Regulatory Impact Statement

Amendments to tax disclosure rules for New Zealand foreign trusts

Agency Disclosure Statement

This Regulatory Impact Statement (RIS) has been prepared by Inland Revenue.

It provides an analysis of options to address concerns that New Zealand foreign trusts may be vulnerable to misuse for avoidance or evasion of foreign tax, or for money laundering and other criminal purposes.

The analysis in this RIS was informed by the Government Inquiry into Foreign Trust Disclosure Rules (the Inquiry) which undertook an extensive independent review of the policy and operation of the foreign trust rules.

It should be noted that the Inquiry also recommended changes to the anti-money laundering (AML) requirements. These AML amendments are currently being considered by the Ministry of Justice, alongside work currently underway to bring in Phase II of the AML regime. If these AML proposals are accepted, a RIS for them will be completed as part of the Phase II policy proposals.

To ensure that amendments recommended by the Inquiry and accepted by the Government could be implemented in line with the application time frames recommended by the Inquiry, and to provide for the amendments to be considered by select committee, this RIS was prepared under time constraints.

We have consulted with other relevant government agencies, but not more widely, on the proposals. However, it is noted that as part of its review, the Inquiry invited submissions from the public and received 23 submissions.

The policy option recommended would impose additional costs on New Zealand resident trustees of foreign trusts. However it is considered that as they will reduce the potential for misuse of foreign trusts, these additional costs are justified. None of the policy options would impair private property rights, restrict market competition, reduce the incentives for business to innovate and invest, or override fundamental common law principles.

Carmel Peters
Policy Manager, Policy and Strategy
Inland Revenue

5 July 2016

STATUS QUO AND PROBLEM DEFINITION

Policy and law concerning the taxation of trusts

1. New Zealand tax law distinguishes between different types of trusts. Foreign trusts are trusts with no New Zealand resident settlor (the person who settles assets on the trust)

2. New Zealand's rules for taxing trusts were introduced in 1988, as part of a wider package of international tax reforms. Most countries tax trusts on the basis of the residence of the trustee (which was New Zealand's previous approach). However, from 1988, New Zealand's rules for the taxation of trusts have been based on the residence of the settlor, not the residence of the trustees. That is, New Zealand taxes a trust on its worldwide income if the settlor is a New Zealand resident – regardless of the residence of the trustees.

3. The general idea behind this approach is that even though the trustees have legal ownership of the assets, the settlor is really the economic "power behind the throne" because they set up the trust by transferring the assets to the trust and appointing the trustees. Taxation based on the settlor's residence makes it difficult for New Zealand residents to avoid tax by holding their assets through overseas trustees.

4. From this starting point, it naturally follows that a trust with a foreign settlor is a foreign trust even when the trustees are resident in New Zealand. A foreign trust that derives foreign sourced income will not be taxed in New Zealand on that income (assuming no New Zealand resident beneficiaries).

5. There is now a foreign trust industry in New Zealand as a result of non-resident settlors being able to accumulate assets and income in a foreign trust with no New Zealand tax. New Zealand advisors (and their overseas agents) help foreigners establish and manage foreign trusts for a fee. Foreign trusts with New Zealand trustees are marketed on the basis of New Zealand's settlor-based tax rules, and stable regulatory environment based on common law.

Current tax disclosure and record-keeping requirements

6. Since 2006, foreign trusts which have a New Zealand resident trustee have been required by the Tax Administration Act 1994 (TAA) to disclose certain information to the Commissioner of Inland Revenue upon establishment. There is currently no formal registration process or register for foreign trusts.

7. The information that is required to be disclosed upon establishment is the name or identifying particulars of the foreign trust, the name of a New Zealand trustee, and whether there is an Australian settlor.

8. New Zealand resident trustees of foreign trusts are also required to keep certain records in relation to the foreign trust, including the trust deed, and (if they are known) the names and addresses of settlors who make a settlement on the trust and beneficiaries who receive a distribution.

9. These records must be provided to Inland Revenue on request. If the information provided upon initial disclosure has changed, the New Zealand resident trustee of a foreign trusts must update the information, but annual filing with Inland Revenue is not otherwise required.

Sanctions for non-compliance

10. Under current law, an intentional breach of a requirement to supply information to Inland Revenue can result in a fine of up to $50,000 and imprisonment for up to 5 years.

11. As noted above, foreign trusts are not taxable in New Zealand if they earn no New Zealand sourced income. However, the current rules provide that if a foreign trust does not have a qualifying resident foreign trustee for an income year and information requested by Inland Revenue is not provided, then if a conviction occurs the foreign trust will be subject to New Zealand tax on its worldwide income. A foreign trust will have a qualifying resident foreign trustee if one of its trustees is a member of a specified professional body (such as the New Zealand Law Society or Chartered Accountants Australia and New Zealand).

12. This means that where a trustee of a foreign trust is convicted of intentionally not providing information to Inland Revenue in relation to that foreign trust, the foreign trust will not be subject to New Zealand tax as long as one of its trustees is a New Zealand lawyer or chartered accountant.

Audit activity and information sharing

13. Inland Revenue currently performs some audit activity in relation to foreign trusts. A key reason for these audits is to ensure that the trusts do not in fact have New Zealand settlors (as if they do have a New Zealand settlor the trust is taxable in New Zealand on its worldwide income), and that the record-keeping requirements of the TAA are complied with.

14. Where Inland Revenue finds information that is of interest to other authorities (overseas tax authorities or domestic law enforcement agencies) in the course of these audits, Inland Revenue will pass this information on where authorised.

15. Inland Revenue shares information about foreign trusts with overseas tax authorities with whom New Zealand has a treaty which has tax information exchange provisions. This information is shared upon request from the overseas tax authority or where Inland Revenue considers that the information may be of interest to that tax authority. Where the settlor of a foreign trust is Australian, Inland Revenue provides this information automatically to the Australian Taxation Office.

16. The circumstances in which Inland Revenue shares information about foreign trusts with domestic law enforcement agencies are relatively limited (for example, information can be shared if it concerns individuals or if it is requested by Police and it relates to serious crime).

Problem definition and recent developments

17. Concerns have been raised that the existing disclosure and record-keeping requirements in relation to foreign trusts are insufficient – particularly in light of expanding obligations to exchange information with our treaty partners. These concerns may have the potential to impact on New Zealand's international reputation.

18. In particular, in April 2016, information about the "Panama Papers" was released by the International Consortium of Investigative Journalists. The Panama Papers comprise approximately 11.5 million confidential documents of a Panama based law and trust services firm, Mossack Fonseca. The documents, which are said to date back as far as the 1970s, were

obtained in early 2015. Allegations reported in the media include tax evasion, money laundering, and other illicit activities.

19. References in the Panama Papers to New Zealand foreign trusts and, in particular, allegations that New Zealand foreign trusts may be used in structures which are established to hide assets and evade or avoid foreign tax, added to the above concerns.

Government Inquiry into Foreign Trust Disclosure Rules

20. The Government commissioned an Inquiry (the Government Inquiry into Foreign Trust Disclosure Rules) into whether New Zealand's foreign trust disclosure rules and their enforcement are sufficient to ensure New Zealand's reputation is maintained. The terms of the Inquiry can be found at Appendix 1.

21. The Inquiry conducted an extensive review of the disclosure rules relevant to foreign trusts. The Inquiry reported to the Ministers of Finance and Revenue on 20 June 2016. This report can be found at Appendix 2.

22. The Foreign Trust Inquiry made a number of recommendations. These fell into three broad categories:

- Registration and increased disclosure recommendations that would be administered by Inland Revenue.

- Anti-money laundering (AML) law and implementation recommendations.

- Increased information sharing between New Zealand government agencies about foreign trusts for enforcement purposes.

23. It should be noted that the Inquiry also recommended changes to the AML requirements. These AML amendments are currently being considered by the Ministry of Justice, alongside work currently underway to bring in Phase II of the AML regime. If these AML proposals are accepted, a RIS for them will be completed as part of the Phase II policy proposals. For this reason the options considered in this RIS do not attempt to address the AML concerns raised in the Inquiry.

24. We note that other options were considered by the Inquiry. These options included extending Automatic Exchange of Information (AEOI) obligations to foreign trusts, and having a public register for trusts. All these options were rejected by the Inquiry. We have considered the Inquiry's recommendations on these options and we agree with the conclusions for the reasons given by the Inquiry.

Scale of the problem

25. There are about 12,000 foreign trusts with a New Zealand resident trustee that have been disclosed to Inland Revenue.

26. In 2014, it was estimated that the value of the fees collected in respect of foreign trusts, plus employment income for third party employees and principals for each foreign trust provider entity, amounts to approximately $24 million per annum, on average. This figure

has been calculated from Inland Revenue data. (Other reported estimates of fee income resulting from the industry range from $20 million[1] to $50 million[2] per annum.)

27. The contribution to the New Zealand tax take, in terms of income tax on fee income, goods and services tax, and PAYE paid on behalf of third party employees and principals for each foreign trust provider entity, is around $3 million per annum, on average. This figure has been calculated from Inland Revenue data.

OBJECTIVES

28. The **main objective** is to reduce the potential for misuse of foreign trusts in New Zealand (both actual and perceived)[3] in respect of foreign tax avoidance or evasion.

29. The Inquiry also proposed changes to reduce the potential for foreign trusts to be used for money laundering and other illicit purposes. Reducing the potential for foreign trusts to be used for money laundering and other illicit purposes is not an objective against which the options considered in this RIS are assessed. However, the Inquiry considered that increased disclosure requirements would be likely to partially address this issue. It should be noted that the Inquiry also recommended changes to the AML requirements. These AML amendments are currently being considered by the Ministry of Justice, alongside work currently underway to bring in Phase II of the AML regime. If these AML proposals are accepted, a regulatory impact statement for them will be completed as part of the Phase II policy proposals.

30. All the options are assessed against the status quo in relation to the main objective and the following criteria:

(a) **Maintaining New Zealand's reputation as a leader in best practice of international exchange of information** – Ensuring that New Zealand is able to maintain its reputation as a leader in best practice of international exchange of information, particularly in light of the recent expansion of international obligations (in terms of number of treaty partners, the amount of information, and frequency of exchange).

(b) **Maintaining an open economy** – The options should ensure that New Zealand maintains an open economy which welcomes an active financial services sector.

(c) **Fairness and integrity** (including perceptions of fairness and integrity) – The options should ensure that the law is seen as treating people fairly and consistently and should not allow people to avoid their tax obligations (including any foreign tax obligations).

---

1 IFSDG, "Exporting Financial Services: A Report from the International Funds Services Development Group" (IFSDG, 2011) at 47. Cabinet established the IFSDG in March 2010 to look at financial services opportunities for New Zealand. The estimate is said to be from industry sources in 2009.

2 Refer to www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=10844389.

3 The Inquiry noted that while it did not find any direct evidence of misuse, it is reasonable to conclude that there are cases where foreign trusts are being used in this way.

(d) **Coherency of the tax system** – The options should be consistent with other fundamental principles of the tax system.

(e) **Efficiency of compliance and administration** – The options should, to the extent possible, minimise compliance costs for foreign trusts and administrative costs for Inland Revenue.

31. In this context, we consider that more weight should be given to criteria (a), (c) and (d). For example, where there is a conflict between maintaining New Zealand's reputation and minimising compliance and administrative costs, there should be relatively more weight attached to maintaining New Zealand's reputation.

REGULATORY IMPACT ANALYSIS

32. Three options have been considered in this RIS:

Option 1: Retain the status quo
Option 2: Implement the changes recommended by the Inquiry that relate to registration, increased disclosure, and increased information sharing with some refinements *(Inland Revenue's recommended option).*
Option 3: Repeal the tax exemption for foreign trusts.

Option 1

33. Option 1 is to retain the status quo.

Assessment against objective and criteria – option 1

Main objective

34. The status quo does not meet the objective of reducing the potential for perceived misuse of foreign trusts in New Zealand in respect of foreign tax avoidance or evasion.

Maintaining New Zealand's reputation as a leader in best practice of international exchange of information

35. Although New Zealand's current disclosure requirements are sufficient to meet the existing obligations for exchanging tax information under treaties, given the recent international movements towards increased information sharing between tax jurisdictions, in the current environment these rules may not be sufficient to maintain New Zealand's reputation as a leader in best practice of international exchange of information.

Maintaining an open economy

36. The status quo is consistent with maintaining an open economy which welcomes an active financial services sector, where those activities are legitimate.

Fairness and integrity

37. Perceived or actual misuse of foreign trusts in New Zealand in order to avoid tax obligations in other jurisdictions could impact negatively on fairness and integrity.

Coherency of the tax system

38. The impact on coherency of the tax system is mixed. The tax exemption for foreign trusts is consistent with New Zealand's framework for taxing trusts. However, the disclosure requirements for foreign trusts seem insufficient in light of recent international trends.

Efficiency of compliance and administration

39. The compliance costs for foreign trusts under current rules are very low.

40. In terms of administrative costs, there are currently some costs for data entry and the exchange of information. Inland Revenue also runs an audit project on foreign trust providers.

Option 2

41. This option would implement a package of changes relating to registration, increased disclosure, and information sharing. This package essentially follows the Inquiry's recommendations, with some minor modifications as indicated. The Inquiry's recommendations are contained in Appendix 1.

Registration and initial disclosure

42. Under option 2 the current disclosure process would be formalised as a registration process. The resident trustee of the trust would be required to declare 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 applicable record-keeping requirements in the TAA, the Anti-Money Laundering and Countering Financing of Terrorism Act and Regulations, and the Automatic Exchange of Information (AEOI) requirements (once enacted).

43. To ensure that sufficient information is provided to Inland Revenue, more information would be required to be disclosed upon establishment of the trust, and in particular, the name, email address, foreign residential address, country of tax residence and Tax Identification Number of:

i. the settlor or settlors
ii. the protector (if there is any)
iii. non-resident trustees
iv. any other natural person who has effective control of the trust (including through a chain of control or ownership)
v. beneficiaries of fixed trusts, including the underlying beneficiary where a named beneficiary is a nominee.

44. In addition to the above disclosure, the trust deed would also be required to be filed with the registration form, and, in the case of discretionary trusts[4], any class of beneficiary not listed in the trust deed should be described on the registration form.

[4] A discretionary trust is a trust where the beneficiaries have no fixed entitlement to distributions from the trust.

On-going disclosure requirements

45. There would also be on-going disclosure requirements under option 2. Foreign trusts would be required to file an annual return with Inland Revenue that includes any changes to the information provided at registration, the trust's annual financial statement, and 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.

46. Inland Revenue considers that, as part of option 2, the annual return should include the amount of any settlements on the trust in the relevant period and the names, foreign address, Tax Identification Number and country of tax residence of that settlor. This information is currently required to be kept as part of the existing record keeping requirements. It would be more useful if this information was directly provided to Inland Revenue.

When a trust qualifies for the tax exemption

47. The exemption from New Zealand tax on foreign-sourced income should apply only to a foreign trust with a resident trustee that has registered and fulfilled the associated disclosure obligations at that time.

48. The Inquiry also recommended that the qualifying resident trustee safe harbour should be reviewed. Inland Revenue considers that, as part of option 2, the qualifying resident trustee safe harbour should be removed.

49. The qualifying resident trustee safe harbour was introduced in 2006, as part of amendments which introduced the current disclosure requirements for foreign trusts. We understand that, at that time, it was considered that this safe harbour would encourage foreign trusts to use a professional New Zealand accountant or lawyer as a trustee, and that having a trustee who is a professional New Zealand accountant or lawyer would be an appropriate check to prevent non-compliance. However, the current qualifying resident trustee safe harbour does not provide a clear and appropriate signal about the importance of complying with the disclosure rules.

Registration and annual filing fees

50. Fees for registration and annual filing would be charged. This recognises that foreign trusts benefit from New Zealand's regulatory environment and that there are costs involved to the Crown, both in processing registrations and returns and in enforcing the rules relating to foreign trusts. Charging fees would recompense the Crown for those costs. The Inquiry's recommendations note that a fee of $500 for registration and then annually would be reasonable. We note that the registration and filing fees recommended by the Inquiry would be higher than those for companies, limited partnerships, and charities under New Zealand law.[5] Inland Revenue considers that further analysis is required to determine the quantum. Further, we consider that, as part of option 2, it may be appropriate for the level of fees to be modified in future by Order in Council. This would allow those fees to be relatively easily changed if necessary to recognise the costs involved in administering foreign trusts, and is consistent with the approach taken in relation to setting registration and filing fees for companies.

---

[5] The fee for registering a company is $150, and the fee for registering a limited partnership is $270. The annual filing fee for companies and charities is approximately $50, and the annual levy for limited partnerships is $20.

Information sharing with relevant agencies

51. Under option 2 the Department of Internal Affairs and the New Zealand Police would be able to search the register of foreign trusts. These agencies may need the information contained on the register for law enforcement purposes. The list of agencies with access to the register could be expanded in the future if there is good cause for it.

Assessment against objective and criteria – option 2

Main objective

52. Obtaining more information about the settlor and beneficiaries and providing it to other authorities (overseas tax authorities and domestic enforcement agencies) would help ensure that foreign trusts are not misused. More disclosure in relation to foreign trusts and access to the information by relevant agencies would make it difficult for these vehicles to be used to avoid foreign tax. This option meets the main criteria.

Maintaining New Zealand's reputation as a leader in best practice of international exchange of information

53. By increasing the information available to Inland Revenue that can be shared with New Zealand's treaty partners, option 2 would maintain New Zealand's reputation as a leader in best practice of international exchange of information. This would be an improvement on the status quo.

Maintaining an open economy

54. We consider this option is consistent with maintaining an open economy which welcomes an active financial services sector, where activities are legitimate. While there would be some increase in compliance costs for this industry, as noted below, these are not significant given the current record-keeping requirements and in some cases, the similar requirements for AEOI and AML legislation.

55. In terms of maintaining an open economy, we consider that option 2 is no better or worse than the status quo.

Fairness and integrity

56. The impact on fairness and integrity (including on perceptions of fairness and integrity) is expected to be positive. The requirements are likely to provide increased integrity, and the registration requirements will signal the increased disclosure requirements. This would be an improvement on the status quo.

Coherency of the tax system

57. The impact on coherency of the tax policy framework and disclosure rules would be an improvement on the status quo.

58. This option would retain the tax exemption for foreign trusts, which is consistent with New Zealand's framework for taxing trusts.

59. Increasing the disclosure requirements for foreign trusts would be consistent with recent trends for increased disclosures to tax authorities for the purposes of detecting tax avoidance and evasion.

Efficiency of compliance and administration

60. There may be additional compliance costs for foreign trusts. However we do not consider that these will be significant.

61. Much of the information that would be required to be provided is already required to be collected by the New Zealand-resident trustee in accordance with existing record-keeping requirements.

62. At the moment, identity and address information of settlors and beneficiaries is required to be collected, although only "if known". The new information that foreign trusts will be required to collect mainly relates to identity and address information about the settlor and beneficiary (including the Taxpayer Identification Number for those persons). We note that these information requirements would be broadly in line with the type of information disclosure standards that will be required under the proposed AEOI requirements.

63. The foreign trust would also need to do a new annual return to Inland Revenue rather than simply keeping records.

64. In some (but probably not most) cases, this information may be required to be provided under AEOI or AML legislation. However, we anticipate that entities will be able to use the same information collected for multiple regulatory regimes. Accordingly, while we acknowledge duplication in those cases might potentially increase compliance costs, we consider that compliance costs arising from duplication are relatively minimal.

65. Under option 2, there will be some increased administrative costs for Inland Revenue as a result of redesigning the current disclosure statement, a new annual return, and additional data entry. These costs are likely to be under $1 million. There may also be some additional resources required for increased exchange of information with domestic law enforcement agencies and overseas treaty partners. The costs relating to additional data entry and enforcement could depend on the numbers of foreign trusts.

66. Overall, in terms of efficiency of compliance and administration, option 2 would be slightly worse than the status quo.

Option 3

67. This option would repeal the tax exemption for foreign trusts. This option was suggested by some submitters to the Inquiry. The Inquiry did not recommend this option.

68. We note that it is possible for foreign trusts to be established in New Zealand for legitimate purposes that do not include foreign tax abuse or illicit activity. However, taxing foreign trusts on their worldwide income would deter the use of trusts even if they are used only for legitimate reasons.

Assessment against objective and criteria – option 3

Main objective

69. This option would meet the main objective to reduce the potential for misuse of foreign trusts in New Zealand (both actual and perceived) in respect of foreign tax avoidance or evasion.

Maintaining New Zealand's reputation as a leader in best practice of international exchange of information

70. To the extent that this option deters the use of foreign trusts, there would be no relevant activity and therefore no impact on New Zealand's reputation as a leader in best practice of international exchange of information. This is an improvement on the status quo.

Maintaining an open economy

71. This option would not be consistent with maintaining an open economy which welcomes an active financial services sector, as this would deter the use of foreign trusts in New Zealand in situations where they are used for legitimate reasons. This may adversely impact New Zealand's financial services sector. This would be worse than the status quo.

Coherency of the tax system

72. This option is not consistent with other fundamental principles of the tax system, which does not tax foreign-sourced income of non-residents and therefore lacks coherence. Accordingly, this would be worse than the status quo.

Fairness and integrity

73. The impact of this option on New Zealand's on fairness and integrity is likely to be mixed. Overall, to the extent that foreign trusts are (or are perceived to be) misused for foreign tax avoidance or illicit purposes, this would have a positive impact. On the other hand, to the extent that foreign trusts are used for legitimate purposes, this option may have a negative impact as, in the context of New Zealand's other rules, this approach may be perceived as inconsistent. It is not clear that option 3 is better or worse than the status quo.

Efficiency of compliance and administration

74. If this option significantly reduces the likelihood of foreign trusts operating in New Zealand, which we would expect to happen, this would reduce administrative costs to Inland Revenue, and compliance costs for foreign trusts. In this respect it would be an improvement on the status quo.

CONSULTATION

75. Inland Revenue has consulted with The Treasury, the Ministry of Justice, the Department of Internal Affairs, and the New Zealand Police. They have raised no concerns with the proposals in the preferred option (option 2).

76. To ensure that amendments recommended by the Inquiry and accepted by the Government could be implemented in line with the application timeframes recommended by

the Inquiry, while still being subject to select committee scrutiny, the time period for preparing this RIS has been shortened. Accordingly, Inland Revenue has not consulted more widely on the proposals.

77. However, in forming its recommendations, the Inquiry invited public submissions, and received 23 submissions, including from Chartered Accountants Australia New Zealand, the New Zealand Law Society, Transparency International, the New Zealand Council of Trade Unions, accounting firms, trust and company services providers, and individuals. The Inquiry also consulted with the Privacy Commissioner.

78. Part 11 of the Inquiry's report summarised the submissions made to it.

79. Most of the submitters who commented on the taxation of foreign trusts considered that settlor-based approach for taxing trusts (which results in the tax exemption for foreign trusts) should continue, but that there should be some changes to disclosure requirements. Two submitters considered that the trust should be taxed on its worldwide income if there is a resident trustee. One submitter suggested abolishing foreign trusts.

80. Most submitters who commented on the current disclosure rules considered the current disclosure regime to be inadequate. The Inquiry noted that not all submissions were explicit about what disclosure obligations should be changed. One submitter thought that providing the extra information that is obtained for Australian settlors would be sufficient, while others wanted more extensive disclosure, including details of settlors and beneficiaries and annual income statements and distribution information.

81. The Inquiry noted that a number of submissions considered that the upcoming requirements to provide information under AEOI should help address shortfalls in disclosure, and that some thought that AEOI would be a complete solution. However, the Inquiry concluded in Part 6 that, for a significant number of foreign trusts, AEOI will not result in any material increase in the amount of information required to be disclosed to Inland Revenue. Inland Revenue agrees that the AEOI due diligence and reporting requirements seem likely to have only limited application to foreign trusts.

CONCLUSIONS AND RECOMMENDATIONS

82. The following table summarises the consideration of the options from the regulatory analysis section above. Within the overview table the following symbols are used:

- ✓ Better than the status quo
- × No better than the status quo
- ×× Worse than the status quo
- ? Unclear

Options	**Analysis against the objective and criteria**
Option 1 – Status quo	Does not meet the main objective
Option 2 – Increased disclosure, largely following the Inquiry's recommendations *(Inland Revenue's recommended option)*	Meets the main objective New Zealand's reputation ✓ Open economy ✓

	Fairness and integrity ✓ Coherency of tax system ✓ Compliance and administration: ××
Option 3 – Repeal the tax exemption for foreign trusts	Meets the main objective New Zealand's reputation ✓ Open economy ×× Fairness and integrity ? Coherency of tax system ×× Compliance and administration: ✓

83. We do not recommend option 1 (the status quo) as that does not meet the stated objective to reduce the potential for misuse of foreign trusts in New Zealand (both actual and perceived) in respect of foreign tax avoidance or evasion and money laundering and other illicit purposes.

84. We consider that option 2 would address the concerns relating to foreign tax avoidance or evasion. It may partially address the concerns relating to money-laundering and other illicit purposes. Accordingly, the recommended option in this RIS will meet the objective to reduce the potential for misuse of foreign trusts in New Zealand (both actual and perceived) in respect of foreign tax avoidance or evasion.

85. We recommend option 2 (increased disclosure, largely following the Inquiry's recommendations) over option 3 (repeal of the tax exemption for foreign trusts), on the basis that option 2 will address the concerns regarding misuse of trusts without imposing excessive administrative costs. While option 3 would also meet the stated objective, it does not satisfactorily meet the criteria in relation to an open economy and the coherency of the tax system. Option 2 will increase administrative costs for Inland Revenue and compliance costs for trust and company service providers. However, at this stage we consider that the administrative costs are relatively minimal. We do not consider that the increased compliance costs, which relate to additional information and the obligation to file annual returns, are likely to be significant. This increased information is broadly similar to the type of information that trust and company service providers (TCSPs) would be expected to provide where AEOI and AML obligations apply. Accordingly, requiring this information does not seem unreasonable.

IMPLEMENTATION

86. Legislative change would be required to implement option 2. Legislative amendments required to implement option 2 could be included in a bill to be introduced in August 2016. This bill is expected to be enacted by the end of 2016.

87. Transitional provisions for existing foreign trusts are planned to provide them with enough time to comply with the proposed requirements. It is proposed that new foreign trusts would need to comply with the amended rules from the date of enactment, and that existing foreign trusts would have until 30 June 2017 to comply with the registration requirements. This transitional provision would allow existing trusts approximately six months to either collect the information required or to wind-up. New foreign trusts would need to comply with the annual filing obligation from date of enactment. Existing foreign trusts would need to comply with the annual filing obligation in relation to income years beginning on or after 1 April 2017.

88. Inland Revenue would administer the proposed changes. Some systems changes would be required to implement option 2. No changes to FIRST (Inland Revenue's mainframe IT system) would be required. A revised form upon registration and a new annual disclosure form would also be required.

89. In implementing option 2, Inland Revenue would work with TCSPs to ensure that they and their clients understand the changes and their new obligations. As the industry is reasonably small, we consider that this is achievable.

90. Inland Revenue will continue with its current audit and education programme in relation to TCSPs.

91. Implementation of a searchable register of foreign trust registrations would require Inland Revenue to operate a manual spread-sheet database, which will be shared with other government agencies authorised by legislation.

92. Commentary on the proposed legislative changes would be released when the Bill is introduced. In addition, a special report and a *Tax Information Bulletin* containing further explanation of the amendments would be published once the Bill is enacted.

MONITORING, EVALUATION AND REVIEW

93. In general, Inland Revenue's monitoring, evaluation and review of new legislation takes place takes under the generic tax policy process (GTPP). The GTPP is a multi-stage tax policy process that has been used to design tax policy in New Zealand since 1995. The final stage in the GTPP is the implementation and review stage, which involves post-implementation review of the legislation, and the identification of any remedial issues. Opportunities for external consultation are also built into this stage. In practice, any changes identified as necessary for the new legislation to have its intended effect would be prioritised in the context of the current Tax Policy Work Programme, and any proposals would go through the GTPP.

94. The Inquiry recommended that the registration requirement be the responsibility of Inland Revenue initially, but the Government may want to consider if another department, such as the Companies Office, may be a more appropriate department at a later time.

95. Inland Revenue agrees with the Inquiry's recommendation to review the position in future (after the existing rules have bedded in). It is possible that there may be efficiencies from another department other than Inland Revenue administering the registration of foreign trusts. This review would need to include consideration of:

a. ensuring that information sharing between the other department and Inland Revenue is adequate (given that Inland Revenue may need to share information with its overseas counterparts, and to enforce the sanction of taxing the foreign trust's income); and

b. ensuring that the other department has the appropriate ability to investigate foreign trusts (both under legislation and operationally).

96. As part of this future review, Inland Revenue would report back to Ministers on the operation of the new disclosure rules.

97. The Inquiry also recommended that a review be undertaken of the current legislative arrangements for the sharing of information between three agencies (Inland Revenue, the Financial Intelligence Unit of the New Zealand Police and the Department of Internal Affairs) to determine the financial and efficiency gains and other implications (including secrecy considerations) of sharing strategic intelligence and other information between agencies.

98. Inland Revenue agrees in principle that there should be a review. It may be appropriate to include other regulatory agencies as well. In terms of timing, we consider that this should be considered in light of:

a. current work on reforming the secrecy provisions in the TAA; and
b. the timing of Phase II of AML/CFT and other priorities.