

The Treasury

Budget 2013 Information Release

Release Document

July 2013

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Chair
Cabinet External Relations and Defence Committee

Foreign Account Tax Compliance Act (FATCA)

PROPOSAL

1. This paper seeks agreement to submit an expression of interest to the United States to enter into a treaty-level intergovernmental agreement (IGA) for the purposes of the Foreign Account Tax Compliance Act (FATCA). This paper also seeks agreement to enter into negotiations with the United States on an IGA and that Inland Revenue be the lead agency and assume primary responsibility, with the Minister of Revenue, for the negotiation of an IGA. [1]

EXECUTIVE SUMMARY

2. FATCA was enacted in 2010 by the United States (the US) to combat tax evasion by US citizens. To achieve this, FATCA requires foreign financial institutions (FFIs), including banks, life insurers and managed funds, to provide details relating to US citizens' accounts to the US's Internal Revenue Service (IRS). Financial institutions that do not enter into an agreement with the IRS will face a 30% US withholding tax on US-sourced payments.

3. New Zealand's financial institutions have expressed significant concerns about the compliance burden imposed by FATCA. Further, complying with FATCA requirements may be in conflict with domestic legislation such as the Privacy Act 1993 and the Human Rights Act 1993.

4. Some of the concerns about FATCA may be addressed by New Zealand entering into an IGA with the US. This would build on New Zealand's existing information-exchange arrangements with the US under the *Convention between New Zealand and the United States for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* of 1982 (the DTA).

5. The key difference between having an IGA in place and "unabridged FATCA" is that, with an IGA, financial institutions would not need to provide the information on US citizens' accounts separately to the IRS. Instead, they would provide the information to the tax department of their own country (in New Zealand, this would be Inland Revenue), and that tax department would exchange the information with its counterparts in the IRS. In addition, a number of other FATCA requirements would be relaxed under an IGA – for example, there

would be extended deadlines for providing information. For these reasons, entering into an IGA with the US is the very strong preference of New Zealand's financial institutions.

6. There are two further advantages of entering into an IGA. Under an IGA, the IRS should provide Inland Revenue with useful information about New Zealand residents' US accounts. Entering into an IGA also provides the opportunity for countries to negotiate an annex of low-risk schemes and institutions (such as KiwiSaver schemes) that would be exempt from having to comply with FATCA requirements. However, the US has signalled that, aside from this annex and small technical changes to suit the New Zealand context, the IGA text is non-negotiable.

7. A number of countries have already expressed interest in concluding an IGA, including Australia, France, Germany, Spain, Switzerland and Japan. The United Kingdom finalised its IGA with the US in September 2012.

8. We propose that the New Zealand Government lodge an expression of interest with the US to enter into an IGA. This would be in the form of a letter from the Minister of Finance to his counterpart in the US, US Treasury Secretary Timothy Geithner. Such an expression of interest would not bind New Zealand to conclude an IGA, but would be a clear signal of New Zealand's interest and would allow discussions to begin.

9. Entering into an IGA would have administrative impacts for Inland Revenue, including system implications. The scale of these impacts, including the resource and funding implications, is not yet fully understood. If Ministers agree to lodge an expression of interest to enter into an IGA, Inland Revenue will carry out a feasibility analysis for implementing these changes.

[1]

11. To provide a clear indication to the financial sector of how the Government intends to respond to FATCA, we propose that the Minister of Revenue issue a press statement once New Zealand's expression of interest has been lodged with the US [1]

BACKGROUND

12. FATCA was enacted by the US in 2010. Its purpose is to combat tax evasion by US citizens through the use of offshore financial accounts. FATCA requires foreign financial institutions (FFIs) to enter into an agreement with the IRS to identify US account holders and report specific information relating to these account holders on an annual basis. The information to be exchanged includes the account holder's US Taxpayer Identification Number (TIN), account number, account balance, and income.

[1]

13. The introduction of the FATCA requirements involves a staggered process, with FFIs having the ability to register with the IRS from 1 January 2013, and full implementation of the regulations expected in 2017.

14. The definition of an FFI is broad and includes banks, insurance companies and managed funds. The US does not have jurisdiction over non-US financial institutions. FFIs that do not fulfil their obligations under FATCA are deemed to be non-participating and face a withholding tax of 30% on US-sourced payments. Account holders who have not provided the information required under FATCA (so-called “recalcitrant” account holders) are also subject to a 30% withholding tax. If the account continues to be “recalcitrant”, the FATCA rules would require the FFI to close it.

15. New Zealand’s financial industry has expressed strong concerns about FATCA, including the heavy compliance burden that it imposes. Further, complying with certain FATCA requirements may be in conflict with domestic legislation such as the Privacy Act 1993 and the Human Rights Act 1993. There is also no provision under New Zealand law to allow FFIs to withhold tax from recalcitrant account holders.

16. If FATCA were to apply to New Zealand financial institutions in its unabridged form, it would cause major disruption and impose significant costs. The main costs would be in the following areas:

- the complex enquiries that would be necessary to determine whether existing account holders were US citizens or, if the account holder is an entity, whether the entity has a substantial owner that is a US citizen
- the need to eventually close accounts of existing customers that did not respond adequately to the enquiries (so-called recalcitrant account holders)
- complex changes to IT systems that would be necessary to identify data of US account holders that is currently not required to be exchanged
- the need to withhold tax on certain recalcitrant account holders and other financial institutions that did not cooperate
- the risk that low-risk retirement schemes (most notably KiwiSaver schemes) would be subject to FATCA
- the need to enter into a separate information-exchange agreement with the US (as well as the existing exchange of information channel with the Inland Revenue)
- the risk that complying with FATCA requirements would result in a breach of New Zealand domestic law (e.g. the Privacy Act 1993 or the Human Rights Act 1993).

17. Some of these concerns about FATCA may be addressed by New Zealand entering into an IGA with the US. The IGA would be a bilateral treaty and would build on New Zealand’s existing information-exchange provisions in article 25 of the DTA. The US signalled the IGA approach as an alternative to “unabridged FATCA” in a joint press release with France, Germany, Italy, Spain and the United Kingdom in February 2012. Further details of the IGA approach were provided in July this year when the US released two alternative model IGAs. The US has since reported that approximately 40 other countries have signalled their interest in negotiating an IGA, including Australia.

18. The two alternative IGA models that countries can adopt are referred to as the model 1 IGA and the model 2 IGA. The key difference between them is that under a model 2 IGA the FFI would exchange the information directly with the IRS, rather than via the tax department in the FFI's own country. A model 2 IGA is likely to be more suitable for countries in which legal and other difficulties would arise if existing exchange-of-information channels were used. It is understood that Japan and Switzerland are considering a model 2 IGA. It should be noted that the US has indicated that a model 2 IGA is an interim solution only, and countries adopting this approach would be expected to transition into a model 1 IGA over the medium term.

19. Because of the temporary nature of the model 2 IGA, the discussion in this Cabinet paper focuses on the model 1 IGA.

COMMENT

20. The key difference between having an IGA in place and "unabridged FATCA" is that, with an IGA, financial institutions would not need to provide the information separately to the IRS. Instead, they would provide the information to the tax department of their own country (in New Zealand, this would be Inland Revenue), and that tax department would exchange the information with its counterparts in the IRS.

21. An IGA provides a number of other benefits, so is the very strong preference of New Zealand financial institutions. The benefits include:

- removing the requirement to withhold tax from recalcitrant account holders and non-complying FFIs
- giving extended deadlines for providing certain information
- removing the risk that FFIs would be in breach of domestic law
- giving New Zealand the opportunity to negotiate a list of low-risk schemes and institutions (such as KiwiSaver) that would be exempt from FATCA.

22. Countries operating under a model 1 IGA would likely receive additional benefits over those operating under a model 2 IGA. That is, if New Zealand were to enter into a model 1 IGA, the US would be required to reciprocate and provide Inland Revenue with information about New Zealanders with accounts in US financial institutions on an automatic basis. This information would go beyond what is already exchanged under the DTA and would be valuable for New Zealand in enforcing its tax laws and supporting the integrity of the tax system, through better data matching and identification of taxpayers.

23. While not removing all the costs associated with FATCA, a model 1 IGA has the potential to reduce many of them. The main savings are as follows:

- removal of the requirement to close down the accounts of recalcitrant customers (though financial institutions would still be required to make many of the same enquiries on whether existing account holders are US citizens)
- extension of the deadlines for when particular types of data need to be exchanged
- removal of withholding tax obligations
- the ability to exempt low-risk New Zealand retirement schemes (most notably KiwiSaver schemes) from FATCA

- utilisation of the existing information-exchange channel with the Inland Revenue, instead of entering into a separate agreement with the IRS
- removal of the risk that complying with FATCA would cause financial institutions to be in breach of New Zealand domestic law.

24. For these reasons, we recommend that Cabinet agrees to New Zealand making a formal expression of interest to the US to enter into an IGA. This would be in the form of a letter from the Minister of Finance to his counterpart in the US, US Treasury Secretary Timothy Geithner. As there are still a number of details to work through (in particular, systems implications for Inland Revenue), the expression of interest would be on a strictly no-commitments basis. It would, however, strongly indicate to the US that New Zealand is interested in an IGA.

25. All indications suggest that the US is not envisaging that countries substantially negotiate the main text of either IGA model as would normally occur with a DTA. Essentially, entering into the model 1 IGA would be on a “take it or leave it” basis. However, it is likely that technical amendments to reflect the New Zealand context may be possible, provided they do not change the substance of the IGA provisions. The only substantive aspect of the IGA that appears realistic for New Zealand to negotiate is the New Zealand-specific list of low-risk schemes and institutions that would be exempt from FATCA. We recommend, therefore, that Cabinet agree that officials enter into negotiations with the US on technical aspects of the main IGA text and to determine which low-risk schemes and institutions will be exempt from having to comply with the FATCA requirements.

26. We recommend that Inland Revenue be the lead agency and assume primary responsibility, with the Minister of Revenue, for the negotiation of an IGA. This is because the IGA concerns exchange of information by Inland Revenue and builds on the existing DTA.

Timeframes

27. The FATCA legislation will be in force from 1 January 2013. However, the first obligation that financial institutions face under FATCA is to register with the IRS by 30 June 2013. Ideally, to give New Zealand’s financial institutions a clear indication of the Government’s response to FATCA, an IGA should be entered into by 1 January 2013. This timeframe is, however, very tight. The next best approach would be to ensure that the IGA was completed but not necessarily in force in early 2013 or, at the latest, by 30 June 2013.

Other issues

28. Officials are still considering the implications of some aspects of the model 1 IGA. There are a few key points to note:

- Certain aspects of the IGA would require New Zealand to amend its domestic law. For example, under the model 1 IGA, New Zealand would undertake to amend its domestic law so that New Zealand’s financial institutions would require US customers to provide a US TIN. If any of these amendments to domestic law give rise to privacy or human rights concerns, officials will consult with the Office of the Privacy Commissioner or the Ministry of Justice as appropriate.

- Officials are envisaging that such amendments to domestic law may relate to all foreign tax residents, not just US citizens.
- A number of technical and interpretive issues arise under the model 1 IGA. Officials are seeking clarification on these points from US officials.

29. Entering into an IGA would have administrative impacts for Inland Revenue, including system implications. The scale of these impacts, including the resource and funding implications, is not yet fully understood. Inland Revenue's work programme has a number of significant projects currently underway, including major deliverables in 2012 and 2013 for student loans and Budget 2012, as well as reforms in child support in 2013 and 2014. Depending on scale, the resource implications of implementing FATCA requirements may require a review of priorities in Inland Revenue's work programme.

30. Inland Revenue is also managing significant fiscal pressures over the next few years, including investment into transformation initiatives, self-funding other policy initiatives and the escalating costs of supporting aging technology infrastructure. Inland Revenue is not in a position to absorb further costs and will likely seek funding for both operating and capital costs. As a consequence, Inland Revenue could be subject to the Treasury Better Business Case requirements, depending on the scale of change required to support an IGA.

31. If Ministers agree to lodge an expression of interest to enter into an IGA, Inland Revenue will carry out a feasibility analysis for implementing these changes. This will provide a high-level view of the resources and funding required and will in turn determine whether the proposed changes will be subject to the Better Business Case requirements.

[1]

Next steps

31. If Cabinet agrees, the Minister of Finance will lodge an expression of interest with his US counterpart, US Treasury Secretary Timothy Geithner, to enter into a model 1 IGA. This would allow IGA discussions with the US to begin. Officials will then report back to the Minister of Finance and the Minister of Revenue later this year on progress with the IGA discussions.

[1]

33. We further propose that, [1]

the Minister of Revenue issue a press statement announcing that New Zealand has expressed interest in entering into discussions to conclude an IGA with the US, and that an officials/private-sector joint working group is formed to work on FATCA issues. This would give some certainty to the industry.

34. Officials will continue working on the impact a model 1 IGA would have on Inland Revenue's information systems. Officials will report back to the Minister of Finance and the Minister of Revenue on this once this work has been completed, including the estimated administrative costs.

35. Officials will also work closely with the financial industry and other stakeholders on FATCA issues. This work will include working out how information will be exchanged between financial institutions and Inland Revenue and the types of low-risk schemes (including KiwiSaver schemes) that should be exempted from having to comply with FATCA requirements.

CONSULTATION

36. The Ministry of Foreign Affairs and Trade and the Ministry of Business, Innovation and Employment have been consulted, and their views are fully reflected in this Cabinet paper.

FINANCIAL IMPLICATIONS

37. There are no financial implications from the proposals in this Cabinet paper.

38. Officials are working through the administrative and information systems impacts of an IGA, and will report back with any associated costs.

HUMAN RIGHTS

39. The proposals in this Cabinet paper have no human rights implications.

LEGISLATIVE IMPLICATIONS

40. The proposals in this Cabinet paper do not have any legislative implications.

41. If New Zealand concludes an IGA, this will have treaty status. Legislative changes may be required for its implementation.

REGULATORY IMPACT ANALYSIS

42. A Regulatory Impact Statement is not required, on the basis that the regulatory implications arising from the IGA negotiations are largely consistent with existing policy. A National Interest Analysis will be prepared when the IGA is presented to Cabinet for consideration.

GENDER IMPLICATIONS

43. This paper has no gender implications.

DISABILITY PERSPECTIVE

44. This paper does not require a disability perspective.

PUBLICITY

45. We propose that, [1] the Minister of Revenue issue a press statement announcing that New Zealand has expressed its interest in entering into an IGA with the US. The press statement will also announce the establishment of an officials/ private sector working group to work on FATCA issues.

RECOMMENDATIONS

46. It is recommended that Cabinet:

1. **Note** that the United States has enacted the Foreign Account Tax Compliance Act (FATCA), which requires foreign financial institutions to provide certain information to the Internal Revenue Service.
2. **Note** that concluding a bilateral treaty-level intergovernmental agreement (IGA) with the United States will relieve some of the burdens of the FATCA for New Zealand's financial institutions.
3. **Agree** that the Minister of Finance lodge New Zealand's expression of interest with his counterpart in the United States, Treasury Secretary Timothy Geithner, in New Zealand entering into a model 1 IGA with the United States for the purposes of FATCA.
4. **Note** that the United States has indicated that the main text of the IGA is not open for substantive negotiation (although technical amendments to reflect the New Zealand context may be possible).
5. **Note** that the only part of the model 1 IGA text that is open for substantive negotiation is the annex containing the low-risk schemes and institutions that will be exempt from having to comply with the FATCA requirements.
6. **Agree** that officials enter into negotiations with the United States on technical aspects of the main IGA text and to determine which low-risk schemes and institutions will be exempt from having to comply with the FATCA requirements.

7. [1]

8. **Agree** that the Minister of Revenue issue a press statement announcing that New Zealand has lodged an expression of interest with the United States. The press statement will also announce the establishment of an officials/private-sector working group to work on FATCA issues.

9. **Note** that an IGA gives rise to systems issues for Inland Revenue and that officials are looking at the fiscal implications of potential systems changes.

10. **Note** that officials will work closely with the private sector and other agencies on a number of details, including the low-risk schemes and institutions (most notably KiwiSaver) that should be exempted from the requirements of FATCA under an IGA.

Hon Bill English
Minister of Finance

____ / ____ / ____
Date

Hon Peter Dunne
Minister of Revenue

____ / ____ / ____
Date