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Government Inquiry: Foreign Trust Disclosure Rules

20 May 2016

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Mr John Shewan
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Dear John

Government Inquiry: Foreign Trust Disclosure Rules

Thank you for inviting us to make a submission to the Government Inquiry into the foreign trust disclosure rules.

Preliminary comments

New Zealand's current rules for the taxation of trusts have been in place since 1988. The rules were introduced at least in part to prevent New Zealand tax residents using trusts with non-resident trustees to shelter income from New Zealand tax. The fundamental basis of the approach to taxing trusts in New Zealand is to focus on the settlor. Trustee income, derived from New Zealand and foreign sources, is subject to income tax if a settlor of the trust is a tax resident of New Zealand. Conversely, foreign sourced trustee income derived by New Zealand resident trustees is not subject to New Zealand income tax if the settlor was a non-resident at the time of settlement and has remained a non-resident. In the latter case the trust is treated as a "foreign trust". The tax treatment of foreign sourced income derived by trustees of a foreign trust is consistent with New Zealand's policy objective of not taxing foreign sourced income derived by a non-resident.

New Zealand's rules for taxing trusts are principled, fit for purpose and appropriate. We do not support any change to the settlor based approach to taxing trusts. The focus of the Inquiry is appropriately on the disclosure rules that apply to foreign trusts and not on the substantive tax rules that apply to the taxation of trusts.

Although New Zealand's trust taxation rules are fit for purpose, the foreign trust disclosures that were introduced in 2006 could now be perceived as being inadequate. This does not surprise us given that globally there has been a shift in attitudes to disclosure of information and tax secrecy in the intervening decade. Many governments and much of the public now appear to have an increasing expectation of higher degrees of tax transparency. The most obvious manifestation of that change in expectations is reflected in the work being undertaken by the OECD and G20 in relation to base erosion and profit shifting. Accordingly it is against that background that the current disclosure rules for foreign trusts need to be assessed and our comments are made in that context.

The Inquiry should be mindful that most trusts are set up for genuine purposes, such as philanthropy, inheritance, the protection of vulnerable people and the support of family members. Caution will be required if changes made to the disclosure rules have negative implications for all trusts.

Our submissions in response to the specific questions you have asked are as follows:

1. ***Are the existing foreign trust disclosure rules adequate to ensure New Zealand's reputation as a country that co-operates with other jurisdictions to deter abusive tax practices is maintained?***

The OECD reports that jurisdictions with which New Zealand has exchange of information obligations generally consider New Zealand to be an exceptional 'exchange of information' partner[1].

However, we believe there is a risk that New Zealand's reputation as a country that co-operates with other jurisdictions to deter abusive tax practices could be compromised by the foreign trust disclosure rules. This is principally because the rules require the automatic disclosure of very limited information only (the name of the trust, the identity of the trustees and, if relevant, the trustees' membership of an approved organisation), which could be perceived as being inadequate.

The fact that the current rules do not require the disclosure of information about the settlor(s) of a foreign trust and their country of residence is likely to mean that it is difficult both for Revenue Authorities in other countries to identify New Zealand foreign trusts (about which they are, or could be, interested in requesting information from Inland Revenue) and for Inland Revenue to comply with information requests it does receive. A foreign Revenue Authority may have information about a settlor resident in their country but not have information about the New Zealand foreign trust or the trustees. In order to ask for information about a New Zealand foreign trust the other jurisdiction first has to have knowledge that the foreign trust exists. Inland Revenue is likely to have access to information about the New Zealand trustees only and not to know the identity of the settlor(s). This 'information asymmetry' is likely to make it more difficult for other countries to enforce their laws and for New Zealand to detect and prevent the abuse of the rules.

The difficulty in detecting and preventing abuse of the rules does not apply in the case of foreign trusts settled by Australian residents. This is because of the changes made to the disclosure requirements in 2006, which require a resident foreign trustee to indicate whether a settlor of a foreign trust is an Australian resident. We note that the rules also require disclosure of any alteration to 'particulars', which, in the case of a foreign trust settled by an Australian resident, would require disclosure of any subsequent additional settlors within 30 days of the trustee becoming aware of the change. The disclosure requirements were changed to enable New Zealand to meet its exchange of information obligations with Australia and, in particular, because Australia was concerned that New Zealand foreign trusts were being used to avoid Australian tax. Currently, when a resident foreign trustee indicates that a settlor of a foreign trust is an Australian resident, Inland Revenue routinely provides the disclosed information to the Australian Taxation Office (ATO).

The Australian Income Tax Assessment Act 1936 contains a number of provisions which effectively

[1] Global Forum on Transparency and Exchange of Information for Tax Purposes: Peer reviews: New Zealand 2011, OECD, p 76.

prevent Australian residents from using New Zealand foreign trusts to avoid Australian tax. We presume the effectiveness of the Australian legislation is buttressed by the information shared by Inland Revenue.

2. ***Concerns have been raised that foreign trusts may be used as vehicles to hide investments that might not have a legitimate source. Do you consider that the existing anti-money laundering/countering foreign terrorism (AML/CFT) legislation is able and sufficient to address such concerns?***

In our view the existing anti-money laundering /countering foreign terrorism legislation may not be sufficient to ensure foreign trusts are not used as vehicles to hide investments that may not have a legitimate source.

Trust or company service providers ("TCSPs") are reporting entities under the AML/CFT legislation so have to collect, verify and retain information on the beneficial ownership[2] and control of a trust. In addition, they must have systems, procedures and controls in place to lower the risk of their business being used by criminals to launder money or finance terrorism. Accordingly, the use of a TCSP as a trustee should lessen the likelihood of a foreign trust being used to hide investments that may not have a legitimate source.

However, the AML/CFT legislation does not currently apply to lawyers and accountants who routinely establish trusts on behalf of their clients. Hence, lawyers and accountants do not have obligations that require them to collect, verify and retain information on the beneficial ownership and control of a trust. Obviously this would be addressed once the AML/CFT rules applied to these groups. In the meantime they are generally subject to (lesser) obligations under the Financial Transactions Report Act 1996, which do oblige them to report suspicious transactions and carry out basic customer due diligence.

Bank accounts and financial assets of a foreign trust are unlikely to be located in New Zealand, which means that any additional comfort that could be provided by scrutiny by New Zealand institutions under their AML/CFT procedures is not provided. Instead the comfort is provided by other countries' financial institutions – those which are the source of funds for the trust or by those which are invested in by the trust. This is a global issue which is addressed by the relevant global forum and Financial Action Task Force (FATF) compliance reviews of individual countries. If a trustee has applied the AML/CFT rules and that trustee is regulated by New Zealand we do not see a need to involve other New Zealand financial institutions.

We anticipate the introduction of the second phase of the AML/CFT reforms, which are likely to introduce obligations for other business and professions, such as lawyers and accountants, will alleviate some of these problems.

3. ***If 'no' to either of the above questions, is this because the law is not adequate or because the enforcement is not sufficiently rigorous?***

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[2] For a trust, the beneficial owners may include: Trustees and any other individual who has effective control over the trust or specific trust property or has the power to amend the trust's deeds,or remove or appoint trustees. This might include a protector or special trustee (if there are any) or one or more of the beneficiaries of the trust. AML/CFT Customer Due Diligence – Trusts, FMA, RBNZ, Internal Affairs, April 2013

We have answered 'no' to both of the above questions because we consider the current disclosure and AML/CFT rules are likely to be perceived as being inadequate. Our reasons are outlined above under each question.

4. ***What changes to the foreign trust disclosure rules or their enforcement do we recommend?***

We recommend adopting the approach applied in the current rules to foreign trusts settled by Australian residents. This would require amending the disclosure requirements in section 59B of the Tax Administration Act 1994 to include a requirement for the name of any settlor(s) and their country of residence to be disclosed. We believe that the disclosure rules will work more effectively if they require the disclosure of the identity of the settlor(s). This will enable Inland Revenue to comply with information requests that relate to a settlor. In addition, other jurisdictions will be able to address any inadequacies in their legislation if they establish their residents are using New Zealand's foreign trust regime to avoid tax in their country.

Consideration could also be given to whether the rules should also require the disclosure of the persons who have beneficial ownership (where distributions have been made) and of the persons who have control of the trust (such as persons with a power of appointment / dismissal of trustees), which would be consistent with the approach adopted for Automatic Exchange of Information (AEOI) and AML purposes.

Most foreign trusts are likely to be treated as financial institutions (FIs) with reporting obligations under AEOI but some may not be FIs themselves. For those foreign trusts that are not FIs themselves, AEOI may nevertheless impose reporting obligations on any FIs which deal with them. Those reporting obligations may not be to Inland Revenue given it is unlikely that the investments are in New Zealand. It is the countries in which the trusts invest which would report to the country of residence of the settlors and beneficiaries (the controlling persons). The Inquiry should consider whether AEOI will obviate the need for change to the foreign trust disclosure rules given the likely inclusion of foreign trusts as FIs and the likelihood their financial assets will be reported by another jurisdiction.

We note that the second phase of the AML/CFT reforms is likely to place obligations on accountants and lawyers to collect, verify and retain information on the beneficial ownership and control of trusts and to monitor transactions undertaken by those trusts. The AML rules are focused on AML/CFT except to the extent that tax evasion is suspected. It is only to that extent that they will buttress the foreign trust disclosure rules.

5. ***What other actions might be taken?***

We consider that the application of AML/CFT to all service providers to New Zealand foreign trusts should be considered. A review may result in:

- reconsideration of the removal of the lawyers' and accountants' current exemption;
- a narrowing of that exemption to exclude work in relation to a New Zealand foreign trust;
- waiting for the current process for extending AML/CFT to be completed and applied. We note that

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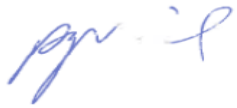
the next New Zealand FATF review is due in 2019. We assume that decisions on the continuation and/or scope of the exemption would need to be made in time for that review. However, a confirmed timeline has not been publicised.

We do not have sufficient information to confirm our preference.

Amended tax disclosure rules and extensions of the AML/CFT rules will bring further oversight of an independent nature. This will assist in targeting abusive tax practices and investments that might not have legitimate sources and should also address any negative perceptions about New Zealand's reputation in this context.

Please contact us if you wish to discuss any aspect of our submission.

Yours sincerely



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