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Automatic Exchange of Information (AEOI) - Excluded Entities and Excluded Accounts Lists

Introduction

1. The New Zealand Law Society (Law Society) welcomes the opportunity to comment on entities and accounts that should be included on New Zealand's lists of other low risk "Non-Reporting Financial Institutions" (NRFIs) and "Excluded Accounts" for the purpose of implementing the Common Standard on Reporting and Due Diligence for Financial Account Information (the CRS).

Comments

Alignment with FATCA

2. As a general principle, the Law Society submits that the lists of NRFIs and Excluded Accounts for CRS purposes should, to the extent possible, be aligned with the categories of non-reporting financial institutions and non-reportable financial accounts for Foreign Account Tax Companies Act (FATCA) purposes. CRS and FATCA are both aimed at targeting offshore tax evasion through the exchange of financial account information, and the CRS was developed based on the FATCA Model 1 intergovernmental agreement. A standardised approach across the two regimes would maximise efficiency, reduce the scope for inadvertent non-compliance, and minimise compliance costs.

3. In saying that, the Law Society acknowledges that New Zealand's commitment to implement the CRS is, unlike the FATCA intergovernmental agreement which is a negotiated bilateral treaty, made under a multilateral agreement and that New Zealand's ability to formulate the lists of NRFIs and Excluded Accounts is constrained by the criteria set out in section VIII.B.1(c) and VIII. C.17(g) of the CRS respectively.

Non-Reporting Financial Institutions

4. There are several categories of entities that are treated as non-reporting financial institutions under the New Zealand/US intergovernmental agreement (the NZ IGA) for FATCA purposes, but are not NRFIs as defined in section VIII.B.1 of the CRS.

5. Some of these differences between FATCA and CRS may not have any practical effect bearing in mind the multilateral nature of CRS and the lack of registration requirements. There are, however, some categories that may currently be relied on by some entities for non-reporting

treatment under FATCA and whose omission from NRFI treatment under CRS could potentially have significant impact, such as:

5.1 treaty-qualified retirement funds (NZ IGA Annex II, section II.A), in particular KiwiSaver schemes;

5.2 Maori authorities (NZ IGA Annex II, section I.C);

5.3 organisations registered under the Charitable Trusts Act 1957 and donee organisations as defined in the Income Tax Act 2007 (NZ IGA Memorandum of Understanding); and

5.4 entities in New Zealand that manage or operate an employee stock option or employee share purchase plan and are not otherwise a financial institution (NZ IGA Memorandum of Understanding).

6. The Law Society submits that the above categories should be considered for inclusion in New Zealand's list of low risk NRFIs under section VIII.B.1(c) for the reason set out in paragraph 2.

7. The entities that are directly affected would be better placed to make detailed submissions on how they satisfy the criteria in the CRS. However, the Law Society makes the following comments in respect of paragraphs 5.1, 5.3 and 5.4 above.

Treaty-qualified retirement funds (paragraph 5.1)

8. In respect of retirement schemes that qualified as "treaty-qualified retirement funds" for FATCA purposes:

(a) retirement schemes under the Financial Market Conducts Act 2013 (FMCA) comprise registered schemes that are KiwiSaver schemes or superannuation schemes, workplace savings schemes, and Schedule 3 schemes;

(b) they are "investment entities" and therefore "financial institutions" under the CRS because they primarily conduct as a business the investing, administering or managing of financial assets or money on behalf of customers, or their gross income is primarily attributable to investing, reinvesting or trading in financial assets and they are managed by another entity that is a financial institution;

(c) they have substantially similar characteristics to the specific "Broad Participation Retirement Fund" and "Narrow Participation Retirement Fund" categories of NRFI described in Section VIII.B.1(b) in that:

- they are established to provide retirement, disability or death benefits to beneficiaries that are current or former employees (or persons designated by such employees) in consideration for services rendered;
- they are subject to government regulation by the Financial Markets Authority (FMA) under the FMCA;
- membership of KiwiSaver schemes, workplace saving schemes and Schedule 3 schemes are generally limited to New Zealand citizens and those entitled to live in New Zealand indefinitely;

- distributions or withdrawals are generally allowed only on the occurrence of specified events related to retirement, disability or death;

(d) but they may not come within the specific category of:

- "Broad Participation Retirement Fund" (further defined in Section VIII.B.5 of the CRS) because they are not tax-favoured, 50% or more of total contributions may come from persons other than sponsoring employers, and contributions by employees are not limited by reference to their earned income;

- "Narrow Participation Retirement Fund" (further defined in Section VIII.B.6 of the CRS) because employee and employer contributions are not limited by reference to earned income and compensation of employees;

(e) notwithstanding that they do not come within a specific category of NRFI in Section VIII.B.1, they present a low risk of being used to evade tax because:

- they are subject to regulation by the FMA under the FMCA;

- they are subject to anti-money laundering and 'know your customer' procedures, with limited exceptions;

- they are required to report information about account holders to Inland Revenue in relation to RWT/NRWT and, if they are a portfolio investment entity (PIE) (which most retirement schemes are), PIE tax liability. We note also that reporting will increase in both frequency and scope if the Government's proposals on the provision of investment income information (as set out in the July 2016 discussion document *Making Tax Simpler – Investment income information*) are implemented;

- they generally have narrow criteria for membership and restrictions on withdrawals and payments of benefits, which make them unlikely to be used as vehicles for tax evasion.

Charitable trusts and donee organisations (paragraph 5.3)

9. In respect of organisations registered under the Charitable Trusts Act 1957 and donee organisations as defined in the Income Tax Act 2007:

(a) they may be "investment entities" and therefore "financial institutions" if their gross income is primarily attributable to investing, reinvesting or trading in financial assets and they are managed by another entity that is a financial institution;

(b) for FATCA purposes, the Memorandum of Understanding to the NZ IGA states that they are treated as NFFEs that satisfy the requirements in Annex I, Section B.4(j) of the NZ IGA to be an "Active NFFE" (and therefore are not reporting financial institutions);

(c) they have substantially similar characteristics to the category of "Active NFE" described in Section VIII.D.7(h) of the CRS, which is the equivalent provision to Annex I, Section B.4(j) of the NZ IGA, in that:

- organisations registered under the Charitable Trusts Act 1957 must exist principally or exclusively for a charitable purpose, or a religious or educational purpose and donee organisations must be established for charitable, benevolent, philanthropic or cultural purposes within New Zealand;

- they do not have any shareholders or members who have a proprietary or beneficial interest in their income or assets;

- the laws of New Zealand do not permit any of their income or assets to be applied for private pecuniary profit;

- on dissolution, the assets of donee organisations must be distributed to a charitable organisation and held for charitable, benevolent, philanthropic or cultural purposes in New Zealand and the surplus assets of organisations registered under the Charitable Trust Act 1957 must be disposed of as directed by the High Court;

(d) donors to donee organisations are eligible for tax credits on cash donations but donee organisations do not come within the definition of "Active NFE" in Section VIII.D.7(h) of the CRS because they are not exempt from income tax in New Zealand (unless they are also registered as a charitable entity under the Charities Act 2005);

(e) organisations registered under the Charitable Trusts Act 1957 also do not come within the definition of "Active NFE" in Section VIII.D.7(h) of the CRS because they do not have any specific tax concessions;

(f) they pose a low risk of being used to evade tax because they can only be established for charitable, education or religious purposes (in the case of organisations registered under the Charitable Trusts Act 1957) and charitable, benevolent, philanthropic or cultural purposes (in the case of donee organisations) and cannot be used for private pecuniary profit. In addition, Inland Revenue approval is required for donee organisations.

Entities that manage or operate employee stock option or share purchase plans (paragraph 5.4)

10. In respect of entities in New Zealand that manage or operate an employee stock option or employee share purchase plan and are not otherwise a financial institution:

(a) they may be "investment entities" and therefore "financial institutions" by virtue of primarily conducting as a business the investing, administering or managing of the plan shares on behalf of participants;

(b) they may also be "custodial institutions" and therefore "financial institutions" by virtue of holding the plan shares on behalf of participants as a substantial portion of their business;

(c) for FATCA purposes, the Memorandum of Understanding to the NZ IGA states that they are treated as NFFEs that satisfy the requirements in Annex I, Section B.4(i) of the NZ IGA to be an "Active NFFE" (i.e. are "excepted NFFEs" as described in the US Treasury Regulations) and therefore are not reporting financial institutions;

(d) employee stock option and employee share purchase plans pose a low risk of being used to evade tax because membership is restricted to employees and the quantum of assets held under those plans are inherently limited by the plan rules and employees cannot voluntarily contribute to such plans;

(e) accordingly, entities that manage or operate such plans and that are "financial institutions" solely as a result of their involvement in such plans also pose a low risk of being used to evade tax.

Excluded Accounts

11. As with NRFIs, the Law Society notes that there are several categories of financial accounts that are treated as excluded accounts under the NZ IGA for FATCA purposes, but are not Excluded Accounts as defined in section VIII.C.17 of the CRS. The Law Society also notes that the CRS contemplates that dormant accounts may be included by jurisdictions on their lists of Excluded Accounts. The Law Society will, however, leave any submissions on the inclusion of the above accounts on New Zealand's list of Excluded Accounts to be made by those financial institutions that are affected should they wish to do so.

12. From the Law Society's perspective, the only comment it wishes to make on the list of Excluded Accounts is that the list should include an account established in connection with legislation. Such accounts are excluded for FATCA purposes under the exclusion for escrow accounts in Annex II, section V.E.1 of the NZ IGA. Although the FATCA exclusion for escrow accounts is substantially similar to paragraph (e) of the Excluded Account definition in Section VIII.C.17 of the CRS, the CRS definition does not cover accounts established in connection with legislation.

13. The Law Society submits that accounts established in connection with legislation inherently present a low risk of being used to avoid tax and should be treated as Excluded Accounts in line with the general principle of achieving consistency between FATCA and CRS to the extent possible.

Conclusion

14. This submission was prepared by the Law Society's Tax Law Committee. If you wish to discuss this further, please do not hesitate to contact the committee convenor Neil Russ, through the committee secretary Jo Holland (04 463 2967 / jo.holland@lawsociety.org.nz).

Yours faithfully

Kathryn Beck
President