

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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Tax policy report: Foreign trusts: record keeping and filing requirements

Date:	17 June 2004	Priority:	High
Security Level:	In Confidence	Report No:	T2004/957 PAD2004/092

Action sought

	Action Sought	Deadline
Minister of Finance and Revenue	Agree to recommendations	21 June 2004
Associate Minister of Finance and Revenue (Hon David Cunliffe)	For your information	None
Associate Minister of Finance (Hon Trevor Mallard)	For your information	None

Contact for telephone discussion (if required)

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17 June 2004

Minister of Finance and Revenue

cc: Associate Minister of Finance and Revenue (Hon David Cunliffe)

Associate Minister of Finance (Hon Trevor Mallard)

Foreign trusts: record keeping and filing requirements

Executive summary

Under current tax law, foreign trusts (being trusts that have no New Zealand resident settlor) are not required to file income tax returns if they receive only foreign-sourced income or keep records for New Zealand tax purposes.

As legislation does not require foreign trusts to regularly provide information, there is a risk that New Zealand may be unable to supply foreign tax authorities with information relating to some foreign trusts if requested. This has been identified as an area of considerable concern by Australian authorities, and the issue has also been raised by other countries during double tax agreement (DTA) negotiations.

Without an effective mechanism to obtain information on such trusts, New Zealand may be unable to comply with its exchange of information agreements with its DTA partners. Failure to provide information could impact negatively on New Zealand's relationship with other DTA signatory countries, particularly Australia. Also, as trusts can be established for the purposes of channelling funds through to tax havens, New Zealand could develop an international reputation for enabling harmful tax practices.

To address these concerns, we propose that the Tax Administration Act 1994 be amended to impose a statutory obligation on foreign trusts to keep records for New Zealand tax purposes and provide certain information to Inland Revenue. In addition, the trustee(s) will be required to complete and file a new annual disclosure statement.

The Organisation for Economic Co-operation and Development (OECD) established a Trust Technical Sub-group (the Sub-group) as part of the Forum on Harmful Tax Practices. In February 2003, the Sub-group agreed that all trustees should be subject to the standards outlined in its discussion draft which relate to the maintenance of accounting records, by certain entities (such as trusts). In addition, the majority view was that the country of residence of the trustees, or other persons with possession or control of the information requested, should have rules that require compliance with the standards. The proposal

outlined in this report would meet the Sub-group's proposed minimum record keeping standards.

In initial discussions, Australian authorities indicated that they would like information on foreign trusts to be provided electronically. Therefore, we propose that certain information collected from foreign trusts would be transferred to Australia in electronic format on an annual basis. New Zealand may also receive requests for information from other DTA signatory countries under the exchange of information provisions. This information would be provided on a case-by-case basis.

If you agree to the proposals contained in this report, we request your permission to undertake limited consultation. We also seek your approval to advise the Australian Taxation Office (ATO) of this proposal, the consultative process to be adopted and the proposed legislative timeline, prior to commencing consultation. Inland Revenue will also ask ATO if it has any preference for making an announcement regarding this issue.

Recommended action

We recommend that you:

- (a) **Agree** that the Tax Administration Act 1994 be amended to require foreign trusts to keep certain records and provide certain tax information to Inland Revenue.

Agreed/Not agreed

- (b) **Note** that the proposal outlined in this report would meet the proposed minimum record keeping standards agreed to by the OECD Trust Technical Sub-group.

Noted

- (c) **Note** that information collected by Inland Revenue on foreign trusts will be transferred to Australia on an annual basis and other DTA signatory countries upon request.

Noted

- (d) **Agree** that limited consultation on this issue be undertaken with the Institute of Chartered Accountants of New Zealand, the Trustee Corporations Association of New Zealand and the New Zealand Law Society.

Agreed/Not agreed

- (e) **Agree** that an item will be placed on the Inland Revenue website to advise other interested parties, particularly those off-shore, that we are considering a proposal to introduce information keeping and reporting standards for foreign trusts, and invite them to provide submissions on this issue.

Agreed/Not agreed

- (f) **Agree** that Inland Revenue should advise the ATO of this proposal, the consultative process to be adopted and the proposed legislative timeline before commencing consultation. Inland Revenue will also ask ATO if it has any preference for making a public announcement regarding this issue.

Agreed/Not agreed

- (g) **Note** that there will be up-front and on-going administrative costs associated with the implementation of this proposal. Inland Revenue will seek to quantify these costs during the consultative process. Once the on-going costs of this proposal have been estimated, Inland Revenue may seek funding for these costs as part of the 2005-06 budget bid.

Noted

- (h) **Agree** that the proposed amendments should apply from the income year commencing 1 April 2005.

Agreed/Not agreed

- (i) **Agree** that the proposed amendments be included in the tax bill scheduled for introduction in November 2004.

Agreed/Not agreed

Stephen Glover
for Secretary to The Treasury

Michael Nutsford
Portfolio Manager
Inland Revenue Department

Hon Dr Michael Cullen
Minister of Finance and Revenue

The issue

1. Under current tax law, foreign trusts are not required to apply for an IRD number, file income tax returns if they receive only foreign-sourced income or keep records for New Zealand tax purposes. A foreign trust is defined in the Income Tax Act 1994 as any trust which has had no New Zealand resident settlor since 17 December 1987, or from the date that the trust was first settled, whichever is later.
2. As legislation does not require foreign trusts to keep and regularly provide information, there is a risk that New Zealand may be unable to supply foreign tax authorities with information relating to some foreign trusts if requested. If foreign trusts vest, move off-shore or the trustee(s) changes, there may be no way of obtaining information pertaining to their earlier activities. Without an effective mechanism to obtain information on such trusts, New Zealand may be unable to comply with its exchange of information agreements with its DTA partners.
3. This has been identified as an area of considerable concern by Australian authorities, and the issue has also been raised by other countries during DTA negotiations. In particular, the issue has been raised in Australian senate hearings, and the Australian Taxation Office (ATO) has specifically raised these concerns with Inland Revenue. Inland Revenue responded that, to date, the department has always been able to answer specific requests for information, but Inland Revenue would consider making available to them (following a law change) a list of Australian settlors and beneficiaries. ATO indicated that this should address Australia's concerns.
4. The Australian Transaction and Analysis Centre (AUSTRAC) monitor money movements in and out of Australia, with a view to identifying high-risk transactions. Trends in AUSTRAC data show a recent decline in numbers and amounts of direct transaction flows to known tax havens, but an appreciable increase in flows to New Zealand. Consequently, Australian authorities are concerned that funds are being directed through New Zealand to tax havens.
5. Failure to provide information could impact negatively on New Zealand's relationship with other DTA signatory countries, particularly with Australia. Also, as trusts can be established for the purposes of channelling funds through to tax havens, New Zealand could develop an international reputation for enabling harmful tax practices.
6. To address these concerns, we propose that foreign trusts be required to keep records for New Zealand tax purposes, provide certain information up-front when they are first established in New Zealand or New Zealand trustees are appointed, and provide information to Inland Revenue on an annual basis. This report outlines a proposal to collect, store and transfer information to foreign tax authorities (particularly Australia), on New Zealand foreign trusts.
7. In discussions with Inland Revenue, representatives from a United Kingdom legal firm stressed that their clients do not establish New Zealand foreign trusts for the purpose of hiding information. Therefore, provided information reporting requirements are clearly spelt out,

this requirement should not impact significantly on United Kingdom investment in New Zealand via trusts.

The OECD's proposed minimum information keeping standards

8. The Organisation for Economic Co-operation and Development established a Trust Technical Sub-group (the Sub-group) as part of the Forum on Harmful Tax Practices.

9. In February 2003, the Sub-group agreed that all trustees should be subject to the standards outlined in paragraphs 20-22 of its discussion draft. These standards relate to the maintenance of accounting records and the source documents that make-up accounting records, by certain entities such as trusts. The standards specify that accounting records should be kept for a minimum of five years and should be accessible to the jurisdiction's authorities within a reasonable period of time. Paragraphs 20-22 have been included as an appendix to this report for your information.

10. In addition, a majority view was held that the country of residence of the trustees, or other persons with possession or control of the information requested, should have rules that require compliance with the standards. The proposal outlined in this report would meet the Sub-group's proposed minimum record keeping standards.

Proposal to provide information

Collection of information

11. We propose that the Tax Administration Act 1994 be amended to impose a statutory obligation on foreign trusts to keep certain records for New Zealand tax purposes and provide certain information to Inland Revenue. Inland Revenue already has systems and processes in place to collect information from trusts that have a New Zealand resident settlor. Where possible, these systems and processes will be modified to include foreign trusts.

12. We propose that the requirement to complete an *IRD number application form for non-individuals* (IR596) be extended to include foreign trusts that have no New Zealand sourced income. This would require the New Zealand resident trustee of a foreign trust to apply for an IRD number and provide a copy of the deed of trust.

13. The New Zealand resident trustee of all foreign trusts would also be required to complete a new annual disclosure statement. To complete this form, it would be necessary for the trustee to provide Inland Revenue with a full set of annual financial statements, supply details of distributions to beneficiaries and settlements made on the trust during the year, and supply names and contact details for the settlor(s), trustee(s) and beneficiaries.

14. Under current law, the New Zealand resident trustee of a foreign trust that receives New Zealand sourced income is required to complete an *income tax return for estates or*

trusts (IR6) in respect of that income. This requirement will remain following the proposed amendments.

Foreign trusts that move off-shore

15. Certain taxpayers are required to retain in New Zealand, records that enable the ascertainment of their tax liabilities, for a period of seven years after the end of the income year to which they relate. If the Tax Administration Act is amended to require foreign trusts to keep certain records, the New Zealand resident trustee(s) of a foreign trust would also be required to keep records for seven years. If a foreign trust ceases to have a New Zealand resident trustee, the requirement to keep records for seven years would remain.

Penalties for non-disclosure or for knowingly providing false information

16. Under current legislation, a New Zealand resident settlor of a trust may incur a penalty of up to \$50,000 for failing to disclose certain information about a trust or for knowingly providing false information. If the Tax Administration Act is amended to impose a statutory obligation on New Zealand resident trustees of foreign trusts to provide certain information, such trustees would be liable for the same penalty if they commit these offences.

Transfer of information

17. In initial discussions, Australian authorities indicated that they would like information on foreign trusts to be provided electronically. Therefore, we propose that certain information provided by foreign trusts will be stored by Inland Revenue and transferred to Australia in electronic format on an annual basis. Should Australian tax authorities require additional information (such as a copy of the deed of trust) this would be provided.

18. New Zealand may also receive requests for information from other countries with which we have a DTA, under the exchange of information provisions. This information would be provided on a case-by-case basis.

Next steps

19. If you agree to the proposals contained in this report, we request your permission to undertake limited consultation on this issue with the Institute of Chartered Accountants of New Zealand, the Trustee Corporations Association of New Zealand and the New Zealand Law Society. We also propose that an item be placed on our website to advise other interested parties, particularly those off-shore, that we are considering a proposal to introduce information reporting standards for foreign trusts, and invite them to provide submissions on this issue.

20. We request your permission to advise the Australian Taxation Office of this proposal, the consultative process to be adopted and the proposed legislative timeline prior to commencing consultation. The indicative timeline is as follows:

External consultation	June – July
Report back to Minister on final policy proposals	end of August
Cabinet approval and drafting	end of September
Introduction of tax bill	16 November

21. We will also ask the Australian Taxation Office if it has any preference for making a public announcement regarding this issue. For instance, you and the Australian Treasurer, Hon Mr Peter Costello, may wish to make a joint announcement.

22. Once the consultative process is completed, officials will report to you on final policy proposals. If you agree to these proposals, we will draft a Cabinet paper for your referral to the Cabinet Economic Development Committee.

Administrative costs

23. There will be up-front and on-going costs associated with the implementation of this proposal. However, as Inland Revenue currently holds no information on most foreign trusts, it is difficult to estimate the number of foreign trusts that may provide information following the proposed changes. Inland Revenue will seek clarification on this point as part of the consultative process. Once the on-going costs of this proposal have been estimated, Inland Revenue may seek funding for these costs as part of the 2005-06 budget bid.

Compliance costs

24. The New Zealand resident trustee of *all* foreign trusts will incur compliance costs associated with this proposal, as all foreign trusts will be required to complete the new annual disclosure statement.

25. In addition, the New Zealand resident trustee of a foreign trust that receives no New Zealand sourced income will incur additional compliance costs following the proposed changes, as they will be required to apply for an IRD number (complete an IR596). The trustee of a foreign trust that receives New Zealand sourced income is already required to apply for an IRD number under current law.

26. We consider that the imposition of compliance costs can be justified, as failure to collect and provide information pertaining to foreign trusts may damage our relationships with DTA signatory countries. Furthermore, the purpose of the foreign trust rules is not to provide a mechanism for New Zealand to contribute to harmful tax practices.

Economic impacts

27. There are no benefits that arise directly from the presence of foreign trusts in New Zealand. However, foreign trusts may generate income flows that are taxable in New Zealand, thereby increasing the tax base. For instance, if a foreign trust receives any New Zealand sourced income or the New Zealand resident trustee receives fees for his or her services, this income is taxed. Also, if a foreign trust employs New Zealand based professional services, the fees received by the professional are taxed.

28. The implementation of the proposal outlined in this report may provide a deterrent for foreign trusts to establish or remain in New Zealand. Some foreign trusts may move off-shore or establish elsewhere to avoid the requirement to disclose information to New Zealand tax authorities. This may be due to the sensitive nature of the information requested and/or the compliance costs that could be incurred in providing it.

29. The migration of foreign trusts is likely to result in a reduction in the economic benefits discussed above. However, we believe that the potential economic cost to New Zealand of failing to comply with its exchange of information agreements with DTA signatory countries significantly outweighs the economic benefit.

30. Failure to provide information relating to certain trusts on request could damage New Zealand's relationships with DTA signatory countries, particularly Australia. New Zealand is also at risk of developing an international reputation for enabling harmful tax practices.

Timing

31. We propose that the amendments apply from the income year commencing 1 April 2005. New Zealand foreign trusts in existence on 1 April 2005 that had not previously obtained an IRD number (completed an IR596) would be required to do so at that time.

32. We recommend that the proposed amendments be included in the tax bill which is scheduled for introduction in November 2004.

Consultation

33. The Ministry of Foreign Affairs and Trade and the Ministry of Justice have been consulted in the preparation of this report and have indicated that they agree with the proposed recommendations.

34. The Ministry of Economic Development has been consulted with respect to the economic implications of this proposal.

C. The Standard on Preparation, Maintenance and Access to Accounting Information

I. Maintenance of accounting records

20. Any entity subject to the Standard needs to keep accounting records. Accounting records should:

- (a) correctly explain the relevant entity's transactions;
- (b) enable the relevant entity's financial position to be determined with reasonable accuracy at any time; and
- (c) allow financial statements to be prepared.

21. Accounting records should include underlying documentation, such as invoices, contracts etc. They should reflect details of:

- (a) all sums of money received and expended and the matters in respect of which the receipt and expenditure takes place;
- (b) all sales and purchases and other transactions; and
- (c) the assets and liabilities of the relevant entity.

22. The extent of a relevant entity's accounting records will depend upon the complexity and scale of the relevant entity's activity but shall in any case be sufficient for the preparation of financial statements.

