Tax Working Group
Te Awheawhe Tāke

Tax Working Group Public Submissions Information Release

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) of the Official Information Act.

To: Tax Working Group Secretariat
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By email: submissions@taxworkinggroup.govt.nz

Dear Tax Working Group

You have called for submissions on your paper "Future of Tax: Submissions Background Paper" (the (Paper")

Introduction

As stated in the Paper, New Zealand's 'broad-based, low-rate' system, with few exemptions for GST and income tax, has been in place for over thirty years. We consider that it is still the best approach for New Zealand. The system is based on residence and territoriality (i.e. source).

In the Paper you have asked whether the tax system should be changed. Below, we examine whether the tax system should be changed in relation to the taxation of trusts. We provide our recommendations and a summary at the end of this paper.

Taxation of Trusts

As you are aware, the current system of tax in New Zealand is based on residence and source concepts. So in general terms New Zealand residents are taxed in New Zealand on their worldwide income, and non-New Zealand residents are only taxed in New Zealand on income sourced from within New Zealand.

This is the basis for the New Zealand Foreign Trust regime – whereby a trust settled by a non-New Zealand resident settlor, with a New Zealand resident trustee, will only be taxed in New Zealand on New Zealand sourced income. Income derived outside of New Zealand will not be taxed here. The logic here is that there is no economic basis for New Zealand to tax a trust settled exclusively by non-residents when the trust earns no New Zealand sourced income, even if the trustee is resident in New Zealand.

Conversely, the trust taxation regime provides that a trust settled by a New Zealand resident will be liable for tax in New Zealand on its worldwide income even if the trust has a non-New Zealand resident trustee.

The trust taxation regime has worked perfectly well for over 30 years, and is consistent with the approach taken in many other jurisdictions in the OECD and common law world.

The OECD has previously reviewed the New Zealand trust taxation rules and determined that they are in acceptable form.

However, over the last few years there has been some concerns expressed that New Zealand's Foreign Trust taxation regime was not robust enough to ensure New Zealand was complying with its international obligations. There was concern that New Zealand was not protecting against the use of companies and trusts to assist foreigners with tax avoidance or evasion in their home jurisdictions. These concerns were particularly prevalent following the Panama Papers release, which triggered the Shewan inquiry into the New Zealand Foreign Trust regime, and the subsequent foreign trust registration regime.

We submit that the application of the following regimes has now adequately addressed any concerns which may have existed:

1. The Anti-Money Laundering and Countering Financing of Terrorism Act 2009, which requires trustees to identify all parties to the trust and ensure verification of the underlying source of funds or wealth settled on a Trust. Tax evasion is a "predicate offence" under AML Law, so all trustees (and other financial institutions) need to ensure structures are tax compliant.
2. Application of FATCA rules requiring automatic exchange of information with the USA.
3. Application of the Common Reporting Standard (CRS) requiring automatic exchange of information with 60 jurisdictions (the list will be expanded next year).
4. The New Zealand Foreign Trust registration regime, which requires the registration of each and every New Zealand Foreign Trust including submitting trust documents, information on Settlors, Protectors and Beneficiaries and information on settlements made on the trust.
5. Annual reporting under the New Zealand Foreign Trust registration regime which includes provision of financial accounts and information on additional settlements and any distributions made by the Trust.

We submit that the application of the above regimes is sufficient to protect New Zealand's reputation and ensure that we are compliant with all of the required OECD obligations.

Application of the Reverse Hybrid Rules

There has been some suggestion that the New Zealand Inland Revenue Department wishes to treat New Zealand Foreign Trusts as reverse hybrids under the BEPS rules and to introduce rules around this. We believe this is an incorrect interpretation of the definition of a reverse hybrid and there should be no application to New Zealand Foreign Trusts in this context.

New Zealand would be unique in the OECD in applying the reverse hybrid concept to trusts as they are not fiscally transparent. The reverse hybrid concept is targeted at fiscally transparent entities such as limited partnerships and US LLCs. It would result in double taxation: the OECD has expressly stated that the application of BEPS rules should not cause this outcome.

We submit that the regimes that have been set out above (at 1-5) are more than sufficient to ensure that New Zealand Foreign Trusts are not being used for tax avoidance purposes and that the various reporting regimes and international exchange agreements will be sufficient to ensure New Zealand compliance with international policy.

We submit that the taxation of New Zealand Foreign Trusts should remain in its current form and should not be amended, including any potential application of the reverse hybrid rules to New Zealand Foreign Trusts under the BEPS regime.

Recommendations and summary

We therefore conclude that New Zealand should not change its tax laws in relation to the taxation of New Zealand Foreign Trusts.

The Foreign Trust registration requirements together with our anti-money laundering rules, FATCA and CRS reporting regimes all meet international standards and are appropriate to help protect the trust industry from being misused for tax avoidance, tax evasion and money laundering. The substantial regulatory requirements that now apply to all Foreign Trusts give legitimacy to the trust industry and bolster New Zealand's reputation as a safe and politically and economically stable country within which a trust can be managed.

It should be borne in mind that the foreign trust 'industry' generates substantial export earnings and employment (and hence downstream tax). If closed down because of a misapplication of the reverse hybrid rules this would have a negative impact on the New Zealand economy and the livelihoods of hundreds of people for no global benefit, as the existing structures managed here would simply move to other jurisdictions – including a number with a much lower level of transparency and international cooperation than New Zealand.

If the Inland Revenue Department continue to move down the path of including New Zealand Foreign Trusts as reverse hybrids under the BEPS rules, then we submit that the Tax Working Group should review the trust rules relating to this as its application is incorrect in the circumstances; is beyond the requirements of the OECD, and will result in double taxation.

We would be happy to engage with the Tax Working Group and the Secretariat to address any of our submissions.

Yours faithfully

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