

The Treasury

Foreign Trust Inquiry Information Release

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[1]	to prevent prejudice to the security or defence of New Zealand or the international relations of the government	6(a)
[2]	to protect the privacy of natural persons, including deceased people	9(2)(a)
[3]	to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials	9(2)(f)(iv)
[4]	to maintain the effective conduct of public affairs through the free and frank expression of opinions	9(2)(g)(i)
[5]	that the making available of the information requested would be contrary to the provisions of a specified enactment [the Tax Administration Act 1994]	18(c)(i)

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9 and section 18 of the Official Information Act.

20 May 2016

Mr John Shewan
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The Treasury
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Dear John

Government Inquiry into Foreign Trust Disclosure Rules - Submissions

Introduction

1. I am making these submissions on behalf of the New Zealand Branch of the Society of Trust and Estate Practitioners (STEP). STEP is the leading professional body of practitioners in the fields of trusts, estates and related issues, advising families across generations. STEP promotes best practice, professional integrity and education to its members. Our members help families plan for their futures; from drafting a Will or advising family businesses, to helping international families and protecting vulnerable family members.
2. Today STEP has over 20,000 members across 95 countries. They include lawyers, accountants and other trust and estate specialists.
3. I was the founding chairman of the STEP New Zealand Branch; I have served as a STEP Worldwide Council member and I am presently a branch committee member.

Background

4. Before addressing the specific questions raised in your letter requesting submissions on the foreign trust disclosure rules, I will provide some general background information on the foreign trust "industry". Much of this may be known to you but for completeness I provide a brief overview.

5. The foreign trust regime has been in place since approximately 1988, when our trust taxation rules were subject to a major overhaul. The focus moved away from taxing trusts based on the residency of the trustee and instead focused on the residency of the settlor. Thus an offshore trust settled by a New Zealand resident would be taxable here on its worldwide income, and conversely a New Zealand trust settled by a non-resident would not be taxable in New Zealand unless it earned New Zealand sourced income. There is no logical basis for departing from this entirely coherent approach to the taxation of trusts, which itself is consistent with taxation of certain other flow-through vehicles such as limited partnerships and zero-rate PIE funds.
6. Astute international advisers have been using New Zealand trusts for international clients since at least the early 1990s. In my experience the attraction of New Zealand is not tax neutrality (given that tax free status is a feature of a great many jurisdictions around the world). The reasons New Zealand has been chosen by clients and their advisers are:
 - it is a high quality jurisdiction with good infrastructure (for example court system, professional services, government services);
 - it is a stable, independent parliamentary democracy;
 - New Zealand is rated as one of the least corrupt countries in the world.
7. Whilst tax planning may be an element in the use of some (but not all) New Zealand foreign trusts, this is no different to New Zealand domestic trusts. Because of New Zealand's extensive network of double tax agreements and tax information exchange agreements, and the enactment of the Double Tax Agreements (Mutual Administrative Assistance) Order 2013, New Zealand would not be a preferred jurisdiction for aggressive tax planning, tax avoidance - or worse - tax evasion.
8. In my experience of advising clients in relation to foreign trusts over 25 years, I have personally seen no cases of the abuse of the New Zealand foreign trust regime. That is not to say that there might not have been occurrences, just as we have domestic cases of tax avoidance or tax evasion. The point I am making is that the more traditional, secretive

offshore centres would be the logical home for such unscrupulous advisers or clients.

9. Whilst foreign trusts might sound exotic to many, they are in broad terms no different in many respects to New Zealand domestic trusts. Clients use them for privacy, controlled succession of assets to future generations, and some measure of asset protection. In relation to domestic trusts, asset protection is often directed towards matrimonial, creditor or business risk. However, some international clients come from jurisdictions where the rule of law is thin or non-existent; there is the risk of misappropriation of assets by corrupt government officials or others, and there is the risk of kidnapping and extortion by criminal elements who identify wealthy individuals. "Asset protection" takes on a whole new meaning for such clients.
10. In my experience the client due diligence standards applied by New Zealand foreign trust service providers are equal to - or exceed - those applied in other reputable jurisdictions. In other words, it is customary to obtain verified client identification including proof of address; evidence of source of funds/wealth; professional or bank references as to the person's good standing and *bona fides*; and confirmation that the client has obtained (or will obtain) domestic tax advice and will comply with their domestic tax obligations.
11. In the media there have been various comments about the likely level of economic benefit generated for New Zealand from the foreign trust industry. Given no firm statistics are collated it is impossible to provide precise numbers, but based on my knowledge of the industry I believe the estimates of economic activity/benefit referred to in the media are grossly underestimated. There is no doubt that the foreign trust industry generates very substantial fees annually and employs a very considerable number of individuals, all of whom pay tax. Aside from trustee fees services are also provided by lawyers, accountants and auditors. If the industry was closed down (and I know that is not within the terms of reference of your enquiry, but I cover it for completeness) there would be a very significant loss of economic benefit to New Zealand and a considerable number of people would have to seek alternative employment or move offshore to continue working in this area.
12. The media 'feeding frenzy' arising from the Panama papers has resulted in common sense and logical analysis being thrown out the window. As I have

said above, foreign trusts are in essence no different in their objectives than New Zealand domestic trusts and I do not see the media or opposition politicians suggesting that all New Zealand domestic trusts should be closed down or be subject to full public disclosure / transparency.

13. The right to privacy is a fundamental human right and whilst this should not tip over into asserting a right to secrecy in relation to illegitimate activities, there is no logical basis for treating foreign trusts any different than domestic trusts in this regard. Moreover, the risks for some foreign parties establishing New Zealand trusts (in terms of their personal safety and risk of financial expropriation) are much greater than those for clients who have the good fortune to live in New Zealand where we have a stable democracy and reliable civil service, and a much lower level of criminal activity such as kidnapping.
14. One thing is certain: if there is an over-reaction to the push for greater disclosure in relation to foreign trusts (at its extreme, the (frankly) offensive suggestion that there should be publicly searchable registers identifying persons associated with these trusts and their investments), then there is nothing more certain than there will be a total loss of business. Clients will simply move to other jurisdictions which have a more coherent and balanced approach to personal privacy issues and a facility for exchange of tax information through proper and secure channels.
15. I turn now to the specific questions you have raised in your email.

Item 1

16. Presently trustees of foreign trusts have a broad obligation to retain trust records in New Zealand pursuant to section 22 of the Tax Administration Act 1994. This, coupled with our extensive network of double tax agreements, tax information exchange agreements, and our obligations under the Mutual Assistance Convention lead to the conclusion that our foreign trust disclosure rules are adequate to ensure that New Zealand can be a good "global citizen" and co-operate with other jurisdictions on a reciprocal basis to deter abusive of tax practices.
17. When Automatic Exchange of Information (AEOI) is implemented with the CRS regime in mid-2017, New Zealand will move to automatic exchange of extensive information with jurisdictions which are participants in the CRS

initiative. As you know the list of countries participating in that programme is lengthy. A notable non-participant of CRS is the United States, however we are already under an exchange of information obligation with the US under FATCA, on an automatic basis.

18. In light of FATCA and CRS, in my view any concerns expressed in relation to the current foreign trust disclosure rules would be absolutely extinguished once CRS is implemented. That said, at the present time the one point of weakness in the IR607 disclosure is that whilst the identity of the trustee and the name of the trust is disclosed to New Zealand IRD, for an effective information request to occur under the current "on request" arrangements, the Foreign Tax Authority would need to know the name of the settlor. I am aware anecdotally of such information requests being made as, not surprisingly, in the event of an audit of a foreign settlor the name of the trust will very often come to light.
19. If, however, this is considered to be a weakness in the current disclosure regime (which will of course be rectified with the implementation of CRS in 2017) one small but simple adjustment to the IR607 disclosure would be to include a box identifying the full name of the settlor and the country of residence of the settlor.
20. I do not see it as appropriate to include beneficiary details, because under a discretionary trust beneficiaries named within the class of beneficiaries may never in fact receive any distributions from the trust. For AML purposes a trust settlor is generally considered the key person, and in the banking world is often referred to as the ultimate beneficial owner (UBO), although that title is misleading given that the settlor has disposed of assets to the trustee and no longer has ownership or control of those assets.
21. In summary, any perceived weakness in the IR607 form would be rectified by inclusion of reference to the identity and country of residence of the settlor. Of course there is a good argument that modification of the present IR607 form is unnecessary given that CRS implementation is just over a year away.

Item 2

22. In my experience all foreign trust service providers I have ever dealt with are extremely concerned to ensure that funds injected into a New Zealand

foreign trust are from a legitimate sources. Failure to ensure this could result in substantial penalties (including criminal penalties) under the AML legislation, not to mention enormous reputational damage for the service provider who might make a mistake in this area.

23. In my opinion the existing AML/CFT legislation is more than adequate to address such concerns. However, I would note that presently there is a “carve-out” from the current AML regime for certain service providers including lawyers and accountants. I believe the Government has the intention of extending the new AML regime to these service providers very soon, and perhaps the only reason it has not happened before now is that the government departments involved in administering the AML legislation have been more than fully occupied dealing with implementation of the new regime in relation to non-exempted service providers.
24. The AML “carve out” for lawyers and accountants also reflected the fact that those professionals are subject to their own strict professional standards and disciplinary processes. That plus the professional training they have received arguably makes them less exposed to the risk of inadvertent or deliberate involvement in money laundering.
25. I should note however that service providers presently exempted from the new AML regime are generally subject to the responsibilities under the prior legislation, the Financial Transactions Reporting Act 1996 (FTRA). This Act, like all AML legislation, imposes an obligation on service providers falling within the definition of a “financial institution” (which is defined very broadly) to positively identify their clients, and to report suspicious transactions.
26. The FTRA is somewhat less bureaucratic than the new AML legislation which can be very burdensome for smaller service providers in terms of the need to have detailed practice and procedure manuals and the like, however the FTRA is effective in providing serious sanctions for service providers who either deliberately or recklessly process transactions which are suspicious.
27. Nevertheless, and despite the bureaucratic burdens the current AML regime places particularly on smaller service providers, I would see the extension of the new AML regime to the presently excluded service providers to be a positive step in further bolstering New Zealand’s excellent reputation, and minimising the risk of money laundering and terrorist financing.

Item 3

28. I believe the current AML law is more than adequate and I believe enforcement is rigorous. The only improvement might be the extension of the new regime to currently exempted service providers who presently fall under the old FTRA.

Item 4

29. I have addressed this under Item 1. As an additional point I would reiterate that under no circumstances should there be publicly searchable registers concerning foreign trusts. Trusts are a private fiduciary relationship and cannot be compared to companies. One can imagine the hue and cry if there were public registers concerning New Zealand domestic trusts detailing particulars of settlors, beneficiaries and assets/income. The same principles should apply equally to foreign trusts.

Item 5

30. Another measure that might be considered to bolster the reputation of New Zealand's foreign trust industry, would be to require some "light-handed" regulation of trustees. At its most rudimentary this might include the requirement that all trustees of foreign trusts must include a trustee (or director of a trustee) who is the current holder of a practising certificate as a chartered accountant, solicitor or full member of STEP (as is currently provided for under the Tax Administration Act to attain "qualifying foreign resident trustee" status).
31. Light-handed regulation along these lines would minimise the risk of any marginal service providers taking on inappropriate business or doing things which might bring New Zealand's reputation into disrepute. Concerns about this were in large part neutralised a year or two ago when the Companies Act 1993 was amended to require at least one New Zealand resident director for all companies. This extinguished the risk of New Zealand trust companies being wholly administered by parties outside New Zealand who might be more reckless from a reputational perspective. However, light-handed regulation of New Zealand trustees would further protect New Zealand's reputation, as service providers in the sector would have an

incentive to avoid tax reporting or AML compliance breaches if this might result in the loss of their trust licence.

Closing Remarks

32. The foreign trust industry is a “weightless” export sector. In other words it contributes to New Zealand economic activity, domestic tax collection, and the earning of foreign exchange in the same way as the primary industry sector and tourism, but without any downside from an environmental perspective. Clearly those other industries are much more substantial in terms of economic contribution, but that is not a reason of itself to discard an activity which is valuable in its own right, and could continue to grow in size with appropriate legal changes and government support. There is a risk of the New Zealand economy being a “two-trick pony” relying on the primary sector and tourism. There is a lot to be said for cultivating value added service industries which make good use of New Zealand infrastructure and our well educated workforce and effective legal system.

Yours Sincerely

A handwritten signature in black ink, consisting of a large, stylized loop followed by a horizontal stroke that tapers to the right.

John Hart
STEP New Zealand Branch