

Part 1 Executive Summary

Purpose of Inquiry

- 1.1 The Inquiry is required to examine New Zealand's foreign trust disclosure rules and to report on whether the rules, and the enforcement of them, are sufficient to ensure New Zealand's reputation is maintained when considered alongside the country's commitment to various OECD and other international agreements. In short, are the rules fit for purpose?

Conclusions

- 1.2 The Inquiry concludes that the existing foreign trust disclosure rules are inadequate. The rules are not fit for purpose in the context of preserving New Zealand's reputation as a country that cooperates with other jurisdictions to counter money laundering and aggressive tax practices.
- 1.3 The Inquiry considers that a significant increase in information disclosed when a foreign trust sets up, annual reporting and increased enforcement, will satisfactorily address the issues identified. Banning foreign trusts or removing the current tax exemption is not considered to be necessary or justified.
- 1.4 In theory, New Zealand's existing tax disclosure and exchange of information arrangements should be sufficient to deter tax abuse, and its anti-money laundering rules should ensure that funds held by foreign trusts are from legitimate sources. However, under current law and enforcement practices the risk of detection by authorities is low. The Inquiry considers that the disclosure requirements can be justifiably described as light-handed.
- 1.5 Strengthened disclosure requirements should act as a deterrent to offshore parties looking to use New Zealand foreign trusts for illicit purposes.
- 1.6 The Panama Papers have not been released publicly by the journalists who have them and were not available to the Inquiry. There has been no direct evidence of illicit funds being hidden in New Zealand foreign trusts, or of tax abuse. However, based on the work undertaken, including a review of IRD files, the Inquiry considers it is reasonable to conclude that there are cases where foreign trusts are being used in this way. The current legislation, regulations and practice that govern disclosures by foreign trusts present both the potential and the environment for this to occur.
- 1.7 Publicity around the Panama Papers has the potential to cause reputational damage both to New Zealand and to many other countries. The Inquiry considers that any significant adverse impact on New Zealand internationally is unlikely if appropriate action is taken to tighten the disclosure rules.
- 1.8 Foreign trusts, like domestic trusts, are a legitimate vehicle used primarily to manage family wealth. New Zealand is an attractive location in which to base a foreign trust as it offers stable political, judicial and legislative settings and respect for property rights and privacy. The supporting services industry is significant, and generally comprises skilled and efficient professionals.
- 1.9 Allowing foreign trusts to establish in New Zealand is consistent with the Government's policy of maintaining an open economy which welcomes foreign investment and an active financial services sector.

- 1.10 The tax treatment of foreign trusts follows New Zealand's long established and principled policy of not imposing New Zealand tax on foreign source income derived by non-residents. It does not result in New Zealand being a tax haven under established OECD criteria. However, the Inquiry notes that the classification *tax haven* is an ambiguous label that is now of historic relevance. It is best not used as a basis for decision making without much deeper inquiry.
- 1.11 New Zealand has a strong and well-deserved reputation as an active member of OECD and other international bodies working to clamp down on global corruption, money laundering, financing of terrorism and tax abuse. It is also regarded as a country that leads by example and it rates well in international peer reviews. Actions to increase disclosure requirements would be consistent with New Zealand's commitment to global transparency initiatives, and can be expected to be well regarded by other countries, particularly those in our tax treaty network.
- 1.12 Before the Inquiry began, the Government had introduced legislation to counter the use of Look Through Companies (LTCs) in foreign trust and other structures to derive foreign source income in excess of a low amount. While the Inquiry was underway the impending introduction of phase 2 of the Anti-Money Laundering (AML) rules was announced. This is expected to be enacted in 2017 and will result in lawyers and accountants being required to apply the AML rules. The Inquiry supports these initiatives and thinks that they will reduce the scope for inappropriate use of foreign trusts.
- 1.13 The foreign trust regime does not appear to be inconsistent with any specific obligations under current international agreements to which New Zealand is a party. However, as there is a reasonable likelihood that the regime is facilitating the hiding of funds or evasion of tax in some instances, the Inquiry considers that New Zealand's tax treaty partners would have a legitimate expectation that some action will be taken.
- 1.14 The recommendations in this report are designed to achieve a balance between allowing foreign trusts to continue in New Zealand and materially reducing the scope for foreign trust structures being used for illicit purposes such as hiding illegal funds or evading tax. If adopted, the changes may result in a reduction in the number of foreign trusts, in particular those that rely on non-disclosure to achieve their effectiveness.

Recommendations

- 1.15 The Inquiry recommends that-

Registration process

- 1.16 Foreign trusts be required to register on establishment using an expanded version of the current disclosure form, IR 607.
- 1.17 A register of foreign trusts, searchable only by regulatory agencies, be maintained.
- 1.18 The registration document include a signed declaration that the person establishing the foreign trust, the settlor(s) and the trustees have been advised of and have agreed to provide the information to comply with-
- the record keeping requirements in the Tax Administration Act
 - the Anti-Money Laundering and Countering Financing of Terrorism Act and Regulations

- the Automatic Exchange of Information/Common Reporting Standard requirements (once enacted).

- 1.19 The registration requirement apply to all trusts formed after enactment of the enabling legislation.
- 1.20 A transitional rule that requires existing foreign trusts to register, and to supply the information required, by 30 June 2017.
- 1.21 The registration process be the responsibility of IRD initially. This to be reviewed in the context of the rapidly expanding reporting requirements imposed by international agreements to which New Zealand is a signatory. It is possible that another agency such as the Companies Office (within the Ministry of Business, Innovation and Employment) may be better placed to act as the registering and supervisory agency.

Strengthened disclosure on registration

- 1.22 The information required to be disclosed to IRD when a foreign trust registers be expanded from the current IR 607 disclosures to include the name, email address, foreign residential address, country of tax residence and Tax Identification Number of-
- the settlor or settlors
 - the protector (if there is any)
 - non-resident trustees
 - any other natural person who has effective control of the trust (including through a chain of control or ownership)
 - beneficiaries of fixed trusts, including the underlying beneficiary where a named beneficiary is a nominee.
- 1.23 For discretionary trusts, any class of beneficiary not listed in the trust deed be listed on the registration form.
- 1.24 The trust deed be required to be filed with the registration form.

Ongoing tax obligations

- 1.25 The exemption from New Zealand tax on foreign source income apply only to a foreign trust that has registered and fulfilled the associated disclosure obligations at that time.
- 1.26 Foreign trusts be required to file an annual return with IRD that includes-
- any changes to the information provided at registration
 - the trust's annual financial statements
 - the amount of any distributions paid or credited and the names, foreign address, Tax Identification Number and country of tax residence of the recipient beneficiaries.
- 1.27 The annual return requirement to apply to foreign trusts formed after the enactment date and to all foreign trusts from the income year commencing 1 April 2017.
- 1.28 The basis for foreign trusts that have a *qualifying* resident foreign trustee being exposed to lesser sanctions than other foreign trusts be reviewed to determine whether it should remain.

Registration and annual filing fee

- 1.29 Foreign trusts be required to pay a registration and annual filing fee to recover the costs to the Crown of administering the foreign trust regime. The Inquiry considers a fee of \$500 at registration and an annual fee of the same amount would be reasonable.

Expansion of scope and application of AML rules

- 1.30 For services provided to foreign trusts, consideration be given to the removal by Order in Council in the short term (prior to 31 December 2016) of the regulation that excludes lawyers and accountants from AML reporting requirements. The proposed removal of this exclusion when phase 2 of the AML regime is implemented, as announced by the Government in May 2016, will address this recommendation but may not be effective until towards the end of 2017 or later.
- 1.31 The AML legislation or regulations be revised to include a mandatory requirement to verify in all cases the underlying source of funds or wealth settled on a foreign trust.
- 1.32 Expanded guidelines be issued explaining the scope of customer due diligence required in establishing and verifying beneficial ownership, effective control and source of funds in complex multi-layered trust structures. These should include a series of detailed worked examples.

Suspicious transaction reporting

- 1.33 The legislation or regulations that govern suspicious transaction reporting to the Financial Intelligence Unit of the New Zealand Police be revised to facilitate the reporting of actual or proposed transactions that have not or will not necessarily go through a New Zealand bank.
- 1.34 Greater profile, coupled with training recommendations, be given to the obligation on trust service providers to report suspicious transactions.

Information sharing

- 1.35 A review be undertaken of the current legislative arrangements for the sharing of information between the three agencies (IRD, FIU and DIA) with supervisory responsibility for disclosures by foreign trusts (and other entities). The purpose of the review, which could coincide with the introduction of phase 2 of the AML regime, would be to determine the financial and efficiency gains and other implications (including secrecy considerations) of sharing strategic intelligence and other information between agencies.

Other observations

- 1.36 In determining the effectiveness of New Zealand's laws in preventing illegal funds being housed in foreign trusts and tax evasion, the tax disclosure rules and the information required to be provided under the anti-money laundering regime cannot be considered in isolation. Disclosures required to be made to IRD can be expected to improve the effectiveness of the anti-money laundering regime. A key objective of the recommendations is to introduce a deterrent or signal sending effect, which the current rules lack.
- 1.37 A significant majority of the 23 written submissions to the Inquiry, including from the foreign trust industry and its advisors, support some expansion of the existing disclosure rules. One submission recommended that foreign trusts should be banned or subjected to New Zealand tax.

- 1.38 The Inquiry noted one local media statement that New Zealand's reputation had suffered a 'huge blow' as a consequence of the Panama Papers, and other statements suggesting long-term reputational damage has occurred. The Inquiry's review of international media on the topic does not support that conclusion. With the exception of a small number of articles in the Australian media, references to New Zealand in the international press appear to have been cursory.
- 1.39 The Inquiry considers that greater reputational damage has occurred domestically as a result of the Panama Papers debate. In part this has been caused by the incorrect conclusion that wealthy New Zealanders can use foreign trusts established in New Zealand to avoid or reduce their tax. The foreign trust regime cannot be used in this way. However, suggestions to the contrary cause legitimate questions to be raised over the fairness of the tax system.
- 1.40 The Inquiry was struck by the rapidly expanding number and scope of international agreements to which New Zealand is a signatory that are designed to counter, on a global basis, corruption, crime, money laundering, tax evasion and aggressive tax practices. These overlap government agencies. Issues that arise from this are-
- a) The increased reporting in respect of international transactions, ranging from simple bank transfers to complex cross-border structures, will be significant. Education, training and communication of the reasons for these changes will be pivotal to achieving buy-in from New Zealanders, and compliance.
 - b) There is potential for duplication. For example, the Automatic Exchange of Information/Common Reporting Standard requirements may result in some duplication of information required under the Anti-Money Laundering/Countering Financing of Terrorism rules.
 - c) Consideration might be given to having a single government agency assigned an overall coordination role to ensure these initiatives, and the resulting disclosure requirements, are implemented as efficiently as possible.
- 1.41 Globalisation, coupled with major groupings such as the G20 moving at speed to advocate and implement measures to clamp down on tax evasion and money laundering, is having a significant impact on tax policy and administration. Developed nations are becoming increasingly intolerant of corruption and of avenues through the international financial system that can be a route to financing terrorism. One consequence is a sharp increase in the amount of information that regulators around the world are collecting and sharing. Developments in technology allow the collection, sharing and matching of data at levels and within timeframes not previously thought possible. Another consequence is a proliferation of measures designed better equip countries to tax highly mobile profits in the digital era. This 'new world' can be expected to result in fundamental changes to the way individuals and businesses structure their international dealings.