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Policy and Strategy
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Automatic Exchange of Information (AEOI) – Draft Guidance

1. The New Zealand Law Society (Law Society) appreciates the opportunity to comment on Inland Revenue's *Draft Guidance on the Automatic Exchange of Information* (Guidance), released in December 2016.

Introduction and summary

2. The Law Society welcomes the release of the Guidance and efforts made by Inland Revenue to support and assist the New Zealand financial institutions (NZFIs) tasked with implementing the Common Reporting Standard (CRS).
3. In order to ensure that the Guidance is a useful and complete resource for taxpayers, it needs to be comprehensive, clear in meaning and practical in its application. While the current draft achieves these aims on a number of fronts, the Law Society considers that there is scope to improve aspects of the Guidance.
4. The Law Society's comments address the following matters in the Guidance:
 - A. New account due diligence: Validating self-certifications;
 - B. New entity account due diligence: Identifying whether the entity is a Reportable Person;
 - C. New entity account due diligence: Identifying whether the entity has any controlling persons that are Reportable Persons;
 - D. Due diligence: Treating a new account as a pre-existing account;
 - E. Solicitors' trust accounts; and
 - F. Other miscellaneous matters.

Comments

A. *New account due diligence: Validating self-certifications*

5. For both individual and entity accounts opened on or after 1 July 2017 (new accounts), a Reporting NZFI needs to obtain a self-certification of the account holder's residence(s) for tax purposes. This must be obtained "upon account opening" or on "day one" (being the day that Reporting NZFI takes the first steps to materially progress the account opening process).¹
6. If the Reporting NZFI cannot obtain a valid self-certification upon account opening, then it must decline to open the account. As part of "validating" the self-certification, a Reporting NZFI must confirm its reasonableness based on the information it has obtained in connection with the opening of the account. It is contemplated by the OECD that this validation process can be completed on "day two" (where it is not possible for the process to be undertaken on day one because it is a process undertaken by a back office function of a Reporting NZFI).
7. We envisage that this will be a reasonably common scenario, particularly given that the validation process turns on information collected during account opening (i.e., information collected on day one). For this reason, in the Law Society's view, it is important that the Guidance clearly set out the steps a Reporting NZFI may take while validation of a self-certification is pending.

Recommendation

8. The Law Society recommends that the Guidance clearly provides that the Reporting NZFI may proceed with opening a new account where it has obtained a self-certification on day one, even if it has not yet tested the reasonableness of this self-certification. In this event, the reasonableness and validity of the self-certification will be confirmed within 90 days of the account opening process.
9. The Guidance should also state what a Reporting NZFI must do if it establishes that a self-certification is potentially unreliable. This issue is touched on in Example 5 of Paragraph 5.4 of the Guidance (on pages 68 – 69) where Inland Revenue states that the Reporting NZFI would be expected to ask further questions to determine whether or not the self-certification is reliable. The Law Society suggests that this example should also describe what the Reporting NZFI must do if it cannot validate the self-certification, even after further enquiry. In particular, it should clarify whether the Reporting NZFI is obliged to close the account or if the Reporting NZFI needs to treat (and report on) the account as an undocumented account.

B. *New entity account due diligence: Identifying whether the entity is a Reportable Person*

10. Reporting NZFIs are required to conduct due diligence in respect of an entity account opened on or after 1 July 2017 in accordance with Section VI of the CRS. Stage 1 of this due diligence process involves determining whether the entity is a foreign tax resident. To do this, the Reporting NZFI needs to:

¹ Paragraph 5.4.2 of the Guidance.

- (a) obtain a self-certification that allows it to determine the account holder's residence for tax purposes and confirm the reasonableness of that self-certification based on information obtained in connection with opening the account; and
 - (b) if the self-certification indicates that the account holder is resident in a Reportable Jurisdiction, treat the account as being a reportable account unless the Reporting NZFI reasonably determines (based on information in its possession or that is publicly available) that the account holder is not a Reportable Person.
11. The above steps appear in this order in Section VI(A)(1) of the CRS and are repeated in the Guidance at paragraph 5.6.1. Under this approach a Reporting NZFI must always first obtain a self-certification in respect of a new entity account. However, in contrast, the OECD Commentary permits a Reporting Financial Institution to apply the steps above in the order most appropriate in the circumstances.²
12. Being able to apply these due diligence steps in the order most appropriate in the circumstances is likely to be beneficial to a number of Reporting NZFIs. In particular, the approach mandated by the OECD will mean that a Reporting NZFI does not need to obtain a self-certification from an entity that is known not to be a Reportable Person.
13. For example, if an entity:
- (a) has its stock listed and regularly traded on an established stock exchange;
 - (b) is a known Governmental Entity;
 - (c) is a Financial Institution (based on information that is publicly available, including the IRS' published Foreign Financial Institution (FFI) list); or
 - (d) is registered under the Charitable Trusts Act 1957 and Charities Act 2005;
- the Reporting NZFI will be able to determine that the entity is not a Reportable Person without needing to obtain a self-certification.

Recommendation

14. Given the significant benefit to Reporting NZFIs in being able to apply the steps outlined above in the order most appropriate in the circumstances, the Law Society suggests that the availability of this approach be specifically set out in the Guidance at paragraph 5.6.1. Specific incorporation in the Guidance ensures that all Reporting NZFIs have the best possible chance of being fully aware of their obligations and options. Realistically, it is unlikely that all Reporting NZFIs would otherwise be aware of this choice.

C. *New entity account due diligence: Identifying whether the entity has any controlling persons that are Reportable Persons*

² See paragraph 6 of the OECD Commentary on Section VI. See also Figure 17 and paragraph 166 of the OECD's implementation handbook.

15. Stage 2 of the due diligence to be performed by a Reporting NZFI in respect of a new entity account is to identify whether the entity is a passive non-financial entity (NFE) and, if it is a passive NFE, whether it has any controlling persons that are relevant foreign tax residents. In this regard, the Guidance states (at paragraph 5.6.3) that for the purposes of determining the controlling persons of a passive NFE account holder, a Reporting NZFI should adopt the same procedures outlined at paragraph 5.5.3 of the Guidance for pre-existing entity accounts. This in turn states that to identify the controlling persons of a passive NFE, a Reporting NZFI may rely on information collected or maintained pursuant to anti-money laundering/know your client (AML/KYC) Procedures.
16. While this approach correctly reflects the requirements of the CRS, it will be difficult for Reporting NZFIs to apply in practice in relation to new entity accounts, as a Reporting NZFI will only possess the AML/KYC information required to identify controlling persons after the passive NFE account applicant has completed the relevant application forms. The Reporting NZFI must then analyse this information before seeking self-certifications for these people from the account applicant. This may be a slow process and add further costs and delays to the account opening process.
17. Instead, in many cases, it will be more practical for the Reporting NZFI to request that a passive NFE account applicant lists its controlling persons, and provides self-certifications for those persons, as part of the initial account opening process.

Recommendation

18. The Guidance should allow Reporting NZFIs to request that an account applicant provide a list of its controlling persons as an alternative to the Reporting NZFI identifying these persons itself. The Guidance should also confirm that Reporting NZFIs may rely on any such list provided by an account applicant.

D. Due diligence: Treating a new account as a pre-existing account

19. The CRS permits Reporting NZFIs to treat new accounts as pre-existing accounts in certain circumstances (referred to at paragraph 5.3.1 and footnote 52 of the Guidance). The ability to apply this approach may be significant for some Reporting NZFIs, as by treating a new account as a pre-existing account, the Reporting NZFI may no longer need to obtain a self-certification from the account holder and can instead rely on information held or that is publicly available.
20. One of the requirements to applying this approach is that the opening of the financial account does not require the account holder to provide new, additional or amended customer information (other than for the purposes of the CRS). It is not entirely clear what is meant by “customer information”. For example, if the Reporting NZFI uses the new account request as an opportunity to confirm or update customer details, it is not clear whether this will be viewed as the account holder being required to provide new customer information such that the account is no longer eligible to be treated as a pre-existing account.
21. This rule may also affect umbrella account structures under which an existing account holder maintains various sub-accounts on behalf of different persons. Such account structures may be used by entities involved in the administration of investments for and on behalf of

customers. In this case, from the Reporting NZFI's perspective, the listed account holder and customer for each sub-account will be the custodial entity. If the account holder opens a new sub-account and the Reporting NZFI requires the account holder to specify who that account is held for, it is unclear whether this will be a provision of "customer information" (despite the information provided not relating to the account holder itself).

Recommendation

22. The Guidance should provide examples of when a Reporting NZFI will be able to treat a new financial account as a pre-existing account and what will amount to the provision of new customer information.

E. Solicitors' trust accounts

23. The Law Society welcomes the approach taken to solicitors' trust accounts in the Guidance which mirrors the agreed approach in relation to the Foreign Account Taxation Compliance Act (FATCA). However, it is desirable that certain additional points in relation to solicitors' trust accounts be addressed in the Guidance.
24. In particular, a Reporting NZFI bank will need to obtain a self-certification for each interest-bearing deposit account (IBDA) held in the name of the law firm that is opened on or after 1 July 2017. Given that the bank is required to treat each client IBDA "as if it was a depository account directly made by the client" (paragraph 11.2.4.3), the self-certification will need to be made by the law firm's client (rather than the law firm). This should be clearly stated in the Guidance.
25. The Law Society also suggests that law firms be permitted a 90 day window to obtain self-certifications from their clients and provide these to the Reporting NZFI bank. In the interim, the Reporting NZFI bank should be permitted to open the IBDA. This approach is similar to treating the new IBDA as a change of circumstances (i.e. the ultimate account holder, being the law firm, is still the same but there is a change to whom it is beneficially holding funds for). It also recognised that there may be a delay between a law firm receiving funds and being able to obtain the necessary self-certifications on behalf of the Reporting NZFI bank (particularly in the case of passive NFE trust clients) which may conflict with the lawyer's duty to ensure that client moneys earn interest wherever practicable.

Recommendation

26. The Law Society recommends that paragraph 11.2.3.4 of the Guidance be expanded to cover how a Reporting NZFI bank will carry out account due diligence in respect of IBDA's in practice and to address the points discussed at paragraphs 23 - 25 above.

F. Other miscellaneous matters

Trusts, due diligence: Reasonable safeguards and procedures to determine whether a distribution has been made

27. A specified discretionary beneficiary of a passive NFE trust will generally be a controlling person of the trust. This is subject to the Reporting NZFI choosing to treat the beneficiary as a controlling person only if they receive a distribution in the reporting period. A Reporting NZFI that adopts this approach will need to have reasonable safeguards and procedures in place to determine when such a distribution has been made. The Guidance suggests (on page 129) that this could include a Reporting NZFI having an arrangement with the trustee (possibly in the account terms and conditions) that the trustee will inform the Reporting NZFI when it has made such a distribution. The Law Society agrees that the approach suggested in the Guidance is pragmatic but suggests that it be explicitly stated that a Reporting NZFI (that has sought such an undertaking from the trustee) does not need to do anything more as part of its obligation to put in place “reasonable safeguards and procedures”. For example, the Reporting NZFI does not need to monitor debits from the financial account or make enquiries of the trustee.

Correction at paragraph 5.6.2

28. The words “pre-existing” should be removed from the first line of paragraph 5.6.2.

Conclusion

29. 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