KPMG
10 Customhouse Quay
P.O. Box 996
Wellington
New Zealand

Telephone +64 (4) 816 4500
Fax +64 (4) 816 4600
Internet www.kpmg.com/nz

Confidential
Mr John Shewan
C- The Treasury
suzy.morrissey@treasury.govt.nz

Your ref Foreign trust review

Our ref 8301296_1.docx

23 May 2016

Dear Sir

Foreign Trust Review

You have asked for KPMG's contribution to your review of New Zealand's foreign trust regime. In particular, the tax disclosure requirements and the potential for investment of illegal funds in relation to that regime.

Our detailed response is attached. A detailed response is required because we consider the context is important. The current position as well as the expected position (for already announced changes) is discussed to support our view.

We have also had regard to the following:

- We acknowledge the global trend for countries to support each other to prevent tax evasion and avoidance and illegal money flows. Increasingly, being a good global citizen is drawing New Zealand into global initiatives for information sharing and joint action, such as the US Foreign Tax Compliance Act and the OECD's initiative on Automatic Exchange of Information. We acknowledge the continued pressure for joint action will impact New Zealand's decisions.
- The global trend raises difficult questions of privacy and secrecy. Balancing those questions with Governments' valid interest in information about their taxpayers is difficult. In the domestic context, Inland Revenue is already considering this balance as part of its Business Transformation work. (Specifically, in its review of the Tax Administration Act, KPMG's submission on which can be found here). To the extent that Inland Revenue arrives at a principled solution to those questions, those principles should inform conclusions about New Zealand's foreign trust regime.
- Trust arrangements are used extensively in New Zealand for family and commercial purposes. The New Zealand rules governing trusts have been the subject of a detailed examination, consultation and report by the Law Commission. We contributed to that process with detailed submissions. We consider the Law Commission's assessment to be useful for establishing the uses of trusts, the legal framework governing trusts, as well as for consideration of disclosure and secrecy issues with New Zealand trusts.

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- The tax and investment of illegal funds are overlapping but separate issues. A solution for one may not work for the other. For example, trusts self-reporting to Inland Revenue may work for tax because of Inland Revenue's powers. It may not be suitable for countering the investment of illegal funds as an important part of that process is independent oversight.
- Importantly, the tax rules and rules to counter investment of illegal funds rely on global action. It should be reasonable to assume that those regimes are being complied with so as to minimise duplication.
- New Zealand has committed to the implementation of international anti-money laundering and countering financing of terrorism (AML/CFT) standards set by the Financial Action Task Force (FATF) to ensure adequate transparency of trusts and companies. We recognise this commitment and the measures already put in place to implement these standards which has informed our views in this submission.

These and the more detailed discussion show that there are trade-offs in determining the appropriate settings for New Zealand's foreign trust regime. We freely acknowledge the difficulty of those trade-offs but in our view there are prospective changes which are likely to cure current deficiencies. It is therefore important that they are factored into the assessment of New Zealand's foreign trust regime.

Our response is based on media reports of the structures used and the application of our knowledge of the relevant laws to those structures. The response is not based on any specific or known transaction.

We would be pleased to discuss our response further.

Yours sincerely

For both

John Cantin
Partner - Taxation

Stephen Bell
Partner – Forensic and Dispute Advisory Services

KPMG
10 Customhouse Quay
P.O. Box 996
Wellington
New Zealand

Telephone +64 (4) 816 4500
Fax +64 (4) 816 4600
Internet www.kpmg.com/nz

New Zealand foreign trust review response

A Summary

In short, we consider the question to be whether New Zealand's tax and investment of illegal funds laws are sufficient to adequately police activities which occur in New Zealand or have a New Zealand connection.

A.1 Taxation

The tax concern is best summarised as a view that an "on request" provision of information is inadequate. Our view is there is no principled objection to the disclosure of information to a foreign Revenue Authority on an automatic basis. Indeed that is the global trend.

However, the implementation of such a regime specifically for New Zealand foreign trusts may not be required given:

- New Zealand's imminent implementation of Automatic Exchange of Information (AEOI), which should increase disclosures made automatically;[1]
- Changes to the "look through company" (LTC) tax rules, in the Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Bill, which will limit the ability to use LTCs to derive NZ tax-free foreign income;
- A possible public beneficial ownership register of company shareholders which should make it easier for foreign Revenue Authorities to identify the use of New Zealand companies by foreign persons and to request information.

However, the efficacy of those rules needs to be tested. In particular, the application of AEOI to trusts may need to be modified to make it easier to comply with, as well as to ensure there is appropriate coverage and reporting.

We have suggested that any tax recommendations should take into account the current review of Inland Revenue secrecy and disclosure rules, as part of the Business Transformation project. There may also be a case for policy changes to confirm and clarify the tax residency status of trusts.

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[1] Standard for Automatic Exchange of Financial Account Information in Tax Matters published by the OECD in 2014. Around 50 jurisdictions are working towards having their first information exchanges by September 2017.

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A.2 Investment of illegal funds

For those[2] who currently have anti-money laundering and countering financing of terrorism (AML/CFT) obligations, we have no evidence of a failure to apply the rules. However, there are specific matters on which further guidance would be helpful.

For those not yet subject to New Zealand's AML/CFT (including lawyers and accountants) obligations, there is a current gap in the coverage of New Zealand's rules. New Zealand should consider whether the current timetable for implementation of Phase 2 for AML/CFT is appropriate.[3]

We agree with the Government's announcement that it will consider establishing a public beneficial ownership of company share register. This will move New Zealand closer to the Financial Action Task Force (FATF) Recommendations. The establishment of a beneficial ownership register for companies will also assist in the mitigation of the risk that New Zealand companies and trusts are misused for money laundering and assist law enforcement, including international cooperation, in the investigation of potential criminal activity.

New Zealand could also consider licensing trust service providers as an additional form of regulatory protection.

B Background – the trust structure and issue

The Panama Papers have disclosed the use of New Zealand foreign trusts in various structures. The independent review has arisen as a result of questions regarding New Zealand's role, if any, in the avoidance of other countries' tax regimes and/or in facilitating the investment of illegal funds.

The focus is therefore on the level of disclosure (if any) to foreign Revenue Authorities and on the effective application of New Zealand's AML/CFT rules.

From the media reports, a simplified and common structure is:

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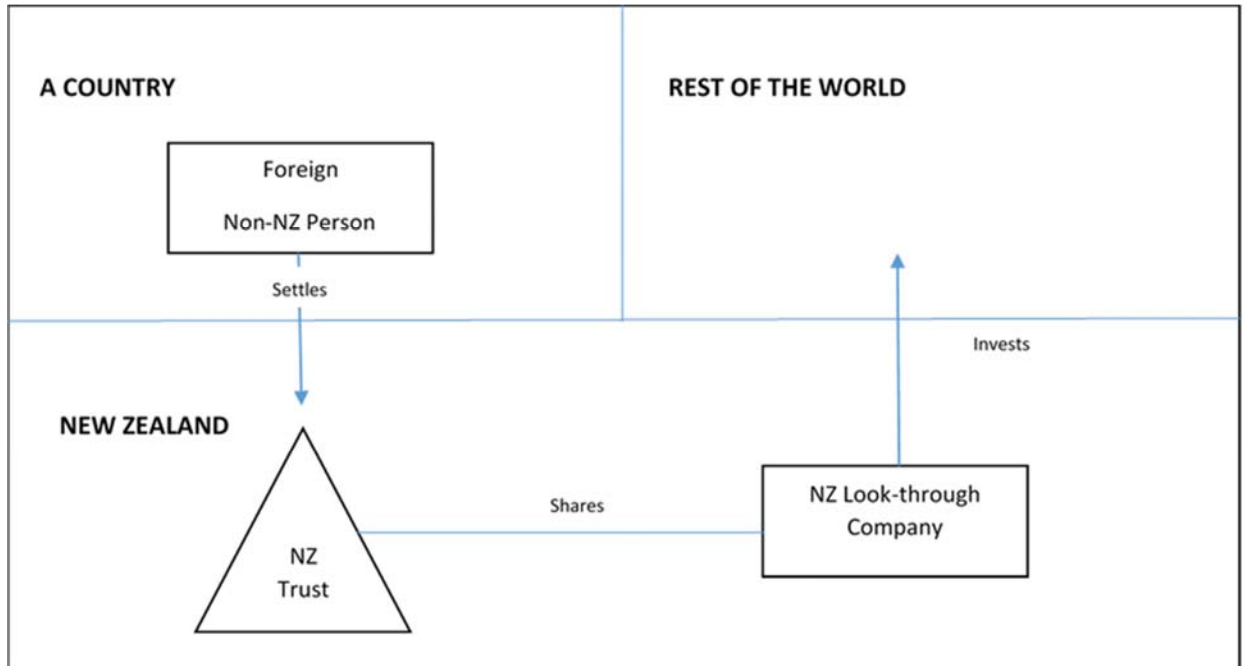
[2] e.g. Trust and Company Services Providers

[3] Phase 2 includes lawyers and accountants for example.



It is this structure that we have in mind when responding to the questions we have been asked to consider.

C Specific assumptions and comments

In this section we outline some broad positions which underlie our responses. This section makes these positions explicit.

C.1 Taxation

C.1.1 Trust income tax policy

The current policy, to tax a trust based on a settlor's tax residence and to exclude foreign sourced income of a New Zealand resident trustee, is sound:

- This approach protects the New Zealand tax base from the use of foreign trusts by NZ residents.
- It appropriately excludes foreign income of non-residents from the New Zealand tax base.

A change to that policy would expose the New Zealand tax base if trustee residence was used as the basis of taxation. The current policy is explicitly aimed at preventing use of foreign trusts by New Zealanders. Limiting the New Zealand taxation of foreign income to that derived by a New Zealand resident trustee would allow New Zealanders to use trusts with foreign trustees to shelter foreign income.

The removal of the foreign income exemption may affect family and commercial arrangements where a NZ resident trustee is appropriate. For example, a trust settled by an Australian aunt with a New Zealand resident nephew as a trustee is a foreign trust. It is appropriate that such a trust continues to be taxed on its New Zealand sourced income only. (We note that if the foreign trust has a New Zealand beneficiary, then any foreign sourced income will be fully taxable on distribution to that beneficiary.)

C.1.2 Reliance on non-disclosure

An arrangement should not rely on non-disclosure of its existence for its effectiveness. The effectiveness of an arrangement should rely on the application of the law to the facts and circumstances of the arrangement. We believe that:

- Disclosure to a Revenue Authority of the existence of an arrangement is a natural consequence of that position.
- A user of an arrangement should not have a tax-effectiveness concern from disclosure but may have other concerns.

C.1.3 Reliance on tax differences

In the present context, the mismatch in tax treatment of trust income, where most of the rest of the world taxes trusts on the basis of the residence of the trustees and New Zealand taxes on the basis of residence of the settlor, is the potential issue.

Differences in tax regimes are due to choices made by different nations as to what should and should not be included in their tax bases. A sovereign nation can change that choice (through due legislative process). Tax differences (and mismatches) should not normally be a specific concern to be addressed.

However, this may assume a degree of sophistication and maturity for a tax regime which does not exist. The existence of a difference in treatment may be due to oversight or inadvertent omission. A change may therefore only occur when a difference is brought to the attention of the relevant Revenue Authority.

C.1.4 Current state of disclosure

Certain information about foreign trusts has to be disclosed to Inland Revenue. Inland Revenue has stated the current foreign trust disclosure requirements are sufficient for it to respond to requests for information from other Revenue Authorities. We note that OECD/Global Forum reviews of NZ's exchange of information processes have not raised any concerns to date.

Further tax disclosures may be required to Inland Revenue pursuant to FATCA and its New Zealand implementation through the Inter-Governmental Agreement and related legislation.

This disclosure may be:

- By a New Zealand Financial Institution (such as a bank or investment entity) that the New Zealand foreign trust is an account holder of, if the trust is not itself a Financial Institution; or
- By the trust itself, if it is a Financial Institution.

Unlike the tax residence rules, FATCA deems a trust to be NZ resident for reporting/disclosure purposes if it is established in New Zealand, governed by NZ law, or if there is a NZ resident trustee. However, there may be no or limited actual disclosures because there are no or limited US beneficiaries/controlling persons of a foreign trust.

Limited public disclosure may also be required due to investment by a New Zealand foreign trust in a New Zealand company or other entity.

- For example, the trustee's shareholding may need to be disclosed in Companies Office filings.
- However, the existence of the trust and the trustee capacity of a shareholder may not be clear from the disclosed shareholding.

C.1.5 Signalled future direction

C.1.5.1 AEOI

New Zealand is currently consulting on the implementation of AEOI under the Common Reporting Standard (CRS). This will require the disclosure to Inland Revenue of financial account information by New Zealand financial institutions (e.g. banks, custodial institutions and, particularly in the context of trusts, if they invest in or are an "investment entity" themselves.)

New Zealand will exchange that information with up to 100 countries (and growing).

For entities, the information to be disclosed includes the controlling person(s), their foreign tax identification details, and their country of tax residence.

If a foreign trust is a Financial Institution, it will need to do due diligence on its settlors, trustees, and beneficiaries and report those who are non-resident. If a foreign trust is not a Financial Institution, Financial Institutions with which it holds an account are required to perform due diligence and report the trust's financial account details, the controlling person(s) and their tax residency. To the extent a foreign trust invests with a NZ Financial Institution, the details of the foreign settlors and beneficiaries will be communicated to Inland Revenue to be automatically exchanged with the tax authority of the jurisdiction of the settlors/beneficiaries.

From our experience with FATCA, the status of a trust, as a Financial Institution or not, is problematic. KPMG has submitted, in the AEOI context, that trusts report their distributions to Inland Revenue as a solution. If this solution is accepted, New Zealand foreign trusts would provide AEOI information to Inland Revenue annually.

The commencement of AEOI reporting and exchange of information is largely due to occur by 2018, with NZ Financial Institutions required to implement due diligence procedures from 1 July 2017. However, under AEOI design parameters being considered, due diligence would not apply to existing trust accounts below a threshold (US$250,000) and reporting on those accounts may be delayed.

It can be reasonably expected that even if a foreign trust is not itself a Financial Institution and does not have a New Zealand financial account which is subject to AEOI in New Zealand it will have a financial account in one of the 100 countries implementing the regime. To the extent a foreign trust invests in a Financial Institution resident in another AEOI compliant country, that country will share financial account and settlor and beneficiary information with the country identified as the country of residence of the settlor and beneficiary.

The key "non-compliant" jurisdiction for AEOI purposes is the United States. United States Financial Institutions will not report under AEOI but will report under FATCA when the United States implements a domestic reporting regime. (The United States has obligations under the various Inter-Governmental Agreements. However, the information it is to exchange is not the same as required under AEOI.)

C.1.5.2 Look through company foreign income

The Taxation (Annual Rates for 2016-17, Closely Held Companies, and Remedial Matters) Bill proposes to change the look through company (LTC) qualification rules. A LTC which is

foreign owned (including by a New Zealand foreign trust) cannot have more than 20% of its income as foreign sourced income.

This means that a company owned by a New Zealand foreign trust with only foreign income will be taxed on its foreign income. This will limit the ability to use the LTC rules to derive tax-free foreign income.

C.1.5.3 Taxpayer secrecy

The issue of taxpayer secrecy is subject to consultation as part of the Business Transformation review of the Tax Administration Act. Although we would not expect submissions to that consultation to have foreign trusts specifically in mind, the questions arising and the resulting principles need to be coherently applied to foreign trusts.

C.1.5.4 Beneficial ownership register

The New Zealand Government has announced that it intends to consider a register of beneficial ownership of companies. This is consistent with announcements by other countries.

C.2 Investment of Illegally Sourced Funds

Despite the legitimate role of foreign trusts, they can be misused for criminal purposes including tax evasion, money laundering and corruption. International studies have shown that criminals seek to use corporate vehicles such as trusts to disguise or hide beneficial ownership. The New Zealand National Risk Assessment[4] on Money Laundering (published in 2010) rated trusts as high risk of being misused for money laundering.

Jurisdictional risk is a key determinant of customer risk globally. New Zealand has a reputation as a country of integrity[5]. Criminals may seek to use foreign trusts within the ownership structure of overseas vehicles in an attempt to avoid raising red flags with overseas financial institutions or third parties. The perception may be that New Zealand ownership overall helps mitigate the risk for foreign financial institutions performing due diligence or monitoring transactions.

New Zealand has taken steps to prevent the misuse of trusts for money laundering, tax evasion and other serious crimes. The AML/CFT Act has introduced strong measures and implements

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[4] Completed by the Police Financial Intelligence Unit

[5] As reflected in Transparency International assessments

many international standards set by the FATF. The AML/CFT regime ensures that reporting entities are subject to regulation designed to prevent and detect money laundering and terrorist financing.

Unlike AEOI and FATCA, a New Zealand foreign trust is unlikely to be an AML/CFT Financial Institution with reporting and due diligence requirements. Instead, the trust is more likely to be the subject of due diligence and reporting obligations.

The AML/CFT regime includes important measures to mitigate the risk of foreign trusts being misused for illicit purposes. Financial institutions are required to conduct enhanced customer due diligence on trusts which are their customers, including identifying and taking reasonable steps to verify the beneficial ownership and the trust's source of wealth or source of funds.

In addition, New Zealand has implemented the FATF Recommendations in relation to trust and company service providers. These businesses are regulated for AML/CFT purposes[6] when they carry out as the only or principal part of their business activities in respect to a legal person or arrangement, including, (a) acting as formation agents; (b) acting as a nominee director or shareholder; and (c) providing registered office or correspondence address. Therefore, trust and company service providers are currently required to comply with AML/CFT obligations to prevent and detect financial crime.

Lawyers and accountants offering similar services as trust and company service providers are currently exempt from the AML/CFT regime[7]. This is inconsistent with the FATF Recommendations and was incorporated into the reasoning why NZ received a 'non- compliant' rating for a number of FATF recommendations in the Mutual Evaluation Report. It is proposed that lawyers and accountants will be subject to AML/CFT regulation in Phase 2. The timeframe for this is unclear.[8]

The FATF Recommendations also require countries to take measures to prevent the misuse of companies and trusts for money laundering by ensuring that there is adequate, accurate and timely beneficial ownership information available[9]. These Recommendations are intended to

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[6] In accordance with regulation 17 Anti-Money Laundering and Countering Financing of Terrorism (Definitions) Regulations 2011

[7] Regulation 20 of the Anti-Money Laundering and Countering Financing of Terrorism (Definitions) Regulations 2011. Lawyers and accountants are technically covered by the Financial Transaction Reporting Act (FTRA) in a limited capacity (principally where real-estate related) and the requirements of that regulation are in many parts inconsistent with FATF .Recommendations. There is also no effective supervision of the FTRA as identified in the APG Mutual Evaluation Report 2009 (MER).

[8] We note the APG MER 2nd follow up report dated October 2013 referenced the Ministry of Justice was to start initial scoping work in the 'fall of 2013' and anticipated Phase 2 to be enacted and in force by 2017 subject to Government approvals and priorities.

[9] Recommendations 24 and 25

ensure that law enforcement authorities have access to this information that can be shared with their international counterparts. New Zealand was rated partially-compliant and non-compliant with these Recommendations.

New Zealand is scheduled to be reviewed by the FATF in a mutual evaluation in 2019. The FATF mutual evaluation will examine technical compliance with the latest FATF Recommendations and determine the effectiveness of NZ's AML/CFT regime. The FATF mutual evaluations are made publicly available and the results of the mutual evaluation report have an impact on NZ's regulatory reputation.

D Application/Answers

1. Whether you consider the existing foreign trust disclosure rules are adequate to ensure that New Zealand's reputation as a country that cooperates with other jurisdictions to deter abusive tax practices?

We understand the current position is that a foreign trust has limited automatic disclosure obligations to Inland Revenue but that Inland Revenue has full powers to request from the trust and to exchange with a foreign Revenue Authority further information when required.

Discussion

At a Revenue Authority level, the only evidence of the adequacy of the current rules is Global Forum/OECD reports on NZ's current exchange of information regime and reported statements by Inland Revenue in response to questions arising from the Panama Papers. We are unable to test Inland Revenue's statements. The response of some Governments to the Panama Papers disclosures indicates that the current level of disclosure may not be considered adequate. It is not clear whether this is disclosure from Panama or New Zealand.

At a media and public opinion level, the perception appears to be that the current rules are inadequate.

We consider that this a response to the question whether New Zealand's Revenue Authority can be trusted? This is a more general question arising from BEPS-type disclosures and Revenue Authorities' responses to those disclosures.

The media and public view seems to be that Inland Revenue cannot be trusted to be unbiased so that it allows tax to be avoided. We do not believe this is the view of tax professionals however. They would generally view Inland Revenue as professional and, if anything, biased in favour of collecting tax where possible. However, the indication is that the current rules are perceived as inadequate and greater public disclosure is required to provide assurance that Inland Revenue is and can fully discharge its role.

We acknowledge that the current disclosure regime means that reliance is placed on a foreign Revenue Authority asking the question of Inland Revenue. The existence of the trust may not be easy to identify from publically accessible information. This may mean that no disclosure to a foreign Revenue Authority is made because there is insufficient information.

Answer

The current regime relies on a foreign Revenue Authority being aware of the foreign trust and asking for further information from Inland Revenue. It is reliance on this which may allow the foreign trust regime to be misused.

This suggests that changes to the disclosure requirements of the foreign trust regime are required. We consider this further at question 4.

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 legislation is able and sufficient to address such concerns?**

Answer

The current AML/CFT laws include measures to mitigate the risk of foreign trusts being misused for illicit purposes. However, there are important steps that could be taken to enhance the AML/CFT laws and therefore New Zealand's compliance with international standards. These are addressed in the answer to question 3. In short, the answer is that more could be done.

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?**

3.1 Taxation

Adequacy

We consider the current disclosure rules are perceived to be inadequate due to the increasing requirements being placed on Revenue Authorities, including Inland Revenue. There is a clear shift from being the domestic jurisdiction's tax "policeman" to being part of a global tax police force as tax avoidance and evasion have taken a global dimension in the post BEPS/Luxembourg and Panama leaks world.

This means that an "on request" regime is perceived as inadequate.

Although we have no specific evidence, we assume that the existence of a foreign trust would be difficult for a foreign Revenue Authority to identify. This is particularly the case if the

investment from New Zealand is made through a New Zealand company. The shareholders on the public register may not be readily or easily identified and the ultimate beneficial owners may not be disclosed. This may limit the ability of a foreign Revenue Authority to make a request for further information.
Further, the questioning of Inland Revenue's enforcement ability is due to the lack of information of what it does in relation to New Zealand foreign trusts, specifically, and on cross-border activity more generally.

Enforcement

We believe there is a gap between what the public sees and what actually occurs, which explains some of the concern. As we note above, our experience is that Inland Revenue does not fail to enforce the rules when it sees a breach of those rules. The question is whether the rules, particularly around disclosure, need enhancement. We believe the answer is yes.

3.2 Illegally sourced funds

Adequacy and clarity of law

The perceived current shortcomings suggest the answer is that the law is not seen as adequate or as clear as it should be. We include our suggestions for improving the rules at the same time (as question 4 does not ask the question directly).

Application of AML/CFT obligations to Phase 2 entities

Lawyers and accountants which may provide similar services to trust and company services are exempt from the AML/CFT regime and are due to be brought within the AML/CFT regime in Phase 2. The implementation of Phase 2 of the AML/CFT reforms will further strengthen the controls around forming and administering foreign trusts to help mitigate the risk that they are misused for criminal purposes. In particular, it will require the application of customer due diligence, ongoing monitoring and regulatory reporting where suspicious activity is identified. This both acts as a deterrent to prevent the misuse of foreign trusts and supports the investigation of criminal activity by providing financial intelligence and information available that can be used to "follow the money" in criminal investigations.

Other Guidance

There are also challenges involved in the implementation of existing AML/CFT laws. We have highlighted some areas below where enhancements could be considered:

- The National Risk Assessment on Monday Laundering in 2010 rated trusts as high risk. However, reporting entities would benefit from having more granular information on how trusts are misused for money laundering and tax evasion to enable them to better detect suspicious activity.

- The existing AML/CFT laws require reporting entities to identify the beneficial owners of trusts which may include trustees, the settlor or beneficiaries which exercise effective control over the trust[10]. However, further guidance on the circumstances in which the settlor and beneficiaries exercise effective control would assist with the implementation of these requirements by reporting entities.
- Financial institutions are required to perform enhanced due diligence on “trusts or another vehicle for holding personal assets”. Reporting entities would benefit from greater clarity or guidance on the intended purpose of “another vehicle for holding personal assets” to ensure consistent application.
- Further guidance could be provided to reporting entities on conducting customer due diligence on trusts and multi-layered entities with trusts included in the ownership chain. Money laundering typologies commonly show that multiple layered entities are often used to disguise beneficial ownership and further guidance would assist Financial Institutions in better implementing the requirements.

Public Register

The lack of a public register may limit the ability of New Zealand’s law enforcement authorities to investigate potential criminal activity involving trusts in a timely manner, including the ability to provide cooperate internationally with foreign counterparts.

Enforcement

We have no evidence of a failure of enforcement.

However, we consider the diversity in the sectors regulated by the Department of Internal Affairs and the complexity of structures and volume of reporting entities present challenges in supervision. Effective supervision of trust and company service providers, and Phase 2 entities when they are brought within the scope of the AML/CFT Act, is an essential component of the AML/CFT regime and should remain a focus in New Zealand.

4 What changes to the foreign trust disclosure rules or their enforcement do you recommend?

4.1 Taxation

In our view, it is important to take into account proposed changes to the tax regime. Otherwise, a solution to any perceived problems may either duplicate future requirements or be rendered obsolete.

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[10] Subject to section 6 of the Anti-Money Laundering and Countering Financing of Terrorism (Requirements and Compliance) Regulations 2011. Or for beneficiaries where they have that have a vested interest of at least 25% in the trust property – interpreted as applying only to Fixed Trusts.

If nothing else changed

If no other changes were being proposed, we would recommend that the same information as for Australian settlors of foreign trusts is collected for settlors of all countries.

Reporting of that information to a specific country would depend on the existence of Double Tax Agreement, Tax Information Exchange Agreement, or whether the country is a signatory to the Convention on Mutual Administrative Assistance on Tax Matters. Information should only be exchanged with countries that we have these links with to ensure that information is used only for the relevant tax purpose.

If other changes are made

We note there are a number of proposed changes, which should assist.

AEOI

We expect AEOI implementation in 2017 will increase disclosure requirements to Inland Revenue and therefore to other Revenue Authorities.

Logically, this should be sufficient. If a country is concerned that its tax residents are inappropriately using a foreign trust (in accordance with their existing domestic law), the country should commit to AEOI. If it has not committed to AEOI, that should be a reasonable sign that it has no material concern (and/or is not prepared to reciprocate).

In short, effective implementation of AEOI, should mean there is no need for further disclosures required for a foreign trust.

However, this may be insufficient to discharge the expectation amongst global revenue authorities (and international organisations such as the OECD and G20) that, as well as exchanging information to assist with enforcement of current rules, information should be exchanged to identify gaps in each country's tax regimes. To address this concern, we recommend that the fact of the use of the foreign trust regime by a resident of the jurisdiction should be disclosed to that other country.

Look through company changes

We would expect the proposed LTC changes to reduce the incentive to use a New Zealand LTC in the ownership structure. (New Zealand company tax at 28% would be payable, if the proposed foreign income threshold for the LTC is breached, so that any foreign tax benefits of this structure would be mitigated.)

Secrecy and confidentiality in the context of Business Transformation

We expect the review of Inland Revenue's secrecy and disclosure rules, in a domestic context, to produce a set of broader rules which are principled. Any changes to the foreign trust disclosure regime should be consistent with those principles.

Public register

A public register also may mean it is easier for a foreign Revenue Authority to identify a trust as a shareholder of a New Zealand company. This would reduce concerns that an "on request" regime is inadequate. The potential for this to occur should be factored into any recommendations for changes to the tax rules.

Other policy considerations – tax residency of a trust

A trust does not have tax residency under New Zealand income tax law. It is the trustees and settlors who are resident, or not, as the case may be.

This raises questions of whether New Zealand law applies to require tax obligations to be met. It also raises issues with respect to the application of Double Tax Agreements.

The Tax Administration Act 1994 requirements for a foreign trust suggest that the trust is subject to New Zealand's tax law. We assume this is by virtue of a New Zealand resident trustee rather than because the trust is established under New Zealand law.

By contrast, for FATCA purposes, the competent authorities of New Zealand and the United States have had to agree a common interpretation of the residency of a trust. This is broadly based on the location/residence of the trustee and governing law.

The status of a trust for Double Tax Agreement purposes, as a resident, also arises. There are competing views. The Australian Taxation Office has taken a view that a New Zealand foreign trust is not resident for Australian DTA purposes.

These different approaches to whether a trust is resident, or subject to New Zealand tax law, creates uncertainty.

Legislative confirmation of a trust's tax residency may assist in eliminating those uncertainties.

4.2 Impact on investment of illegal funds

Expanding the foreign trust disclosure rules will enhance New Zealand's compliance with FATF Recommendation 25 with respect to the transparency of legal arrangements. As noted

above, New Zealand was found to be non-compliant with this recommendation in its last mutual evaluation in 2009. To meet the international standards, the Interpretive Note to Recommendation 25[11] encourages countries to ensure that relevant authorities have access to information on all trusts. For example, this may be through a central registry of trusts or information held by tax authorities.

As a result, enhanced disclosure of information on trusts to Inland Revenue, for example through the introduction of AEOI, combined with effective information sharing arrangements between Revenue Authorities will improve New Zealand's compliance with FATF Recommendation 25.

4.3 Summary of answer to question 4

As reliance on exchange of information on request is seen as inadequate, the routine provision of information to Inland Revenue appears necessary. The actual means by which that is done needs to consider:

- The effectiveness of other policy changes (AEOI and LTC changes) to meet the objective (further specific requirements may not be needed if those changes are effective);
- A legislated rule for residency of trusts may assist with the implementation of AEOI and confirmation of the residence status of New Zealand foreign trusts (including for DTA purposes).

Expanding the level of disclosure to Inland Revenue may also assist with New Zealand's FATF compliance. However, the implementation of a register of beneficial ownership of companies may make it easier for a foreign Revenue Authority to identify the existence of a New Zealand foreign trust to request further information. This may be a more direct route to meeting the FATF obligations.

5 What other actions might be taken?

5.1 Taxation

We recommend no changes to the underlying tax policy in relation to foreign trusts. The existing exemption in section CW 54 of the Income Tax Act 20017 should not be repealed. See our comments above.

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[11] Paragraph 3

5.2 Illegal sources of funds

Public register
As noted above, the New Zealand Government has committed to exploring the establishment of a public central register of company beneficial ownership information. We consider this to be a valuable measure to mitigate the risk of misuse of New Zealand companies, including where foreign trusts form part of the ownership chain, and to enhance New Zealand's compliance with international standards.

International studies and criminal cases have shown that New Zealand-registered companies have been misused by criminals as a vehicle to move illicit funds. In addition, foreign trusts often form part of the ownership chain of New Zealand companies in multi-layered structures. A company registry with beneficial ownership information would be an important measures to mitigate these risks.

We do note that the current register reflects the Companies Act rule that a company does not acknowledge any trust relationship for its shareholders. It is entitled to treat the shareholder on the register as the shareholder. This prevents a company from having to be involved in any dispute between a legal and beneficial shareholder. The impact of a public register on this rule will need to be considered.

Licensing

We understand that the global norm is for trustees of foreign settled trusts to be licensed. An appropriate licensing regime for New Zealand merits consideration.

We note that such consideration would have to take into account existing licensing regimes (for example under the Financial Markets Conduct Act) and also the appropriate requirements for trustees who have a family or personal connection with the trust.