

The Treasury

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- [12] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage
- [13] Not in scope
- [14] 6(e)(iv) - to damage seriously the economy of New Zealand by disclosing prematurely decisions to change or continue government economic or financial policies relating to the entering into of overseas trade agreements.

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

Chair
Cabinet Business Committee

FOREIGN ACCOUNT TAX COMPLIANCE ACT IMPLEMENTATION

Proposals

1. I seek the agreement of the Cabinet Business Committee to Inland Revenue's preferred solution for implementing and administering the United States' Foreign Account Tax Compliance Act (FATCA) requirements.
2. This includes Inland Revenue's obligations set out in the specific treaty known as the Intergovernmental Agreement (IGA). The negotiation of the IGA was approved by the Cabinet External Relations and Defence Committee in October 2012 (ERD Min (12)8/1, CAB Min (12) 37/5 refers). [1]
3. Legislation enabling New Zealand financial institutions (NZFIs) to comply with their IGA obligations was approved by Cabinet on 30 September 2013 (CAB Min (13) 34/10 refers). This legislation now forms part of the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill, currently being considered by the Finance and Expenditure Committee.
4. Inland Revenue is seeking funding for the costs associated with implementing the FATCA changes through Budget 2014. A single stage business case has been prepared and is attached to this paper.
5. The funding sought through the Budget 2014 Package Cabinet paper on 14 April will allow for the implementation of the preferred option outlined in the business case.

Executive summary

6. The purpose of the single stage business case attached to this paper is to support consideration by Cabinet of Inland Revenue's preferred solution to implement the FATCA legislation and IGA requirements.
7. The implementation of FATCA has significant implications for Inland Revenue. Under the IGA, Inland Revenue will be the named "competent authority" and, as such, will act as an intermediary, receiving data from NZFIs and passing this on to the US Internal Revenue Service (IRS).

8. [8]

[8]

9. Inland Revenue must deliver a solution which meets requisite standards with respect to data storage, security and transfer as well as providing compliance support to the IRS.

10. Inland Revenue is unable to fund the implementation and administrative costs arising from FATCA out of its existing baseline, so has prepared the attached single stage business case for Cabinet's consideration. Appropriation of funding will be sought through the Budget 2014 Package Cabinet paper on 14 April.

11. Inland Revenue is confident, on the basis of the information currently available, that the analysis and plans outlined in the business case are robust, and that the FATCA changes can be delivered successfully, on time, and within budget.

12. Inland Revenue identified and evaluated a long list of options against set criteria. The following three options were short listed:

- Option 1: A fully automated system.
- Option 2: A system under which financial institutions are offered a channel choice.
- Option 3: A single channel web browser file upload service.

13. Option 2 is the preferred solution as outlined in the business case and is supported by Treasury.

14. The indicative cost for delivering the preferred solution is \$11.805 million over five years from 2013/14 to 2017/18, with an ongoing cost of \$1.760 million per annum from 2018/19 (both figures include depreciation and capital charges). This includes costs already incurred as part of developing this proposal.

Background

15. FATCA was enacted in 2010 by the United States (US) to combat tax evasion by US citizens. To achieve this, FATCA requires foreign financial institutions (FFIs), including banks, life insurers and managed funds, unless exempted, to provide it with details every year relating to the accounts of "US persons". Financial institutions that do not enter into an agreement with the IRS will face a 30% US withholding penalty on US-sourced payments. New Zealand financial institutions will, unless exempted, be subject to FATCA in this regard.

16. To ease the compliance burden on FFI's the United States has undertaken to negotiate bilateral intergovernmental agreements (IGAs) with willing countries. Under an IGA, the information required by the US would be centrally collected (in New Zealand's case, by Inland Revenue) and then forwarded onto the IRS, rather than FFIs having to enter into direct agreements with the IRS.

17. The Cabinet External Relations and Defence Committee has agreed to the negotiation of an IGA between New Zealand and the US (ERD Min (12)8/1, CAB Min (12) 37/5 refers). The IGA has now been agreed between officials of New Zealand and the United States, and I anticipate seeking Cabinet's approval to its terms in the near future. Ideally, the IGA will be signed prior to 24 April, being the last date that FFI's can register with the IRS to be in the first tranche of deemed compliant FFI's. This "first list" will be published around 1 July.

18. The New Zealand financial industry is strongly supportive of New Zealand entering into an IGA with the US. Inland Revenue has been working closely with private sector representatives via a joint FATCA working group to address any issues, including working on guidance for affected parties, addressing concerns with the implementation of FATCA and consultation on the form of enabling legislation.

19. The IGA is a reciprocal agreement, with the US undertaking to provide information on New Zealand accounts maintained with US financial institutions.

20. In order to fully implement FATCA (and any agreed IGA) domestically, New Zealand will amend its tax legislation to explicitly provide for both the collection of the relevant information from individuals and also for that information to be passed onto Inland Revenue. The domestic legislation was approved by Cabinet on 30 September 2013 (CAB Min (13) 34/10 refers) and now forms part of the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill, currently being considered by the Finance and Expenditure Committee.

21. [8]

Impact of implementing FATCA on Inland Revenue

22. The implementation of FATCA has significant implications for Inland Revenue. Under the IGA, Inland Revenue will be the named “competent authority” that will receive data from reporting NZFIs and pass this on to the IRS.

23. The data required to be passed to the IRS will be held separately but alongside Inland Revenue’s existing tax information and, when required by the IGA, all information received from NZFIs will be transferred to the IRS. The data is required to be kept separate in an operational store to meet Public Records Act 2005 requirements and Organisation for Economic Co-Operations and Development (OECD) standards for security and use of data.

24. The solution to be implemented to facilitate FATCA requirements will need (at a minimum) to allow:

- NZFIs to file data with Inland Revenue in a secure environment;
- NZFIs to make changes to submitted data as required;
- Inland Revenue to securely store data received from NZFIs;
- Inland Revenue to transfer data to the US at least on an annual basis;
- Inland Revenue to provide compliance support as appropriate to the IRS; and
- Inland Revenue to receive reciprocal data from the IRS on New Zealand residents investing in the US.

25. In this context, it is important to note that the “schema” (the form and code for the electronic transfer) is being set by the US Internal Revenue Service so that it receives all information from partner jurisdictions in a form it can readily process. The relevant systems will therefore need to conform with those US standards to both receive data from NZFIs and transfer it to the US.

26. Inland Revenue will need to support the business and process changes that arise from FATCA; specifically there will be additional customer contacts as a result of the change. Initial assessments indicate that this additional workload will be minimal and will not require additional staff as a result.

The preferred solution for implementing FATCA

27. Inland Revenue is confident, based on the information currently available to it, that the analysis, preferred solution and implementation plans outlined in the attached business case are robust. In preparing the business case it has complied with all of the relevant business case requirements, including engaging with the State Services Commission and the Government Chief Information Officer and the Department of Internal Affairs to ensure the proposed solution is in line with the All of Government strategy.

28. Inland Revenue identified and evaluated a long list of options against set criteria, in order to provide a short list of options that had merit for further analysis. The short-listed options were then assessed against each other in terms of cost/benefit analysis and specific evaluation criteria.

29. The following three options were short listed:

- Option 1: B2B Gateway – allows for unlimited NZFIs and multiple jurisdictions to exchange data automatically with Inland Revenue, but this option is seen as wider than the delivery of FATCA and comes with a number of operational and delivery risks. Although this option has been identified as part of Inland Revenue’s future infrastructure, it did not present as the preferred option as it cannot be delivered in the required timeframe. The additional appropriation necessary to implement this option (incl. depreciation expenses, capital charges and contingency) is \$20.5 million.
- Option 2: Channel Choice – offers two channels for NZFIs to exchange data, either by a self-service web browser file upload or a semi-automated B2B technology solution. The additional appropriation necessary to implement this option (incl. depreciation expenses, capital charges and contingency) is \$11.805 million.
- Option 3: Single Channel – allows for NZFIs to exchange data using a self-service web browser file upload but may be unacceptable for some larger NZFIs that require an automatic exchange of data. Also, this option does not allow for future growth and agility. The additional appropriation necessary to implement this option (incl. depreciation expenses, capital charges and contingency) is \$10.8 million.

30. The business case recommends Option 2 - Channel Choice as the preferred solution for the following reasons:

- There is a high confidence that this solution can be delivered within the required FATCA timeframe.

- It provides NZFIs with a choice of channel technology that suits their existing technology capabilities.
- It reduces the implementation risk as the solution:
 - is fit for purpose based on currently known information and volumes;
 - uses existing Inland Revenue ICT knowledge and capabilities; and
 - is not dependent on an external provider.
- It maximises value for money given that Inland Revenue cannot realise any monetary benefits.
- It meets the current needs of FATCA exchange of information as well as providing for a higher level of security than Option 3.

31. This preferred solution, as outlined in the business case, is supported by Treasury.

32. It is noted that the Cabinet paper that sought approval for the legislation that will enable financial institutions to comply with the IGA suggested that the estimated whole of life cost for the various options ranged between \$5.667 and \$8.543 million (paragraph 11, CAB Min (13)34/10 refers). These figures are still accurate because the “whole of life cost”, as defined by the Cabinet Office circular *Capital Asset Management in Departments and Crown Entities: Expectations*, specifically excludes depreciation expenses and capital charges. However, the appropriation figures used in this report include those amounts and the appropriate contingency.

Assumptions and key risks

33. The key assumptions that have been made in the development of the business case are:

- There will be a concluded IGA between the countries by 1 July 2014.
- New Zealand domestic legislation changes will take effect from 1 July 2014.
- The business case scope and cost estimates are based on the IRS’ data and exchange requirements and may be impacted if the IRS change their requirements.
- Inland Revenue’s BT programme of work does not materially affect the scope and priority of this project, and Inland Revenue’s best information to date suggests that the design of FATCA is not inconsistent with the architectural approaches that are being considered for the transformation.

34. Inland Revenue’s FATCA obligations are to be ready to receive information from financial institutions with reportable accounts at least on an annual basis starting April 2015 or as prescribed in legislation. The data will be stored and submitted to the IRS by 30 September each year. Inland Revenue’s first reporting year to the IRS will be 2015.

35. There is a risk that the IRS may extend the implementation date and the project may incur additional project costs as a result of any such delay. At this late stage it is considered that this risk is small, and statements from the US Treasury appearing to confirm a 1 July 2014 start date support this conclusion. In any event, the contingency cost includes funds to accommodate a reasonable delay of up to three months.

36. The business case scope and cost estimates are based on the IRS’ data and exchange requirements to build the IRS FATCA capability as required by the IGA. There is a risk that the scope and cost may be impacted if the IRS changes their requirements. The recent *G-20 Communique Following Feb. 22-23 Meetings in Sydney* also suggests that there is an expectation that New Zealand will soon be involved in broader information exchange using the “Common Reporting Standard”, based on FATCA and being developed by the OECD.

However, because of the relative uncertainty surrounding the scope and timing of that initiative, costs for its implementation are excluded and Inland Revenue will request additional Government funding when required.

37. It is not considered that the preferred option carries significant ICT risks for Inland Revenue because it uses existing technologies. Similarly, given Inland Revenue already receives information from financial institutions in respect of domestic taxes, and transfers the relevant information to the United States under existing exchange of information protocols, it is not considered there are significant risks associated with inadvertent release of personal data.

Financial implications

38. There are no Crown Revenue impacts arising from the implementation of FATCA.

Administration costs

Cost recovery option

39. Inland Revenue did consider a cost recovery model for these changes, under which financial institutions would contribute to Inland Revenue's implementation costs. This would be on the basis that the financial institutions are the primary beneficiaries of the Government's decision to enter into an IGA with the United States.

40. However, a cost recovery model was ultimately not considered appropriate. The main reasons for this conclusion are:

- The IGA is reciprocal, so Inland Revenue will also get some information on New Zealand taxpayers from the United States.
- Not entering into an IGA could have implications for all New Zealanders, not just financial institutions.
- Financial institutions are already bearing significant compliance costs associated with FATCA implementation.
- An appropriate cost apportionment model would be difficult, especially given that the financial institutions that stand to benefit most would be those specifically exempted from FATCA reporting.

Decisions required in Budget 2014

41. Through Budget 2014, Inland Revenue will be seeking the funding required to implement and administer its preferred solution to FATCA. This amounts to \$11.805 million over the five year forecast period of 2013/14 to 2017/18, and \$1.760 million per annum from 2018/19 (both figures include depreciation and capital charges). The five-year cost of \$11.805 million includes operating costs of \$6.684 million (including depreciation and capital charge) and capital cost of \$4.941 million. This includes costs already incurred from July 2013 through March 2014 as part of developing this proposal. The cost forecast for 2013/14 is \$2.712 million which includes operating cost of \$0.590 million and capital cost of \$2.122 million.

42. Inland Revenue has completed a detailed assessment of administrative and organisational impacts of the FATCA changes to determine the expected implementation and

on-going costs. Inland Revenue is confident, on the basis of information currently available to them, that these estimates are robust.

43. A quantitative risk analysis (QRA) of the expected total costs (based on Inland Revenue's base estimate of costs) has been conducted to quantify the risks and uncertainty associated with the implementation.

44. A key outcome of QRA exercises is to associate different levels of cost estimates with different probability levels of occurrence. The current practice for projects of this size and complexity is to seek appropriation at the 85% probability level. Under this approach, the Commissioner of Inland Revenue (Commissioner) is initially only authorised to approve spending up to the 50% probability level; if further funding is required, approval has to be sought from the Minister of Revenue and the Minister of Finance (Joint Ministers) to access the remainder of the funding up to the 85% probability level. This approach is proposed for the FATCA funding.

45. In the case of FATCA, the estimated 85% probability level coincides with an estimate of \$11.805 million for the one-off implementation costs and \$1.760 million per annum for the on-going costs (both these figures include depreciation and capital charges). Of these amounts, it is proposed that implementation costs of \$11.156 million and on-going costs of \$1.634 million per annum will be placed at the disposal of the Commissioner, being estimates which correspond to the 50% probability level. It is also proposed that the difference between the two sets of amounts, specifically implementation costs of \$0.649 million and on-going costs of \$0.126 million, will be set aside as a contingency delegated to the Joint Ministers to approve.

46. The estimated costs, and the proposed Commissioner's and Joint Ministers' contingencies are set out in the table below:

COSTS (\$m)	2013/14	2014/15	2015/16	2016/17	2017/18	Five Year Total	2018/19 & Outyears
Capex	2.122	1.485	0.483	-	-	4.090	-
Opex	0.576	0.595	0.557	-	-	1.728	-
Project Cost	2.698	2.080	1.040	-	-	5.818	-
Ongoing Cost (Opex)	-	-	-	0.161	0.167	0.328	0.165
Total Cost	2.698	2.080	1.040	0.161	0.167	6.146	0.165
Depreciation	0.014	0.028	0.505	0.830	0.830	2.207	0.830
Capital charge	-	0.229	0.308	0.327	0.327	1.191	0.327
Total ex Contingency	2.712	2.337	1.853	1.318	1.324	9.544	1.322
Capex – Commissioner's Contingency	-	0.664	-	-	-	0.664	-
Opex – Commissioner's Contingency	-	0.948	-	-	-	0.948	0.312
Total Commissioner's Contingency	-	1.612	-	-	-	1.612	0.312
Total incl Commissioner's Contingency	2.712	3.949	1.853	1.318	1.324	11.156	1.634
Capex – Joint Ministers' Contingency	-	0.187	-	-	-	0.187	-
Opex – Joint Ministers' Contingency	-	0.462	-	-	-	0.462	0.126
Total Joint Ministers' Contingency	-	0.649	-	-	-	0.649	0.126
Total incl All Contingency	2.712	4.598	1.853	1.318	1.324	11.805	1.760

47. The contingency levels estimated in the QRA exercise are based on the overall uncertainty levels for the project as a whole and are not year-specific as it is impossible to

accurately determine how much should be placed into any individual year. Appropriating the contingency into 2014/15 would decrease the likelihood that Inland Revenue would require subsequent Cabinet approval to make timing adjustments to appropriations. The contingency funding will be reviewed on an annual basis to confirm the proportion of the unused contingency to be carried forward or released to the Crown.

Human rights implications

48. The proposals in this paper have no human rights implications. The potential Human Rights Act implications on FATCA and the IGA more generally were discussed in the Cabinet papers associated with the Cabinet minute CAB Min (13) 34/10.

Legislative implications

49. There are no legislative implications arising from this paper, as the legislative amendments necessary to implement the IGA have already received Cabinet approval (CAB Min (13) 34/10 refers).

Regulatory impact analysis

50. A Regulatory Impact Statement (RIS) titled *Legislation to enable compliance with an intergovernmental agreement between the United States and New Zealand* was prepared for the Foreign Account Tax Compliance Act (United States): Enabling Legislation Cabinet paper considered by Cabinet on 30 September 2013 (CAB Min (13) 34/10 refers).

Gender implications

51. The proposals in this paper have no gender implications.

Disability perspective

52. The proposals in this paper have no disability implications.

Publicity

53. No additional publicity with respect to the attached business case is necessary other than that already scheduled to take place with regard to the IGA and implementing legislation.

Consultation

Comment from the Treasury

54. Treasury has reviewed the business case, and can confirm that it meets the Better Business Case requirements for a single stage business case. Treasury agrees that Option 2 – Channel Choice reflects the most appropriate response to the FATCA legislation and IGA requirements. Not only is it, on balance, the most cost-effective option, but it also maximises

the ability of NZFIs to comply, by delivering the solution within FATCA timeframes, using proven technologies, and by providing NZFIs with two channels to exchange the required data.

55. Treasury supports Inland Revenue's recommendation that funding is sourced from outside its baseline. Requiring Inland Revenue to fund this project from within baselines provides a false economy. Inland Revenue is currently undertaking a business transformation process to achieve Inland Revenue's aspirations and to keep delivering what New Zealand needs. Inland Revenue has already set aside a significant amount of funding from its baseline to contribute to this transformation. Any significant reprioritisation within Inland Revenue's baseline, in order to fund the preferred option, would likely be offset by a reduction in Inland Revenue's planned contributions to its business transformation programme.

56. Treasury is comfortable that options for cost recovery have been sufficiently explored, and agrees that a cost recovery model is not appropriate in this case.

Recommendations

57. I recommend that Cabinet:

Background and policy

1. **Note** that the United States' Foreign Account Tax Compliance Act (FATCA) was enacted in 2010 by the United States (US) to combat tax evasion by US citizens.
2. **Note** that, on 17 October 2012, the Cabinet External Relations and Defence Committee approved the negotiation of an intergovernmental agreement (IGA) with the US with regard to FATCA [ERD Min (12)8/1 and CAB Min (12) 37/5 refer].
3. [1]
4. **Note** that, on 30 September 2013, Cabinet approved amendments to domestic tax legislation to explicitly provide for the collection of FATCA-relevant information for that information to be passed onto Inland Revenue [CAB Min (13) 34/10 refers] and this legislation now forms part of the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Bill, currently being considered by the Finance and Expenditure Committee.
5. **Note** that implementing and administering FATCA requirements, including Inland Revenue's obligations set out in the IGA, will have significant impacts on Inland Revenue who will become the intermediary for data transfer between New Zealand financial institutions and the United States' Internal Revenue Service (IRS).
6. **Note** that, as Inland Revenue is seeking funding for the costs associated with implementing the FATCA changes through Budget 2014, a single stage business case has been prepared and is attached to this paper.
7. **Note** that Inland Revenue identified and evaluated a long list of options against set criteria and the following three options were short listed:
 - 7.1. **Option 1: B2B Gateway** – allows for unlimited NZFIs and multiple jurisdictions to exchange data automatically with Inland Revenue but this option

is seen as wider than the delivery of FATCA, and comes with a number of operational and delivery risks. The additional appropriation necessary to implement this option (includes depreciation expenses, capital charges and contingency) is \$20.5 million.

- 7.2. **Option 2: Channel Choice** – offers two channels for NZFIs to exchange data with Inland Revenue either by a self-service web browser file upload or a semi-automated B2B technology solution. The additional appropriation necessary to implement this option (includes depreciation expenses, capital charges and contingency) is \$11.805 million.
- 7.3. **Option 3: Single Channel** – allows for NZFIs to exchange data using a self-service web browser file upload but may be unacceptable for some larger NZFIs that require an automatic exchange of data. Also, this option does not allow for future growth and agility. The additional appropriation necessary to implement this option (includes depreciation expenses, capital charges and contingency) is \$10.8 million.

8. **Agree** that Option 2 is the preferred solution as outlined in the business case.
9. **Note** that there is a risk that the IRS may extend the implementation date and the project may incur additional project costs as a result of the delay; and that the contingency cost includes funds to accommodate a reasonable delay of up to three months.
10. **Note** that there is a risk that Inland Revenue may be required, in due course, to expand the exchange of information to include other OECD jurisdictions; and that the scope and cost for this requirement are excluded from the business case.

Administration costs

11. **Note** that implementing these changes carries a five-year cost of \$11.805 million (including depreciation and capital charge), from 2013/14 to 2017/18, which includes cost already incurred from July 2013 through March 2014.
12. **Note** that the cost forecast for 2013/14 is \$2.712 million which includes operating cost of \$0.590 million and capital cost of \$2.122 million.
13. **Note** that the five-year cost of \$11.805 million in recommendation 11 includes operating costs of \$6.864 million (including depreciation and capital charge) and capital costs of \$4.941 million.
14. **Note** that there is also an ongoing annual operating cost of up to \$1.760 million (including depreciation and capital charge), starting from 2018/19.
15. **Note** that funding for the costs in recommendations 11 and 14 is being sought through the Budget 2014 Package Cabinet paper on 14 April.

16. **Note** that these costs include an appropriate level of contingency, with some funding that will require approval by the Commissioner and some that will require approval by the Joint Ministers, as outlined in the table below:

Details	\$m increase/(decrease)						
	2013/14	2014/15	2015/16	2016/17	2017/18	Five Year Total	2018/19 & Outyears
Estimated costs	2.712	2.337	1.853	1.318	1.324	9.544	1.322
Contingency subject to the Commissioner of Inland Revenue's approval	-	1.612	-	-	-	1.612	0.312
Contingency subject to approval of the Joint Ministers	-	0.649	-	-	-	0.649	0.126
Total appropriation	2.712	4.598	1.853	1.318	1.324	11.805	1.760

17. **Note** that Inland Revenue is also seeking to establish the approvals in recommendation 16 through the Budget 2014 Package Cabinet paper on 14 April.

Hon Todd McClay
Minister of Revenue

/ / 2014