Intergovernmental tax transparency arrangements create clear risks for accountants

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At a glance

+ New Zealand tax residents are generally required to pay tax on their worldwide income, even if they do not bring it into New Zealand or another country has already deducted tax.
+ By improving the flow of information across borders, intergovernmental tax transparency agreements and treaties increase the risk of professional negligence claims against accountants.
+ These risks also affect accountants who solely provide accounting and tax compliance services, as well as those who act as trustees or advisors.
+ There are several steps accountants can take to help mitigate these risks.

Foreign assets

Many New Zealand individuals and businesses have strong ties to other countries, including overseas family members, offshore properties and overseas investment income. These may be New Zealanders who have spent years working abroad accumulating assets before returning home to raise families or retire, or foreign nationals who have immigrated to New Zealand and have overseas assets.

New Zealand tax residents are generally required to pay tax on their worldwide income, even if they do not bring it into New Zealand and the other country or territory has deducted tax at source. Worldwide income includes rental income from a property overseas, interest from an offshore bank account, and dividends or deemed foreign investment income from a portfolio of overseas shares.

Until relatively recently, many New Zealand tax residents have not paid tax on their overseas assets. This was in part due to New Zealand's self-assessment tax system and Inland Revenue's lack of access to overseas information. This failure was often unintentional, stemming from a taxpayer's mistaken belief following compliance with foreign tax obligations, or from mistaken advice or assurances they had received from overseas accountants.

Over the last few years, this information gap has started to be plugged with more foreign agencies and governments now actively sharing information with Inland Revenue.

International obligations / standards

New Zealand is a member of the Organisation for Economic Co-operation and Development (**OECD**). For many years, the OECD has promoted international cooperation in tax matters through the exchange of information. It has established the standard for the effective exchange of information.

Through the double tax agreements, tax information exchange agreements and the multilateral convention, New Zealand agrees with other countries to a range of information exchanges including:

- **Exchange of land data** – New Zealand exchanges information obtained from Land Information New Zealand with treaty partners and receives similar information from other treaty partners.
- **Common Reporting Standard (CRS)** – The CRS requires jurisdictions to obtain information from their financial institutions and automatically exchange that information with other jurisdictions annually. Currently, there are well over 100 jurisdictions that have committed to this initiative on international tax transparency. New Zealand has successfully exchanged CRS information around the world since September 2018.
- **Exchange of information on request** – These are exchanges where information is requested from, or by, a treaty partner regarding a specific taxpayer or transactions.
- **Spontaneous exchange of information** – These are exchanges where information is proactively provided by treaty partners. For example, if Inland Revenue comes across potential cross-border issues through its local compliance work, it will refer the matter to the other jurisdictions involved.

Risks for accountants

These global information exchange programs create risks for accountants and have resulted in several professional negligence claims. There are broadly two typical situations where claims arise. The first is the non-disclosure of foreign assets or trusts, which can be either innocent or intentional. The second is the disclosure of the foreign trusts to the accountant, but where the taxpayer instructs their accountant not to worry about them as another accountant in the foreign jurisdiction is dealing with them.

Inland Revenue will subsequently receive notification of the existence of foreign bank accounts through the CRS and may subsequently discover overseas assets or a non-complying trust. This can result in taxpayers needing to pay additional taxes, 'use of money' interest, and penalties, as well as the additional costs of preparing voluntary disclosures and negotiating with Inland Revenue. In many instances, the taxpayer seeks reimbursement for these costs from their accountant.

Claims often involve allegations that the accountant did not ask about the foreign assets or explain that they might need to take into account their foreign income.

Mitigating the risks

There are steps that accountants can take to help protect themselves from this risk, including ensuring:

- engagements are clearly defined, including what is included and excluded
- annual questionnaires include detailed questions about foreign assets and trusts, including any beneficial interests and what constitutes an asset
- potential risks and hazards are raised with any client that has foreign assets and/or trusts, and, if the client does not want to take any action, recording the provision of advice and instruction not to act, and
- expert input is sought if they are unfamiliar with the foreign tax or trust issues. There are firms who provide specialist assistance to accountancy firms in this space.

Finally, accountants who are trustees or advisors need to be vigilant about an overseas trust's tax classification. This is because the residency of the trust for tax purposes is determined by the residence of the settlor – not the residency of the trustee.

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If you would like further information about, or guidance on, any of the issues discussed in this article, get in touch with our authors.

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