

The Treasury

Foreign Trust Inquiry Information Release

Release Document July 2016

www.treasury.govt.nz/publications/reviews-consultation/foreign-trust-disclosure-rules

Key to sections of the Official Information Act 1982 under which information has been withheld.

Certain information in this document has been withheld under one or more of the following sections of the Official Information Act, as applicable:

[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)

Where information has been withheld, a numbered reference to the applicable section of the Official Information Act has been made, as listed above. For example, a [2] appearing where information has been withheld in a release document refers to section 9(2)(a).

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

AEOI and foreign trusts - draft IRD internal memo 12 04 2016

The Automatic Exchange of Information (AEOI) initiative will impose reporting obligations on NZ financial institutions. For AEOI purposes, the term 'financial institutions' is broadly defined. [4]

In very simple terms, this would mean that any trust that derives over 50% of its income from managing financial assets, and which is professionally managed, will fall under the AEOI reporting rules. If the trust that has a New Zealand resident trustee, it must report to the New Zealand tax authority (Inland Revenue) unless it reports in another jurisdiction. This would also apply to foreign trusts.

If it is a financial institution, a foreign trust will generally need to determine where its settlor(s), trustee(s), protector(s), beneficiary(ies) and any other person who has ultimate control are resident for tax purposes, and report that information to Inland Revenue, along with financial information such as the value of financial assets held, and any income derived from those financial assets. Inland Revenue will then automatically exchange that information to the applicable jurisdictions of residence.

In addition to the above, any bank or other financial institution that has account held by a foreign trust that is not subject to its own reporting obligations, will have to report information on that trust (including looking through to find the trust's controlling persons.

This note explains the example set out in the attached diagram.

All of the terms in red bold are defined terms in the AEOI Common Reporting Standard.

The example is a foreign trust, because the settlor is non-resident. All of its income is foreign sourced, and the beneficiaries are all non-resident.

Assume that countries X, Y, Z and NZ are **participating jurisdictions** and **reportable jurisdictions** for AEOI purposes.

Is the trust a reporting financial institution (RFI) in NZ?

- is it an **entity**?
yes – CRS defines an entity as including a trust
- is it a **financial institution**?

It is possible that it may be a financial institution – if it is an **investment entity** (>50% from investing in **financial assets**, and meets the 'professionally managed' criteria)

- is it a **participating jurisdiction financial institution**?

yes – trustee E is resident in NZ, which under the CRS establishes a reporting nexus to NZ – NZ is a **participating jurisdiction**

note – the reporting nexus is usually based on tax residence, but as trusts typically don't have tax residence they are subject to a separate test, which is whether a trustee of the trust is tax resident (other flow-throughs such as partnerships have a different test)

however – if the trust is actually tax resident in another jurisdiction **and** reports in that jurisdiction, it will not be a participating jurisdiction financial institution in NZ

as trustee D is resident in country Y, the trust is also a participating jurisdiction financial institution in country Y – and prima facie has reporting obligations in both countries.

- is it subject to the **non-reporting financial institution** carve out?

most categories of NRFI listed in the CRS (Government Entities, International Organisations, Central Banks, Pension Funds) won't apply

however, there is a category of NRFI for a **trustee-documented trust**, which is essentially where a trustee is itself a RFI, and reports – this would apply in this example **if trustee D was an RFI** and reports in country Y

What happens if the trust is not a RFI?

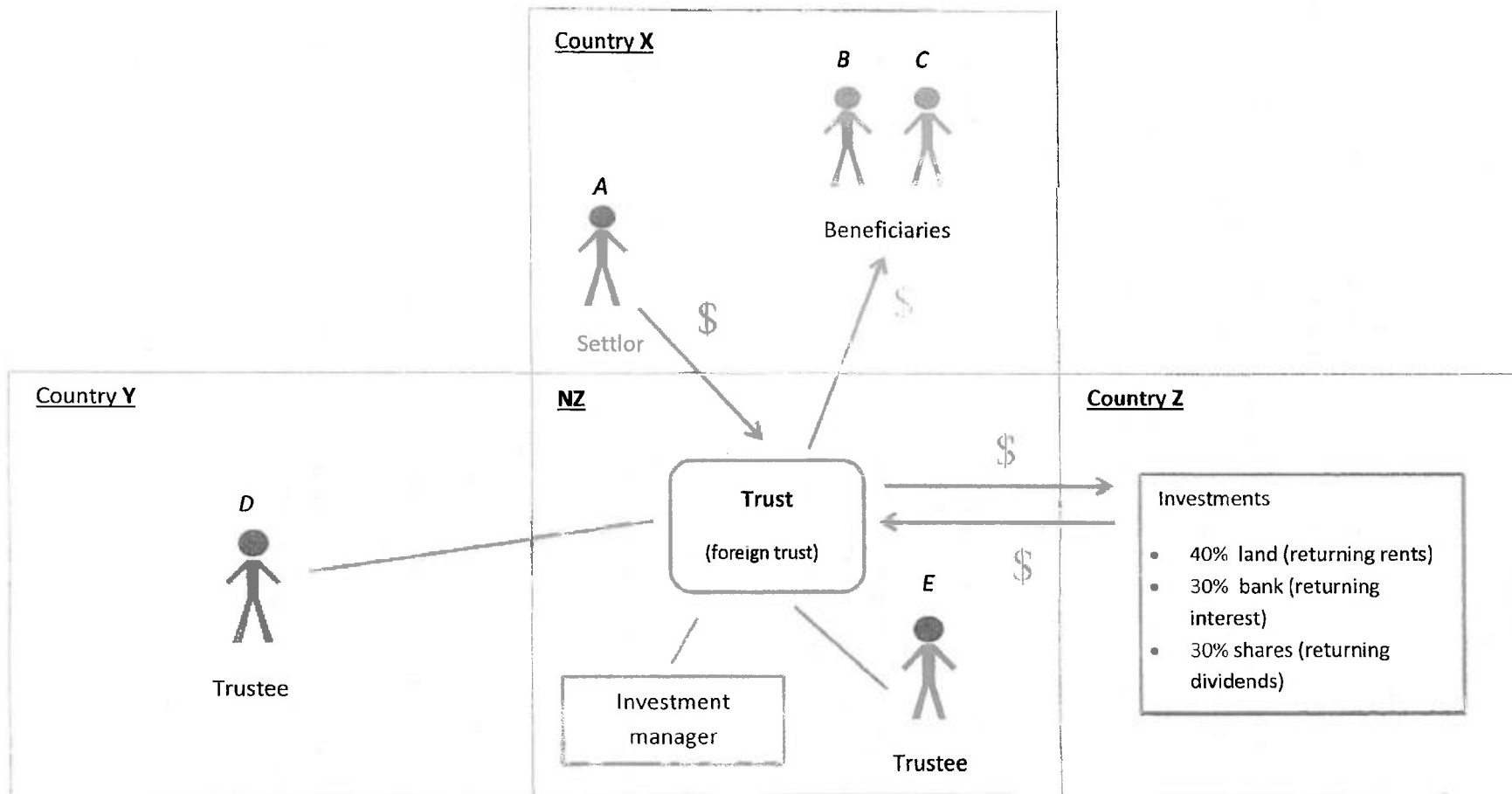
any entity that is not a financial entity, eg because it fails the professionally managed test, is a **non-financial entity (NFE)**

an NFE will either be an **active NFE** or a **passive NFE**

- if it is not a reporting financial institution, is it a **passive NFE**?

yes – it is not an **active NFE** because more than 50% of the income is passive income (interest and dividends), therefore it defaults to being a **passive NFE**

as the trust is not an RFI, the **country Z bank** is required to report on the trust (including looking through to its **controlling persons**)



What information will be reported?

- if the trust is an RFI, trustee E is required to report (to NZ Inland Revenue) on the financial accounts that it holds:
 - settlor A – to country X
 - beneficiaries B & C – to country Y (but only where there is an entitlement to a mandatory distribution or actually receives a discretionary distribution)
 - any other natural person exercising ultimate effective control over the trust, which would likely include:
 - trustee D –to country Y

the rules around how much of the trust's **financial assets** and **income earned from those financial assets** would be attributed to each reportable person are complex and difficult to summarise, but at a very high level would represent the person's interest in the trust (e.g. a beneficiary with a mandatory entitlement to 50% of the trust income would be attributed on the basis of 50%)

- trustee E could appoint a 3rd party service provider to undertake the due diligence and reporting – but ultimate responsibility rests with trustee E
- IN ADDITION, if the trust is an RFI, trustee D is required to report (to country X's tax administration) on the financial accounts that it holds:
 - settlor A – to country X
 - beneficiaries B & C – to country Y (but only where there is an entitlement to a mandatory distribution or actually receives a discretionary distribution)
 - any other natural person exercising ultimate effective control over the trust, which would likely include:
 - trustee E –to NZ

the rules around how much of the trust's **financial assets** and **income earned from those financial assets** would be attributed to each reportable person are complex and difficult to summarise, but at a very high level would represent their interest in the trust (e.g. a beneficiary with a mandatory entitlement to 50% of the trust income would be attributed on the basis of 50%)

- trustee D could appoint a 3rd party service provider to undertake the due diligence and reporting – but ultimate responsibility for ensuring this is done correctly rests with trustee D

- if the trust is a FI, country Z bank has no reporting requirements in respect of the trust
- however, if the trust is not a FI, it is a reportable account to country Z bank, which must report as follows:
 1. on the financial accounts that it holds:
 - the trust – to NZ
 2. look through any passive NFE that holds an account, determine the ultimate controlling persons, and report on any that are reportable persons
 - settlor A – to country X
 - beneficiaries B & C – to country X
 - trustee D – to country Y
 - trustee E – to NZ

How easy would it be for the trust to circumvent the rules to avoid being reported on?

- the CRS requires implementing jurisdictions to put an anti-avoidance provision in place
- however, it would be relatively easy to circumvent the rules, for example
 - the trust can avoid its own reporting obligations by appointing an investment manager that is not a FI (e.g. an individual), and
 - the trust can avoid the passive NFE look through rules by only investing in FIs in non-participating jurisdictions

however, for a high wealth individual investing \$10 million dollars, this probably comes down to their appetite for risk

note that the OECD/Global Forum will monitor developments and revise the CRS rules if such practices become apparent