

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)
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[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.

Contacts: [2]

20 May 2016

Olivershaw Limited Submission to the Government Inquiry into Foreign Trust Disclosure Rules

Executive Summary

This following is our submission to the Government Inquiry into the Foreign Trust Disclosure Rules “the Inquiry”. The submission has been prepared after consultation with the NZ Trustee Companies Association Limited.

The focus of our submission is the framework in which the Commission should approach answering the questions in its terms of reference.

We submit that the regulatory and disclosure rules should be appropriate to actual risks and the need to protect the New Zealand revenue base and international confidence that New Zealand law and tax administration does not facilitate the evasion or avoidance of the taxes of other countries or otherwise facilitate illicit activities.

We submit that it is not efficient or realistic to task the New Zealand Inland Revenue Department with enforcing the vast number of varying tax laws applying throughout the world. It should, however, actively assist international tax enforcement on a multilateral and reciprocal basis in accordance with international best practice subject to this being consistent with protecting basic human rights.

We submit that the regulatory and disclosure rules applying to foreign trusts should be designed to achieve these objectives.

We submit that current law (especially anti-money laundering rules) and Inland Revenue’s first class ranking as a tax administration are consistent with appropriate regulatory and disclosure rules. However, we further submit that there are some weaknesses in the rules. Consideration should be given to enhancing our anti-money laundering legislation by extending its ambit to cover accountants and lawyers. Transparency of the operation of foreign trusts should be addressed

through Automatic Exchange of Information rules currently being developed by officials in consultation with the private sector. Regulatory changes should also be enacted to ensure that a licensed trustee must be resident in New Zealand so that there is someone to be held accountable should there be evidence of non-compliance with the above.

Finally, we submit that private and commercial information provided by foreign trusts should remain subject to strict privacy rules so as to protect the human rights of those involved with the operation of foreign trusts.

Background

The terms of reference of the Inquiry focus on the foreign trust disclosure rules and their adequacy. We appreciate that the terms of reference do not cover New Zealand's income tax laws so far as they affect foreign trusts, nor aspects of the operation of foreign trusts in New Zealand as may have been made public in the so-called Panama Papers, except to the extent that any aspects of these relate to our disclosure rules. We nevertheless consider that a proper understanding of our income tax laws and the operation of foreign trusts is an important context in which the adequacy of our foreign trust disclosure rules should be considered.

Foreign Trusts and Income Tax Policy

The basic feature of our income tax law as it relates to trusts is that the New Zealand tax liability on offshore income is established by the residence of the settlor, not the residence of the trustees or whether the trust is managed or controlled from New Zealand. This rule has been in place since 1988 and is designed to ensure that New Zealand residents cannot place assets in a trust managed and controlled offshore with non-resident trustees so as to defer (or avoid) a New Zealand income tax liability on the income of the trust. The rule seems to have been very effective at protecting the New Zealand income tax base.

As result of this rule, where a trust has non-New Zealand sourced income, it is subject to New Zealand income tax only if a settlor of the trust is resident in New Zealand. This allows a non-New Zealand resident to put assets earning offshore income into a New Zealand foreign trust without this incurring a layer of New Zealand tax over and above tax levied by the country from which the income is sourced or the country where the beneficiaries (or potentially settlors) are resident. This has been the tax basis on which the New Zealand foreign tax business has been developed. Through a New Zealand foreign trust, an overseas family can have their family wealth managed from New Zealand without this resulting in the income from that wealth being subject to an additional layer of New Zealand tax.

While the opportunity this provided New Zealand to develop an international financial services business was recognised by the government as an advantage when the rules were introduced in 1988, the prime objective of the new trust rules was, as noted above, to protect against the use of offshore trusts by New Zealanders to shelter income from New Zealand tax. This is materially different from many tax regimes found in other countries that are targeted at providing tax concessions for overseas income diverted to their country. Examples are the Australian Offshore

Banking Unit regime and the United Kingdom “patent box” rules. The OECD came to the view that both the Australian and the UK rules were potentially harmful tax practices. The OECD reviewed the New Zealand trust rules on a number of occasions (most recently in 2014) and concluded that New Zealand’s rules are not potentially or actually harmful.

A reason for this is that the New Zealand trust rules merely follow standards and orthodox international policy of not taxing non-residents on non-New Zealand sourced income. This should apply not only where a non-New Zealand person invests offshore but also where such a person invests in a New Zealand entity to the extent that it is “looked through” (or is treated as transparent) for tax purposes. Thus where a partnership (or co-venture) is established by one partner resident in New Zealand and one partner resident overseas, the income is attributed directly to each partner. The result is that all New Zealand sourced income is subject to New Zealand income tax, the offshore income of the New Zealand partner is subject to New Zealand income tax, but the offshore income of the foreign partner is not taxable in New Zealand.

This principle of not taxing non-residents on non-New Zealand sourced income that is treated as transparent for tax purposes applies throughout the New Zealand income tax system. Examples are:

- The original rules taxing a New Zealand company’s investments in a Controlled Foreign Company (“CFC”) where CFC income was paid to non-residents as a dividend – subject to New Zealand tax but giving rise to refundable Foreign Dividend Payment credits.
- The extension of the above to undistributed income through the “conduit regime”.
- The non-taxation of non-resident partners on offshore income under our limited partnership rules.
- The exemption from tax of an overseas investor in a variable rate Portfolio Investment Entity (“PIE”) on offshore income.
- The zero rate of tax applied to zero-rate PIEs being PIEs with offshore investors and no material New Zealand sourced income.

The current tax treatment of foreign trusts is merely the application of this principle to trusts. It would be possible for New Zealand to change its tax policy and, for example, subject to tax non-New Zealand sourced income of all entities managed from New Zealand. That would require a substantial revision of New Zealand tax law generally. It would also be likely to impose an additional New Zealand layer of tax, that would not be able to be offset by a reduction of overseas tax, on some entities merely because they operate out of New Zealand. As a result of any such change, New Zealand would become a less desirable place from which to manage an offshore business or investments. Such a move would be counter to the report of the government’s Capital Markets Development Taskforce which saw some opportunities for New Zealand in developing an international financial services industry. The Taskforce saw this as beneficial to New Zealand in terms of both diversifying our economic base and also in terms of expanding New Zealand’s financial expertise which should have spin-off benefits for our domestic capital markets the thinness of which has been seen as an impediment to growth of New Zealand productivity.

The tax treatment of trusts varies internationally. The domestic law of civil law countries (continental Europe) do not in general recognise trusts. Unlike some other countries, New Zealand

focuses for tax purpose on the residence of the settlor. As noted above, that is to protect our tax base. The ability for a non-resident to invest offshore through a trust and not be liable to tax in the country in which trust located is not, however, unusual internationally. For example, trust rules in the USA can give rise to the same outcome.

The New Zealand foreign trust industry in practice

There has been considerable adverse New Zealand media commentary on New Zealand foreign trusts following the release of the Panama Papers. There has, however, been no evidence that trusts have been used to evade or avoid any New Zealand tax revenue. Nor has any substantive evidence been produced to suggest that New Zealand foreign trusts have been used to facilitate evasion of other countries' taxes or money laundering. There has been considerable international media attention on the Panama Papers but overseas media has not highlighted any role played by New Zealand. As a spokesperson for the International Tax Justice Network has said, internationally New Zealand has a "low profile" in this area. There thus seems little foundation in any assertions that New Zealand's international reputation has been damaged by the operations of New Zealand foreign trusts. Certainly no evidence has been produced to demonstrate how this has led to damage to New Zealand except perhaps to the extent that some more ill-considered New Zealand media coverage has impacted negatively on the reputation of New Zealand foreign trusts to be a safe haven for the family wealth of non-residents.

There have been some media comment suggesting that the only or main reason non-residents would hold assets in a New Zealand foreign trust is to evade tax or to hide illicitly obtained funds. There is no basis for such a view. The main business of New Zealand foreign trusts is family wealth management. New Zealand offers skilled and efficient professionals, a good legal system, respect for property rights, honest government and political stability. These attributes are often absent in other less stable areas of the world such as Latin America. As the Panama Papers themselves note, New Zealand is attractive to Mexican families because of "Mexico's unpredictable and uncertain inheritance laws". If family wealth is managed from New Zealand, succession and inheritance can be protected and managed. Moreover, the use of New Zealand trusts means that international investments can be managed in a stable environment without having to abide by several different sets of rules.

Clearly not levying an additional layer of New Zealand tax is important to the competitiveness of New Zealand as a place to manage family wealth. Many other countries also offer safe havens for wealth management without attempting to impose an additional layer of tax for using that jurisdiction. Tax is usually payable in the country in which the income is sourced and/or the country in which the investor resides. In some cases, other countries, for their own policy reasons, do not impose tax on some offshore income of residents or on income sourced in their jurisdiction. This makes it all the more important that New Zealand not impose its own tax where otherwise no or little tax would be levied. It is certainly not up to, or even possible, for New Zealand to attempt through its tax laws to compensate for what we may see as deficiencies of the tax policies of other countries. Those seeking a stable base for family wealth management will simply locate elsewhere.

The above is the context in which the appropriate regulatory and information disclosure rules New Zealand applies to these trusts should be considered. The regulatory environment should not be prejudiced by the false view that our foreign trusts are designed as a vehicle for tax evasion or money laundering. The regulatory requirements should be appropriate to a legitimate international wealth management business and proportionate to the risks involved in that business.

The appropriate regulatory framework

It is of course possible that some funds held by New Zealand foreign trusts could have illicit sources (income on which tax has been evaded or income from criminal activity). As the United Kingdom Institute of Economic Affairs (article of 15 May 2016) notes, criminals operate in places that levy no tax. “In the same way, burglars operate where there is property. However, we would not abolish property because of burglars.”

When considering our trust rules the prime objective should be to ensure that our tax rules and enforcement are robust enough to ensure that overseas trusts are not used to evade New Zealand taxes. As noted above this seems to be the case.

A secondary objective should be to manage the risk that New Zealand foreign trusts are used to hide funds obtained illicitly by non-residents or are used by them to evade or avoid the taxes of other countries. Increasingly, taxpayers operate across jurisdictional borders and it is increasingly recognised that revenue authorities need to co-operate internationally in order to enforce each country’s tax laws. New Zealand therefore benefits from actively co-operating with other countries in this way through better enforcement of our tax laws. Moreover, costs are imposed externally on legitimate New Zealand businesses (including firms managing foreign trusts) should New Zealand be seen as facilitating illicit activities through laws and administrative capability that does not meet international best practice.

This does not mean that the New Zealand Inland Revenue Department (“IRD”) should be tasked with identifying evasion or other illicit activities of non-residents. As previously noted, an overseas person may have funds managed from New Zealand the income of which is not taxed anywhere in the world but this may accord fully with the tax laws in the country in which the funds were generated and the country in which the person lives. To task IRD with the role of policing and enforcing the multitude of tax laws that exist in the world would be highly resource costly, inefficient and ultimately futile. The role of policing and enforcing tax (and other) laws should be left primarily to the revenue (or other) authorities of the countries making those laws. Should the IRD be tasked with such an exercise, it would have to consider all foreign investment into New Zealand, including foreign investment into New Zealand Foreign Trusts, New Zealand companies, New Zealand debt instruments and of course New Zealand real estate. Such an outcome would result in:

- A considerable increase in resourcing of the IRD with no New Zealand revenue to be obtained.
- The identification of a large number of foreign investors into New Zealand, most of whom will be complying with their home jurisdiction rules including those that have a zero rate

(pension funds), those who are not taxable on foreign/New Zealand sourced income and those who have correctly returned their New Zealand sourced income in their home jurisdiction.

IRD should, however, actively assist overseas authorities by providing them with the information they need to enforce their rules. This should be done on a reciprocal basis (New Zealand also wants to enforce its laws so it should provide information on the basis that information exchanges are reciprocated) and subject to the other country abiding by our standards for respecting human rights (the information New Zealand provides should not be used in a way that it can lead to capital punishment and the same rights to privacy should be recognised by countries that we exchange information with). It is recognised that if another country is not prepared to reciprocate with information exchange or cannot guarantee that the information will not be used contrary to minimal standards required to protect basic human rights, then this could allow some non-compliance with the laws of another country. The benefits for imposing these conditions, however, seem to outweigh the benefit of providing the assistance.

Given these considerations, the regulatory and information disclosure rules for New Zealand foreign trusts should be such that they fully meet best internationally agreed standards. Because New Zealand is not itself policing overseas tax rules, and because New Zealand should place some conditions on the information it provides the authorities of other jurisdictions, it should participate in and abide by multilateral agreements in these areas rather than develop its own standards. Put another way, the response to the need to act multilaterally should be developed multilaterally and not unilaterally.

The adequacy of AML and AEOI rules

The relevant instruments that should govern New Zealand foreign trusts are internationally applied anti-money laundering (“AML”) rules and the more recently developed OECD common reporting standard (CRS) and automatic exchange of information (“AEOI”).

In broad terms, under New Zealand’s present AML laws (in force since 2013) a New Zealand foreign trust must carry out customer due diligence (“CDD”) of all settlors, appointors, grantors, beneficiaries and persons acting on behalf of such persons. This must normally be carried out before a business relationship is established. In essence this is identity verification (name, birthdate, address) and includes source of funds for high risk customers. In addition, any transaction or proposed transaction for which there are reasonable grounds to suspect that it may be contrary to the Act must be reported to the Financial Intelligence Unit.

We know of no reason to suggest that our AML laws do not meet the best internationally agreed standards – the appropriate benchmark for the reasons set out above. It is noted, however, that lawyers (and incorporated law firms), accountants and real estate agents can be exempt from our current AML laws, although they may be subject to the prior AML legislation (the Financial Transactions Reporting Act 1996 (“FTRA”) which is still in effect. Whilst less prescriptive than the

present AML legislation, the FTRA does impose certain CDD obligations, together with (most importantly) an obligation to report suspicious transactions.

It is understood that this is intended to be a transitional exemption and is based on such professionals in effect meeting the essence of AML requirements under their professional rules and/or the FTRA. Consideration could nevertheless be given to removing this exemption at least to the extent that services are being provided to a foreign trust or as a trustee of such a trust. That might alleviate any perception that there are holes in meeting best international standards for foreign trusts.

As has been noted, AEOI is still being developed. Depending on their final form, there may be circumstances where a New Zealand foreign trust has minimal reporting requirements under AEOI. The parties to the trust may be resident only of non-participating jurisdictions, the trustee may be a non-financial entity and thus no CRS reporting requirement, or the trust holds all funds in a reporting entity bank so that the trust is relieved of any reporting requirements. It should be appreciated that in general any lack of reporting reflects the perceived low risk. However, some reporting requirement to IRD may be useful so that IRD can identify the trust and if appropriate, separately assess its risk.

It has sometimes been commented upon that even if AML laws are fully complied with, the tax of another country may be being avoided by holding the assets in a New Zealand foreign trust. IRD might have the information, but it does not know that the other country needs it and the other country does not know that IRD has it. As noted above, it would be neither efficient nor practical to task the New Zealand IRD with policing the tax systems of all other countries. Revenue authorities (including New Zealand's IRD) have expertise in identifying high risk taxpayers and suspicious transactions and then following up with international information exchange requests. The concern with asymmetrical information can thus be over-stated. It is nevertheless recognised that information asymmetry can be a weakness in international tax enforcement. The OECD AEOI rules seem designed to target this information asymmetry.

Under the OECD's AEOI rules a foreign trust will be required to provide to IRD annual information in accordance with the OECD Common Reporting Standard ("CRS"). This will require information to be reported on the name, address and tax identification number ("TIN") of the settlor, protector, and beneficiaries that have received distributions that year. This information looks through companies to the ultimate individual owners. CRS also requires financial accounts of the trust to be provided annually being the value of trust settlements, the interests of the settlor and protector, and the nature and value of any distributions to beneficiaries. This information will be required to be reported annually to IRD which will hold it in a computerised registry. IRD will then provide this information annually to every participating jurisdiction where a settlor, protector or beneficiary is resident.

AEOI is yet to be implemented in New Zealand but we understand that the intention is that it will be legislated for this year and implemented with effect from July 2017 at the same time as they are implemented by other OECD early adopter countries. The question might be raised as to whether New Zealand should not adopt AEOI even earlier. We note, however, that the timetable for implementing AEOI is already very tight (no legislation has yet been introduced). Earlier adoption does not seem feasible. Moreover, as noted above, international standards along these lines should

be implemented multilaterally and in that respect July 2017 would be the earliest possible adoption date.

AEOI/CRS requirements should mean that the New Zealand IRD has what is in effect a registry of foreign trusts with key information as to the accounts, settlors and recipient beneficiaries. IRD will exchange this information annually with relevant AEOI participating jurisdictions. This should satisfy any concerns that, despite AML CDD rules, the activities of foreign trusts are not transparent to overseas revenue and other appropriate authorities.

It seems clear that the AEOI rules New Zealand officials are working on meeting best international standards. The only weakness in the rules that could be raised is that information will be shared only with those participating jurisdictions New Zealand agrees to share such information with. To exchange this information more widely, however, would breach the reciprocity requirement and the need to protect basic human rights as submitted above.

A second issue with respect to enforcement is whether IRD has the resources to manage the information and exchange the information it has as appropriate. As a general point, New Zealand's IRD has a long and well-earned reputation for being among the world's best in terms of its ability and willingness to exchange information with other revenue authorities. It should be resourced to carry out this task and not have to divert resources from its core role of managing the New Zealand tax system. The danger is that it is measured on its management of the New Zealand tax system and this could lead it to be reluctant to resource areas it is held less accountable for. IRD and Treasury seem in the best position to comment on this point.

In our view AML and AEOI rules should provide IRD with appropriate best international practice access to relevant information and information exchange processes. Any regulatory measures should be able to manage the risk that those responsible for collecting and providing information to IRD are deficient in doing so. We submit that the proper way to manage this risk is to ensure that someone is accountable for lack of compliance. In this respect our current rules do seem to be able to be improved. Attached to this submission is a submission from the NZ Trustee Companies Association Limited proposing a review of the rules regulating the operation of New Zealand foreign trusts. We emphasise that any changes in this area should be the subject of full consultation with interested parties.

The critical importance of privacy

We support appropriate information on foreign trusts (such as the identity of settlors and beneficiaries) being held and provided to IRD and then exchanged under reciprocal agreements with overseas authorities. This is subject to the need to protect the privacy of the important family and commercial information that can be included in any such data.

There have, however, been some suggestions that information held by IRD under AML and AEOI rules should be available on a publically assessable data base. We submit that this would;

- Be unnecessary in terms of meeting best international practice
- Breach fundamental human rights

- Create very real dangers and problems for those using foreign trusts
- Act as a disincentive to voluntary compliance with AML/AEOI rules
- Result in many foreign trusts leaving New Zealand to a similar jurisdiction which does not have such public reporting.

Public information on the personal financial details of settlors and beneficiaries of foreign trusts may be of considerable public interest but public disclosure would not be in the public interest. Whether funds held by a trust and the income generated from that represents tax evasion or avoidance or other illicit activities can only be properly assessed by the authorities of the country whose laws may have been breached. For the reasons given above, the income may not be taxable in the country of source or the country in which the settlor or beneficiary are resident.

It is well recognised in New Zealand that privacy is a fundamental human right. There are many reasons why a person may want their financial details kept private. This may be just because they do not want others to know – unless there is a clear need such as law enforcement. It may be for family reasons – not disclosing wealth to family members because it could create family conflicts.

In regions of the world less stable than New Zealand, the case for privacy of financial information goes beyond the right of a person to have privacy and goes into core issues of personal safety. Divulging wealth and income can subject people in some countries to the threat of expropriation of that wealth by corrupt officials and the threat of kidnapping and ransom by criminal elements.

For all these reasons the OECD has placed a priority on the protection of the privacy of any information exchanged under AEOI.

Undoubtedly if financial information of foreign trusts were to be made public, most of the funds now managed by New Zealand foreign trusts would relocate elsewhere to jurisdictions that place appropriate weight on the critical importance of privacy. In addition, it would provide a significant incentive to avoid providing the information required under AML and AEOI rules. It could thus undermine voluntary compliance with those rules.

If disclosure were required, it raises the real concern whether there should be disclosure of New Zealand trusts. For the reasons identified above, we strongly submit that such information should not be made public.