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Regular commentary from our experts on topical tax issues

Issue 1

Automatic exchange: account information and tax rulings

Snapshot

Last week Inland Revenue released a discussion document on implementing automatic exchange of information (AEOI). New Zealand financial institutions will need to report foreign account holders to countries that have also signed up to AEOI. (97 countries have signed up so far.) This is modelled on the US Foreign Account Tax Compliance Act (FATCA). AEOI requirements will apply to New Zealand financial institutions from 1 July 2017, with the first reporting due in mid-2018.

Inland Revenue has also confirmed that it will automatically and retrospectively exchange tax rulings. Inland Revenue will share details of all private taxpayer rulings and unilateral transfer pricing rulings, in effect as at 2014. The exchange will be with countries who have signed tax agreements with New Zealand. (NZ has over 50 tax treaties and tax information exchange agreements.) This will mean foreign tax authorities will now have access to businesses' commercial information provided in support of rulings. This could have an adverse impact on the demand for rulings going forward.

Both changes were recommended as part of the OECD's Base Erosion and Profit Shifting (BEPS) work.

A key concern is how confidentiality will be maintained by other tax authorities. They may not have the same stringent secrecy safeguards as Inland Revenue. The risk is that commercially sensitive information becomes public or is misused by a tax authority.

This could impact the demand for rulings, which are an important source of certainty for taxpayers.

Contact us

John Cantin
Partner
T: +64 4 816 4518
E: jfcantin@kpmg.co.nz

Darshana Elwela
National Tax Director
T: +64 9 367 5940
E: delwela@kpmg.co.nz

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What are the proposed changes?

Implementing AEOI

In October 2014, the Government announced that New Zealand would sign-up to global AEOI with effect from 2018 (for reporting in 2019). The discussion document covers New Zealand's implementation. Importantly, the document announces the NZ start date as 1 July 2017, for mid-2018 reporting. This is a six month advance on the previously announced start date.

Is AEOI new?

Not really. It is based on the US FATCA regulations, which New Zealand has applied since 1 July 2014. Under FATCA, New Zealand financial institutions must report on the financial account holdings of US citizens/residents and US controlled entities.

What is AEOI and who and how will it impact?

New Zealand financial institutions must report the financial assets and income of account holders resident in other AEOI-participating countries. (This includes NZ resident entities controlled by non-residents.) All G20 and OECD countries have signed up to AEOI, and many others have also done so. At current count, New Zealand financial institutions will have almost 100 different jurisdictions to report.

A financial institution is broadly defined. It includes depositary institutions (e.g. banks), custodians, investment funds and some insurers. But it may also capture private NZ companies and trusts. This will depend on how they are structured, what they invest in, and how they are managed. The FATCA experience suggests that determining an entity's status will not always be straight forward.

Account holders, both resident and non-resident, can expect further queries as New Zealand financial institutions implement AEOI.

So AEOI is the globalisation of FATCA?

Yes and no. There are a number of important differences:

- FATCA requires reporting of US citizens – one of the US's tests of tax residence. AEOI is based on tax residence, which is more difficult to determine. This means that proxies for tax residence must be used.
- FATCA has reporting thresholds. There are no such limits proposed under AEOI.
- The definitions of "financial institution" and "financial account" are slightly different.
- The information to be exchanged by the US under FATCA is less than the information to be exchanged by AEOI countries. Other countries are treating the US as a non-participating country, for AEOI purposes.
- AEOI does not have penalty withholding tax rates for non-participating financial institutions. (FATCA has a 30% withholding penalty on US sourced payments.)

How will AEOI be implemented in NZ?

From 1 July 2017, New Zealand financial institutions must determine the tax residence of their customers for new financial accounts. The first reports will be due by mid-2018, for the first exchange of information on 30 September.

For accounts opened before 1 July 2017, financial institutions must check their existing account holder information for residence information.

What about taxpayer confidentiality?

AEOI will override New Zealand's privacy legislation. Account holders will not know if their information has been reported or exchanged. However, Inland Revenue can

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John Cantin
Partner
T: +64 4 816 4518
E: jfcantin@kpmg.co.nz

Darshana Elwela
National Tax Director
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E: delwela@kpmg.co.nz

suspend AEOI with another country if there is substantial non-compliance with information confidentiality and data safeguards.

So will FATCA and AEOI be aligned?

At this stage, there are no indications that the two regimes will be aligned. As noted above, there are some material differences between the two. In the short term, at least, there may be duplication of processes.

Some other (initial) thoughts…

New Zealand's implementation of AEOI has been well signalled. However, financial institutions may be surprised at the earlier implementation date. A 1 July 2017 start date means enacting legislation will need to be passed this year.

AEOI is both similar and different to FATCA. While due diligence obligations will be the same, the questions to be asked will be different. On-boarding processes will need to be adapted accordingly. Reporting thresholds will also differ.

AEOI raises the stakes for financial institutions and account holders to get it right. FATCA non-compliance, arguably, raises concerns with just NZ and the US. Non-compliance with AEOI raises concerns with almost 100 countries.

A key question for financial institutions is the ability to perform consistent due diligence processes across all customers, not just those who are resident in countries that have signed up to AEOI. There will be efficiencies in being able to do due diligence only once.

The 'Big Picture'

AEOI compliance is another piece in financial institutions' compliance puzzle to correctly identify their clients. These requirements range from anti-money laundering rules to existing non-resident withholding tax requirements. Each of these "know your client" regimes appears to be developed in isolation and overlaps. For example, the existing reporting of non-residents' investment income should already provide part of the picture. There is a clear case to rationalise and integrate these requirements. This will be doubly important if Inland Revenue moves to a real-time withholding tax system for investment income under Business Transformation.

Exchange of tax rulings with foreign tax authorities

Inland Revenue has announced it will start providing:

- transfer pricing rulings including unilateral advance pricing agreements (APAs);
- rulings which unilaterally downward adjust New Zealand taxable profits;
- permanent establishment rulings; and
- related party conduit rulings

to relevant partner countries from 2016.

New Zealand will not provide rulings on preferential tax regimes. This is because New Zealand is not considered to have any (or at least any which have been classified as harmful).

The exchange applies to tax rulings issued on or after 1 January 2010 and still in effect from 1 January 2014.

Why is this happening?

New Zealand has signed up to the OECD's recommendation to exchange tax rulings. This is part of the move to counter harmful tax practices. It is designed to give tax authorities greater flexibility to identify and swiftly move against such structures.

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Partner
T: +64 4 816 4518
E: jfcantin@kpmg.co.nz

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National Tax Director
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Who will this affect?

This will impact New Zealand businesses that have received private tax rulings from, or negotiated unilateral APAs/transfer pricing agreements with, Inland Revenue that were in effect as at 2014.

What does it mean for business?

Foreign tax authorities will now have access to businesses' commercial information. One of the concerns is how taxpayer confidentiality will be maintained by other tax authorities. They may not have the same stringent secrecy safeguards as Inland Revenue. The risk is that commercially sensitive information becomes public or is misused by a tax authority. The drivers for unilateral rulings can include such concerns.

This is important because the OECD's recommendations for mandatory arbitration, to resolve disputes, is not accepted by many countries. This suggests that some may use the information received to advance their case rather than follow the global rules.

The Inland Revenue announcement does not allow for concerns, particularly with the retrospective nature of the exchange, to be addressed.

Feedback and actions

Inland Revenue has asked for feedback on the detailed design of the AEOI implementation by 31 March. Assuming there is no opportunity to object, the focus for financial institutions should be on what will make implementation as efficient as possible. Avoiding duplication will be a key issue.

AEOI will result in additional queries. Account holders should focus on the rules for determining their status and confirming their compliance with the rules, both here and offshore.

There appears to be no opportunity to provide feedback on exchange of tax rulings by Inland Revenue. Instead, business will need to focus on rulings issued here and offshore to answer the expected inquiries.

For further information

John Cantin
Partner, Tax
Wellington
Phone: +64 4 816 4518
Email: jfcantin@kpmg.co.nz

Darshana Elwela
National Tax Director
Auckland
Phone: +64 9 367 5940
Email: delwela@kpmg.co.nz

kpmg.com/nz
twitter.com/KPMGNZ