Entity" is likely to capture some family trusts. In theory, these entities should already subject to due diligence requirements under FATCA. However, in practice, we believe FATCA non-compliance is likely to be high. Therefore, it is unlikely that many will be focused on their obligations under FATCA, let alone the CRS. We believe these types of entities, particularly, need to be given some additional time to become compliant. Alternatively, as we have submitted below, NZ trusts should be subject to special reporting rules (as part of their income tax return) to ensure their AEOI compliance.

Financial Accounts-based phasing

As Financial Account type will follow entity type, this will effectively be the same as phasing AEOI implementation by entity type.

Due diligence - Pre-existing accounts

In relation to due diligence phasing, we agree with the proposal in the issues paper to allow additional time for low-value pre-existing individual accounts and entity accounts to be reviewed. That is, to allow NZFIs until mid-2019 to review these accounts, with any non-resident account holders only needing to be reported as part of the 2020 AEOI reporting.

AML/CFT audits should build in AEOI checks

Our primary submission allows AEOI compliance to be part of an AML/CFT audit of an NZFI.

Additional process checks (that appropriate tax residence certifications and foreign TINs have been collected and that relevant account holders are reported) should be able to be built into an AML/CFT audit. The audit report would therefore be able to cover AEOI compliance.

This should simplify the process and ensure Inland Revenue has comfort that AEOI compliance is occurring.

Trusts – a different AEOI approach that achieves the same objectives

Trusts tend to be problematic for determining both their Financial Institution status and their controlling persons. This is both for a NZ trust looking to determine whether AEOI obligations apply to it, and any NZFIs that have the trust as an account holder. This has been our experience in the application of FATCA to trusts.

It is likely that most NZ trusts will not be aware of FATCA. They may not be aware of whether they are a Financial Institution (e.g. as an "in business" or a "deemed" investment entity) and, if so, their FATCA due diligence and reporting obligations. If not a Financial Institution, they may not know whether they are a passive or active Non-Financial Foreign Entity ("NFFE").

We believe the same issues will arise with AEOI.

Where a trust is an account holder, the NZFI will need to rely on the trust's self-certification. We do not expect this will provide high levels of comfort about the trust's status.

Submission

We consider that AEOI reporting for NZ trusts as part of the income tax return process would provide outcomes consistent with AEOI objectives.

Under our suggested approach, NZ trusts would need to report all distributions, disclose all recipient beneficiaries and their New Zealand or Foreign TINs, and all settlors on an annual basis. Inland Revenue would then exchange this information with other Revenue Authorities as appropriate. This approach effectively treats each NZ trust as a reporting NZFI, for AEOI purposes.

We believe this is a better approach to due diligence as the trustee is in a better position to know what the trust invests in and who it distributes to. A trustee can be reasonably relied on to ensure that a beneficiary is who they say they are in order to be able to discharge their obligations.

We note that this submission should not take a trust outside the AML/CFT rules. Compliance with those rules would still be required.

The AEOI compliance framework should be based on existing mechanisms

The issues paper (in Chapter 4) seeks feedback on anti-avoidance rules to prevent NZFIs from circumventing CRS due diligence and reporting and effective enforcement provisions to address non-compliance by NZFIs' customers.

The purpose of AEOI is to help combat *"tax evasion arising from wealth held by individuals and entities in "offshore" financial accounts that goes unreported for tax purposes in the home jurisdiction"*. Our working assumption is that where New Zealand taxes any income arising on the Financial Account it is unlikely that such an account would be used to evade foreign taxes. As New Zealand does not have concessions or tax exemptions for savings, it unlikely that a non-resident will be investing in a NZFI to evade tax.

Knowledge offences

We believe the application of the existing knowledge offence penalties in the Tax Administration Act 1994 to non-compliant NZFIs should suffice. We note that this is the compliance approach that has been taken in relation to FATCA. We see no need for additional sanctions on NZFIs, in relation to AEOI non-compliance.

Use of existing regimes to encourage compliance

Key submission

We suggest that existing withholding regimes, such as the RWT, NRWT, AIL and the PIE rules should be used to enforce compliance with AEOI by non-resident account holders. This would be buttressed by the existing knowledge offence provisions.

Non-residents

By way of an example, if a non-resident account holder is asked but fails to provide self-certification of their tax residence (and other details such as their foreign TIN), then a NZFI

could apply RWT rather than NRWT (or AIL) on any interest. If the account holder does not have a New Zealand IRD number (which we assume would be the case[2]) they would be subject to the non-declaration 33% RWT rate.

33% New Zealand tax, rather than 15/10% NRWT (depending on application of Double Tax Agreements) or 2% AIL, would therefore be the outcome of AEOI non-compliance.

Another option is to make New Zealand's requirements to access treaty relief more consistent with offshore requirements (which typically impose more bureaucratic hurdles), for non-residents investing in NZFIs.

This would require the account holder to provide self-certification of their tax residence status and foreign TIN prior to receiving a lower withholding rate under a Double Tax Agreement. (The current requirements should however continue to apply in the case of non-NZFIs that have non-resident investors.) We believe a positive obligation would help encourage AEOI compliance, as we understand that absent an incentive, non-compliance will simply mean that a NZFI reports the investor as an "undocumented account". (An undocumented account is reportable to Inland Revenue but will not be exchanged with any foreign Revenue Authority. Inland Revenue has "follow up" obligations to determine why the account is undocumented and to take steps to ensure documentation is provided.)

If a NZFI treats the account holder as a resident for withholding tax purposes, this should not be a reportable account for AEOI purposes. We believe this would create appropriate incentives for non-residents to correctly declare their status, or suffer a higher tax impost, such that the objectives of the CRS will be achieved.

In the case of investments in PIEs, the non-resident rate is 28% (which equates to the highest resident PIR). This is also the default rate if information is not provided. While a higher non-declaration rate could be prescribed under the PIE rules, we believe a 28% tax impost should be sufficient to dis-incentivise the use of PIEs by non-residents to evade home country taxes.

In the case of Foreign Investment PIEs, non-resident investors must currently provide certification of their NFI status, to access a PIR of lower than 28%. Therefore, the appropriate compliance mechanisms are largely already built into the PIE regime.

Resident entities controlled by non-residents

We acknowledge that one issue under the above approach is the treatment of NZ resident entities (companies and trusts) that are controlled by non-residents. As these will already be subject to domestic tax regimes (e.g. RWT) there is prima facie no incentive for them to disclose the tax residence of their beneficial owners under the CRS.

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[2] Particularly, due to the new requirements for non-residents to open a fully functioning NZ bank account prior to obtaining a NZ IRD number.

The options here are to introduce a higher rate of RWT withholding if an investor does not self-certify or place reliance on the existing knowledge offence provisions for non-compliance with self-certification requirements.

Penalties

We also support a "soft landing" approach to the application of penalties in the first year of AEOI implementation to reflect the short-time frame for NZFIs to implement the new rules.

Residence test

The CRS will use tax residency as the criteria to determine which jurisdiction a Financial Account holder should be reported to. While a review based on residential home address (or other proxies) is proposed for pre-existing accounts, NZFIs will need to seek self-certification for new accounts.

This raises a number of questions:

How will account holders be expected to determine their tax residence?

In theory, this would seem straightforward enough for most account holders – it should typically be the jurisdiction in which they ordinarily reside. However, as *CIR v Diamond* [TRA, HC and CA] has illustrated, determining tax residence is anything but straight-forward, with the New Zealand Commissioner (ultimately unsuccessfully) arguing that a New Zealand citizen who had been out of the country for more than 10 years, still maintained tax residence by virtue of a permanent place of abode here. We would expect similar questions to arise for those on international assignments, secondments and overseas experiences.

Submission

Account holders who are deemed to "have got it wrong" by Inland Revenue should not face penalties for taking positions relating to their tax residence.

What onus, if any, will there be on NZFIs to validate self-certifications in relation to new accounts?

Similar to FATCA, it appears that NZFIs will need to undertake a reasonableness check of the self-certification against other information collected for AML/CFT or other KYC purposes. It is not clear what this requires.

For example, a person's mailing address may be in one country (e.g. country A, because they temporarily live there), but they may be tax resident in another (e.g. country B). In this situation, the information collected by the NZFI for other KYC purposes would suggest the person could be "resident" in country A when they have (correctly) nominated country B. NZFIs are unlikely to have both the personal information and the technical knowledge of other tax jurisdictions to be able to substitute their judgment for the account holder's self-certification. They should not be put in a position where they are required to validate a self-certification.

Submission

It should be made clear that a self-certification of tax residence overrides any other KYC information/indicia collected.

What will happen if an account holder does not respond to a request for self-certification of their tax residence?

Under FATCA, these account holders could be treated as "recalcitrant" and be reported on. We understand that such accounts would be considered "undocumented accounts" which are reportable to Inland Revenue but not to a foreign Revenue Authority. This may be insufficient incentive for an account holder to self-certify.

Submission

We refer to our submissions regarding the use of the existing withholding tax regimes to encourage compliance, as a response to this issue.

What is the status of US FIs under the CRS?

The United States is treated as a "non-participating jurisdiction" for AEOI by most other countries. This means that a US FI account holder would be reported as such to Inland Revenue. As this information will not be exchanged, it appears that this reporting will serve no purpose.

Submission

Consideration should be given to deeming a US FI to be a participating FI so that documentation and reporting is not required. We note that a US reportable account would still be reported to Inland Revenue and exchanged with the IRS under FATCA. We assume that AEOI will not change this requirement.

Legal basis for exchanging information – giving the Multi-lateral convention the force of law

The Multi-lateral Convention on Mutual Administrative Assistance in Tax Matters (the "Multi-lateral Convention") will be the primary legal instrument to give effect to the CRS.

Is the multi-lateral convention authorised by BH 1?

However, New Zealand's domestic legislation (section BH 1 of the Income Tax Act 2007) may need to be updated if the Multi-lateral Convention is to be given the same status as a Double Tax Agreement ("DTA"). This is because a DTA is defined as an agreement between the government of any territory outside New Zealand and the government of New Zealand. While the New Zealand Government has signed the Multi-lateral Convention, it does not require agreement by New Zealand (or any other signatory) for another country to become party to it. Therefore, the Multi-lateral Convention may not meet the present DTA definition in section BH 1.

For completeness, the IGA is an agreement between two countries and therefore seems to be within the section BH 1 definition.

Supplementary information under the CRS

Chapter 5 asks whether domestic law changes are necessary to support the collection of certain (supplementary) information under the CRS. (The information is "supplementary" because the CRS Standard does not explicitly require its collection, but allows the information to be obtained if a jurisdiction sees fit to recommend it). If the Multi-lateral Convention gives effect to the CRS, and the Convention has full force of law in New Zealand, there should be no need for a domestic law change to implement any specific part of the CRS.

We consider whether such information should be provided in our responses to Chapter 5 questions.

Data confidentiality and safeguards

We strongly agree that ensuring the confidentiality and security of data that is reported to Inland Revenue and exchanged under the CRS is paramount.

We agree that Inland Revenue's existing taxpayer secrecy requirements (in section 81 of the Tax Administration Act 1994) should be sufficient to ensure confidentiality of Financial Account information reported by NZFIs to the New Zealand Commissioner. Further, we note that section 81 of the TAA currently apply to safeguard US account holder information reporting under FATCA.

Our concern is with the data secrecy standards and practices of AEOI participating jurisdictions' tax authorities. We note that AEOI is materially different in both the nature and volume of information that will be automatically exchanged. It could have dramatic implications for those reported on, if the information is misused.

Chapter 4 notes that New Zealand will base the majority of its exchange decisions on the outcomes of confidentiality and data safeguard reviews undertaken by the Global Forum on Transparency and Exchange of Information for Tax Purposes (the "Global Forum"). We understand that this is the measure currently used by Inland Revenue to assess exchange of information in other contexts.

We understand the peer review is undertaken by independent personnel and the results are published by the OECD. Further, the methodology is viewed as being robust by Inland Revenue Policy & Strategy. Based on this, the peer review process appears a reasonable measure to determine if a jurisdiction has appropriate and effective data protection safeguards.

Submission 1

However, we consider that taxpayers should be given the opportunity to make submissions to Inland Revenue, before a country is added to the list of exchange jurisdictions. This is because taxpayer experience of a jurisdiction may be quite different from that presented to a Global Forum review team.

Submission 2

We have concerns with Financial Account information being exchanged with countries which have capital punishment for taxation offences (such as tax evasion). We believe that serious consideration needs to be given to New Zealand opting-out of exchanging information where such a sanction could apply, even if the country would otherwise meet the secrecy requirements.

Submission 3

We support a “wider approach” to AEOI due diligence and reporting (see below).

However, depending on how the wider approach is actually implemented, it may require further changes to New Zealand privacy and data collection legislation. This will be the case, for example, if NZFIs carry out due diligence on (i.e. request self-certifications from) all their non-resident account holders but are selective in their reporting to Inland Revenue (i.e. only report account holders residing in AEOI participating jurisdictions at the time). Such an approach may conflict with New Zealand privacy and data collection rules, to only collect information for a defined regulatory purpose.

Non-reporting NZFIs (Excluded FIs)

Chapter 2 of the issues paper suggests that CRS obligations will apply to any Financial Institution resident in New Zealand (excluding any of its branches located outside New Zealand) or any branch of a non-resident financial institution that is located in New Zealand.

“Residence” will be determined by reference to domestic tax residence rules, although in the case of trust Financial Institutions (or other entities where tax residence cannot otherwise be established) the proposal is to use the tax residence of the trustee(s) as a proxy. We note the latter is consistent with the approach taken for FATCA, in the Competent Authority Agreement between New Zealand and the United States.

We note that the AEOI Financial Institution definition broadly follows the US Treasury definitions in the FATCA regulations. We support consistent definitions for FATCA and AEOI purposes.

The differences are in the various carve-outs from AEOI due diligence and reporting, with a number of the FATCA exclusions (such as for “Financial Institutions with a Local Client Base” or “Certain Non-Registering Local Banks”) not available under the CRS.

The issues paper asks for feedback on which entities would qualify as “*entities that present a low risk of being used to evade tax that have substantially similar characteristics to [governmental entities, international organisations, central banks, broad and narrow participation retirement funds, or qualified credit card issuers]”*.

The OECD’s CRS commentary notes that “low risk factors” include Government regulation of the Financial Institution and/or information reporting to tax authorities by the entity. “High risk factors” include non-application of AML/CFT or other KYC procedures, non-compliance with FATF recommendations around transparency and beneficial ownership, and promotion as a tax minimisation vehicle.

We do not believe that entities which are obviously NZFIs will display the high-risk factors as outlined the CRS commentary above. (The exception may be certain trusts that meet the Investment Entity definition, which will not be subject to Financial Markets regulation or AML/CFT, but these would not be excluded entities anyway.)

Therefore, the usefulness of the above carve-out will depend largely on how the term *"substantially similar characteristics"* is interpreted. The OECD's CRS commentary states the following:

> *Each jurisdiction may evaluate the application of this requirement to a type of Financial Institution that does not satisfy all the requirements of a particular description listed in subparagraphs B (1) (a) or (b). As part of such evaluation, a jurisdiction must identify which requirements are satisfied and which are not satisfied, and with respect to the requirements that are not satisfied, must identify the existence of a substitute requirement that provides equivalent assurance that the relevant type of Financial Institution presents a low-risk of tax evasion.*

[Emphasis added]

Based on the above commentary, we believe there is very little scope to define other excluded NZFIs, if the requirement is to identify a substitute requirement that provides equivalent assurance for each requirement that is not met. (We believe the use of "equivalent" rather than "substantially similar" is likely to be instructive.)

To simplify our analysis, we have excluded "like" government entities and international organisations. This then limits the analysis to entities that have substantially similar characteristics to broad and narrow participation retirement funds.

Broad participation retirement funds are defined as Government regulated funds with no investor owning more than 5%, having one or more of the following characteristics: tax exempt, employer sponsored (to the extent of 50% or more of the contributions received), locked-in (withdrawals limited to specified events such as retirement, death or disability), or contribution-capped (the annual permitted contribution is limited to $50,000).

Other than KiwiSaver schemes (which are broad participation retirement funds from the outset and therefore excluded NZFIs under the CRS) we cannot think of any other fund products, operating in the New Zealand marketplace, that will have characteristics substantially similar to those outlined above. However, we outline below how certain PIE accounts could potentially be excluded from the CRS.

It is not clear how far these requirements can be "stretched" while still being substantially similar. For example, can the cap on contributions be higher, say, $100,000 or can a fund have a lock-in period that is not linked to an event like retirement, and still be substantially similar? Note, even if this is the case it is still difficult to identify/describe specific funds which may limit investors' contributions annually or lock-them in.

Excluded Financial Accounts

Similar to the entity type definition, the issues paper suggests that certain Financial Accounts could be excluded from the CRS due diligence and reporting requirements if they meets specific criteria – i.e. having a low risk of being used to evade tax and being substantially similar to types of accounts that are specifically excluded under the CRS Standard.

Dormant Accounts

"Dormant accounts" with an account balance not exceeding US$1,000 are provided as an example of an excluded account, under the CRS. The definition of a "dormant account" is important. The OECD CRS commentary notes:

> *An account (other than an Annuity Contract) is a "dormant account" if (i) the Account Holder has not initiated a transaction with regard to the account or any other account held by the Account Holder with the Reporting Financial Institution in the past three years; (ii) the Account Holder has not communicated with the Reporting Financial Institution that maintains such account regarding the account or any other account held by the Account Holder with the Reporting Financial Institution in the past six years; and (iii) in the case of a Cash Value Insurance Contract, the Reporting Financial Institution has not communicated with the Account Holder that holds such account regarding the account or any other account held by the Account Holder with the Reporting Financial Institution in the past six years. Alternatively, an account (other than an Annuity Contract) may also be considered as a "dormant account" under applicable laws or regulations or the normal operating procedures of the Reporting Financial Institution that are consistently applied for all accounts maintained by such institution in a particular jurisdiction, provided that such laws or regulations or such procedures contain substantially similar requirements to those in the previous sentence. An account ceases to be a dormant account when (i) the Account Holder initiates a transaction with regard to the account or any other account held by the Account Holder with the Reporting Financial Institution; (ii) the Account Holder communicates with the Reporting Financial Institution that maintains such account regarding the account or any other account held by the Account Holder with the Reporting Financial Institution; or (iii) the account ceases to be a dormant account under applicable laws or regulations or the Reporting Financial Institution's normal operating procedures.*

[Emphasis added]

We agree that dormant accounts should be excluded accounts, as this should simplify the need to undertake due diligence on pre-existing accounts. Consideration needs to be given to whether a "New Zealand-ised" definition of a dormant account, for example, based on the Unclaimed Monies Act, can be substituted for the OECD mandated definition. In New Zealand, we note that deposits with banks and financial institutions can become unclaimed monies (and transferred to Inland Revenue) if the person who owns the account has not operated the account for a period of six years. We believe a time frame of three to six years for defining a dormant account is reasonable.

Whether the threshold should be NZ$1,000 (or higher or lower in value) is largely irrelevant, in our view, if the account is genuinely "dormant". If an account is dormant, particularly under the OECD's comprehensive definition, it is not being actively used to evade tax regardless of the account balance (e.g. whether NZ$1,000, NZ$50,000 or higher). However, on the basis that a NZ$50,000 threshold, for example, is unlikely to be palatable, we believe that New Zealand should adopt the highest threshold feasible in the circumstances.

PIE accounts

We believe that consideration should be given to excluding PIE accounts from the definition of Financial Account for AEOI purposes.

Our logic is broadly that:

- PIEs will remain subject to AML/CFT. This should address concerns about verifying investors' identities for those purposes. However, an exclusion from AEOI requirements will mean there is no additional due diligence or reporting to Inland Revenue.
- A PIE is a regulated entity (i.e. will be subject to the Financial Markets Conduct Act and accompanying legislation). In the unlikely event it is not, its Financial Accounts should not be excluded.
- A PIE investment has a low risk of being used to avoid tax.
  - PIE income will generally be attributed to an investor and taxed at their nominated PIR.
  - If the investor is NZ resident, this will be at a rate between 0% and 28% (with measures to ensure the correct rate is notified, such as provision of a NZ IRD number to elect a rate lower than 28%).
  - For a non-resident investor, tax will be deducted at 28% (the highest rate), or if a Foreign Investment PIE, at 0% but only if the investor can verify that they are a NFI. (A NFI notification contains the same tax information as that required under AEOI).
  - PIE income and tax deducted, for each investor, is reported to Inland Revenue annually.

Support for the "wider approach"

We strongly support the wider approach, which would allow NZFIs to treat non-residents of all jurisdictions as potentially reportable for CRS due diligence purposes.

We believe there is likely to be broad support for this approach. As noted earlier, the broad legislative framework needs to support the wider approach and override any other domestic legislation (e.g. privacy) which may conflict.

There are some design choices around what information NZFIs will provide to Inland Revenue.

While it would appear simplest for reporting NZFIs to report all non-resident account holders (not just those who have certified tax residence in AEOI participating countries or those who have not responded to self-certification requests) to Inland Revenue (who would then be responsible for filtering the information to be exchanged), we understand that support for such

an approach may not be universal. We understand that some NZFIs may prefer to only report account holders that are resident in AEOI reporting countries (even though they may collect residence information from all new customers). This would effectively make NZFIs the information "gate keepers".

We understand that Inland Revenue does not believe a dual reporting option is feasible, under the wider approach. The concerns of NZFIs who support the second reporting approach should be tested. If only a single reporting approach is feasible, the first approach should prevail, in our view.

Chapter 5 – detailed issues

We respond below to the detailed design questions:

Consultation question	KPMG comment
Should the CRS reporting period be based on a "tax year"?	We see merit in aligning the CRS and FATCA reporting periods. A 31 March reporting year-end would also align with existing withholding rules for RWT/NRWT. This would also allow a "quick check audit" by Inland Revenue – i.e. a payer of NRWT/AIL can be expected to report accounts for AEOI. Aligning the dates would mean that differences due to timing of reporting periods would not arise. False negatives would be reduced.
Should reporting NZFIs be able to file "nil" returns?	We support the ability for reporting NZFIs to file both nil CRS and FATCA reports to Inland Revenue. This would allow NZFIs to demonstrate compliance, when they have no accounts to report.
Should certain CRS terms be defined?	To the extent possible, CRS terminology should align with existing Income Tax definitions (for example, passive income should have the same definition as for RWT/NRWT purposes).
Should reporting NZFIs be allowed to treat all dollar amounts in the CRS being in NZ$?	We agree that NZFIs should have the option of using New Zealand dollar as the functional currency under the CRS. (However, we note that some NZFIs may prefer USD thresholds to mirror the approach under FATCA.)

Should there be a legislative requirement for reporting NZFIs to obtain and report foreign tax identification numbers and date of birth?	We do not support requiring NZFIS to obtain information they do not hold for pre-existing account holders, if this goes beyond the core CRS requirements. Refer also our earlier submission on the need to align customer due diligence under the CRS with the requirements for AML/CFT to mitigate compliance costs. The CRS should not impose additional CDD requirements to AML/CFT, other than in relation to foreign tax information. (That is, if NZ AML/CFT laws are FATF compliant, this should be sufficient for AEOI compliance.)
Should there be a legislative requirement for reporting NZFIs to obtain and reporting place of birth information?	Again, we do not support legislating a requirement that is in addition to the core CRS requirements. Further, it is not clear why specific domestic legislation would be required if the Multi-lateral Convention will give legal effect to AEOI and the CRS Standard.
Should reporting of average monthly balances or values of reportable accounts be a legislative requirement?	The reporting requirement should be aligned with FATCA. As that requires reporting of year-end (or account closing) balances, a similar approach should apply under the CRS.
Are legislative provisions required so that exchange traded reporting NZFIs are able to comply with their due diligence and reporting obligations under CRS where trades are facilitated by brokers?	We believe that legislative clarity would be useful. The extent of the issue is not clear to us however. We understand that FATCA compliance may be outsourced to a listed entity's registry provider (and they rather than the brokers, or the entity, are likely to undertake investor due diligence). We assume a similar approach would apply under the CRS.
Should reporting NZFIs be able to use third party service providers to fulfil due diligence and reporting obligations?	We support the ability to use third party service providers to fulfil the CRS due diligence and reporting obligations.
Should NZ resident controlling persons of passive NFEs be treated as reportable persons for domestic CRS purposes?	We see no reason, either under the CRS or domestic law, for reporting NZFIs having to also report the NZ resident controllers of passive NFE customers. This will add to compliance costs for no real gain.

Should reporting NZFIs be able to use classifications based on standard industry codes in their CRS due diligence on pre-existing accounts?	We agree that to the extent other regulatory requirements (such as AML/CFT or other KYC) requires disclosure of an industry code this could be one of the indicia that reporting NZFIs should be able to have regard to. However, this should be on a "no fault" basis if the classification is incorrect.
Should reporting NZFIs be able to use the residence address test for lower value pre-existing individual accounts?	We support the availability of the residence address test to establish the tax residence of a pre-existing account holder.
Should an expanded definition of "related entity" be legislated for the purposes of CRS due diligence to include related managed investment funds?	We support an expanded definition based on common management. This would reduce compliance costs for reporting NZFIs by allowing them to leverage pre-existing account due diligence procedures.
Should reporting NZFIs have the option to exclude pre-existing entity accounts with an aggregate account balance of US$250,000?	We support a threshold for reviewing pre-existing entity accounts under the CRS. As US$250,000 is also the FATCA due diligence threshold for reviewing pre-existing entity accounts, a similar level under the CRS is reasonable. (There should be the option to apply this threshold in NZD if desired.)
Should reporting NZFIs be able to apply new account due diligence procedures to pre-existing accounts and/or high value pre-existing account due diligence procedures to low value accounts?	We support the ability for NZFIs to undertake more comprehensive due diligence procedures for pre-existing accounts, if desired. However, this should be optional.
Should the definition of "pre-existing account" be expanded to include an additional account by a pre-existing customer?	We support a wider definition of "pre-existing account" to encompass new accounts opened by the same account holder. However, we note that, AML/CFT or other KYC requirements might require due diligence to be carried out anyway.
Should reporting NZFIs be able to treat a group cash value insurance contract as a non-reportable account	We support this approach in principle. However the practical implications of such an approach should be tested with NZFIs offering such products.

until amounts are payable to employees or beneficiaries?	
Should there be a phased implementation of reporting for "gross process" of custodial accounts?	We support a phased implementation of reporting under the CRS. Reporting of gross proceeds should be deferred to the 2020 reporting period to allow time for changes to NZFIs systems.
Should reporting NZFIs be allowed to report discretionary beneficiaries of a trust that is a passive NFF only when a trust has made a distribution in the period (instead of having to identify all discretionary beneficiaries as controllers)?	We have highlighted in our earlier submissions the differences in the proposed CRS and current AML/CFT requirements. There needs to be alignment and consistency of definitions across different KYC rules.
What are the dates that should be used in the grand parenting rule for certain bearer shares?	It is not clear to us which NZFIs issue bearer shares. Therefore, the practical benefits of grand parenting are difficult to gauge.