Government Inquiry into Foreign Trust Disclosure Rules

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New Zealand Government

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Government Inquiry into Foreign Trust Disclosure Rules

20 June 2016

Hon. Bill English
Minister of Finance
Parliament Buildings
Wellington

Hon. Michael Woodhouse
Minister of Revenue
Parliament Buildings
Wellington

Dear Ministers

In accordance with your letter of appointment dated 18 April 2016, and the New Zealand Gazette notice dated 19 April 2016, I enclose my report arising from the Government Inquiry into Foreign Trust Disclosure Rules.

The report contains a number of recommendations that the Inquiry considers will address the issues identified with the existing disclosure rules, which are not considered fit for purpose.

The Inquiry has benefited from the input of officials from Treasury, Inland Revenue, the Ministry of Justice, the Department of Internal Affairs, the Financial Intelligence Unit of the New Zealand Police, the Department of the Prime Minister and Cabinet, and the Privacy Commissioner. I thank them for their assistance.

I would be pleased to discuss the findings and recommendations at your convenience.

Yours sincerely

John Shewan CNZM

Contents

High-level overview

The issue

Media reports and commentaries on the Panama Papers assert that New Zealand foreign trusts are being used extensively by wealthy individuals in structures that facilitate-

- tax evasion
- aggressive tax planning
- money laundering and hiding of assets.

Potential reputational damage

New Zealand's reputation as a country that cooperates with other countries to counter money laundering, abusive tax practices and other illicit activities may be tarnished.

Perception internationally that New Zealand has weak laws around due diligence and reporting and is generally a 'soft touch'.

New Zealand being cited as a tax haven.

Undermines confidence of compliant New Zealand taxpayers in the integrity of the tax system and leads to comments such as 'Why should I pay more taxes when the wealthy are dodging their taxes through shonky structures shrouded in secrecy?'

Remedies

a) Where the assertions and/or perceptions are not justified: explanation, education and communication.

b) Where the assertions and/or perceptions are justified: change the rules around

- ***tax disclosures*** – primary deterrent to tax-related concerns
- ***anti-money laundering*** – primary deterrent to money-laundering concerns, but tax disclosures will also assist.

Options for reform where the assertions are justified

Option 1 Some increase in information required to be disclosed by foreign trusts (details of settlor and beneficiaries as listed in trust deed).

Option 2 Significant increase in information required to be disclosed (details of settlor, persons with effective control, non-resident trustees, beneficiaries, trustees, trust deed) coupled with an annual return, expanded application of the AML laws and a register of foreign trusts, searchable (but not by the public).

Option 3 As for 2, but foreign trust register is publicly available.

Option 4 Amend the foreign trust tax regime to repeal the exemption from tax on foreign source income.

Inquiry's recommendation

Adopt Option 2 – Significant increase in information disclosure requirements.

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.

Part 2 Background

Reasons for Inquiry

2.1 The Inquiry was announced by the Minister of Finance, Hon Bill English, and the Minister of Revenue, Hon Michael Woodhouse, on 11 April 2016 in response to the release of the 'Panama Papers' the previous week. The Ministers said that in light of the Panama Papers it was appropriate to look at whether the disclosure rules are fit for purpose and whether practical improvements could be made.

2.2 Concern over the adequacy of New Zealand's disclosure rules was prompted by media reports offshore and in New Zealand that the Panama Papers show that New Zealand foreign trusts are used extensively in structures that are allegedly established to hide assets and evade or avoid tax.

2.3 New Zealand obtained a 'compliant' rating, the highest ranking possible, in the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes in the 2013 Peer Review report, and takes pride in its reputation as a country that cooperates with other jurisdictions to deter abusive tax practices. The Inquiry was informed by the Government that maintenance of that reputation is important.

Establishment of Inquiry

2.4 The Inquiry was established pursuant to section 6(3) of the Inquiries Act 2013. It was gazetted on 19 April 2016 (*New Zealand Gazette*, No. 33), and authorised to begin considering evidence from 19 April 2016. For purposes of section 4 of the Inquiries Act, the Treasury was nominated as the relevant department for the Inquiry and undertook the administrative function. Ms Maria Deligiannis was appointed as legal counsel assisting the Inquiry.

2.5 To recognise the longstanding statutory limitations applicable to the provision of information from or on behalf of the Commissioner of Inland Revenue, the Inquiry was required to make such orders as considered necessary under section 15 of the Inquiries Act 2013. An order restricting public access to confidential information received from the Commissioner was issued on 9 May 2016. An order restricting public access to audit reports provided to the inquiry by the Department of Internal Affairs was issued on 13 June 2016.

Terms of reference

2.6 The terms of reference are in Appendix 1. In summary, the Inquiry is required to report and make any recommendations it considers appropriate relating to-

- New Zealand's existing foreign trust disclosure rules and their practical application
- whether the existing foreign trust disclosure rules and their enforcement are sufficient to ensure New Zealand's reputation is maintained when considered alongside its commitment to relevant international agreements and laws
- options for enhancement and enforcement of the foreign trust disclosure rules, including any practical improvements that could be made or other actions that could be taken.

Inquiry's approach and consultation

2.7 The Inquiry obtained briefings from the government agencies responsible for administration of the relevant statutes and international agreements, being the Inland Revenue Department (IRD), Department of Internal Affairs (DIA), Ministry of Justice (MoJ), the Treasury and the Financial Intelligence Unit (FIU) of the New Zealand Police. The Inquiry also met with the Privacy Commissioner and with the Department of Prime Minister and Cabinet. Follow-up meetings were held to clarify issues and obtain further detail where required.

2.8 The Inquiry wrote to 25 parties who, based on media coverage and published articles, had displayed a particular interest in the foreign trust disclosure issue. Public submissions were invited through the Inquiry's page on the Treasury website. A total of 23 written submissions were received. No oral submissions were heard, but the Inquiry did engage with several submitters to clarify aspects of their submissions.

2.9 The Inquiry reviewed samples of external audit reports undertaken on trust service providers to determine compliance with the provisions in the Anti-Money Laundering and Countering of Foreign Terrorism Act 2009.

2.10 Naturally, the Inquiry took a close interest in the coverage of the Panama Papers in the local and international media.

Report format

2.11 The Inquiry's terms of reference require consideration of a number of statutes, international agreements and departmental operational and enforcement policies relevant to the foreign trust disclosure rules. To make the report as readable as possible, detailed technical information is housed in the appendices. The body of the report contains brief summaries of technical matters that underpin the conclusions and recommendations.

Acknowledgements

2.12 The Inquiry records its appreciation to officials for their assistance throughout the Inquiry. It notes particular thanks to Mr Steve Mack, who ran the Secretariat, and to Ms Samantha Aldridge for her substantial assistance in coordinating responses to the Inquiry's questions to IRD. The Inquiry also benefited from the input of Erin Lubowicz from the Ministry of Justice, Kirsty Pleace from the Department of Internal Affairs, Andrew Hill and Christiaan Barnard from the Financial Intelligence Unit of New Zealand Police, Emma Grigg, Carmel Peters, John Nash, Michael Webb, Anu Anand and Rowan McArthur from IRD, and Suzy Morrissey and Penny Mok from Treasury.

Part 3 The Panama Papers

Background to release

3.1 Based on reports in the international media, the Panama Papers comprise about 11.5 million confidential documents obtained by an individual who hacked into the records 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 and made available initially in batches to a German newspaper, *Suddeutsche Zeitung*.

3.2 Due to the volume of documents the German newspaper enlisted the assistance of the International Consortium of Investigative Journalists (ICIJ).[1] The ICIJ distributed the documents to several hundred journalists at media outlets around the world.

3.3 The first media reports on the Panama Papers appeared on 3 April 2016, and the volume of news reports spiralled from that date. The New Zealand media picked up on a number of the international reports, particularly those containing references to New Zealand. Allegations reported in the media reports include tax evasion, financing corruption, money laundering, sanctions violation and hiding of assets.

3.4 Late in April 2016 RNZ News,[2] Television New Zealand (One News) and investigative journalist Nicky Hager joined forces to collaborate in investigating New Zealand links to the Panama Papers. In their first reports on 8 and 9 May 2016 they advised that they had access to all of the Panama Papers through an arrangement with the ICIJ and *Suddeutsche Zeitung*.

3.5 In the ensuing weeks this grouping has released several stories with citing Panama Papers content relevant to New Zealand.

Papers themselves not available to Inquiry

3.6 There is a common misconception that the Panama Papers have been released publicly, and can be inspected. As at the date of release of this report there has been no public release. As a result the Inquiry has been unable to inspect any of the Panama Papers, and has necessarily had to undertake analysis based in part on reports written by journalists who have seen the documents or extracts from them.

3.7 The Inquiry is acutely aware of the danger of reaching conclusions based on unverifiable media reports and associated speculation. It also observes that some New Zealand commentaries on the impact of the Panama Papers confuse New Zealand foreign trusts and their tax status with structures that attempt to evade or avoid New Zealand tax through secrecy, non-disclosure or off-shore investment structures.

3.8 In the absence of access to the papers themselves the Inquiry approached the data collection aspect of its work by-

- considering the structures cited in media reports and associated commentaries

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1 For a description of the ICIJ, refer https://www.icij.org/

2 Previously called Radio New Zealand News.

- determining whether the key issue of concern raised by the reporter or commentator is alleged secrecy/hiding of funds (that may in some cases have been obtained illegally), non-payment of foreign tax, or both
- where the matter is tax related, attempting to determine if the issue is alleged evasion of a foreign country's tax through non-disclosure, or avoidance through the use of a structure that takes advantage of differences between New Zealand's treatment of foreign trusts and the treatment in the overseas county
- reviewing IRD foreign trust files prepared for the purpose of exchanges of information with offshore tax treaty partners
- obtaining comments and analysis from IRD based on their analysis of records held on foreign trusts
- considering submissions to the Inquiry from the foreign trust industry, and associated follow-up inquiries
- considering whether it is reasonable to conclude that the outcomes purported to have resulted from the use of New Zealand foreign trusts could have actually occurred, or have been likely to have occurred, based on the existing disclosure requirements and the application of relevant New Zealand tax and anti-money laundering laws.

ICIJ release on 10 May 2016

3.9 On 10 May 2016 the ICIJ provided unrestricted access to a database containing the names of all of the entities listed in the Panama Papers together with the officers and the intermediaries that helped set up, or provided corporate services to, those entities.[3] The database allows users to search for officers, shareholders and the intermediaries of any offshore entity identified in the Panama Papers. It provides a basic outline of the ownership structure for each entity and the connections it has with officers and intermediaries. However, the database does not identify the function of, or assets held by, any offshore entity. It also contains only limited details as to beneficial owners of the entities.

3.10 IRD has analysed the ICIJ database and determined the following references to New Zealand:

Information Type[4]	Total Number of Lines	Number of Lines Relating to NZ
Entities	213,634	143
Officers	238,404	326
Intermediaries	14,110	19
Addresses	93,454	264
Total	559,602	752

[3] https://www.icij.org/blog/20160509-offshore-data-base-release.html

[4] These are the classifications used by the ICIJ. *Entities* can include trustee companies. *Officers* can include directors. *Intermediaries* can include trust and company service providers, accountants or lawyers.

3.11 It is not possible to be precise as to the total number of foreign trusts covered in this database. Some of the companies listed may be acting in the capacity of corporate trustee of a foreign trust but not be identified as such. Other entries may be duplicates. Thirty-seven foreign trusts are specifically named in the database or are alternatively identifiable through media coverage. IRD has established that all but one of these foreign trusts filed the required IR 607 disclosure form. One trust reported in the media was not finally established and therefore an IR 607 was not required.

3.12 While the number of lines in the database that contain references to New Zealand are only 0.13% of the total, media reports say that New Zealand is mentioned over 60,000 times in the Panama Papers. The Inquiry has been unable to verify this number.

Releases by RNZ, One News, Nicky Hager grouping

3.13 Reports from the RNZ, One News, Nicky Hager grouping have appeared progressively in the New Zealand media since 8 May 2016. However, in common with earlier media coverage, only brief factual outlines of trust settlements and related asset ownership have been reported. The reports focus in particular on high-profile individuals, sometimes with alleged convictions from offshore judicial authorities, who are said to have a direct or indirect interest in complex New Zealand foreign trust and company structures that hold substantial offshore assets.

3.14 It is not possible to conclude from these stories whether funds held through the New Zealand structures are illicit, or if there has been any failure to pay tax that should have been paid in offshore jurisdictions. While that is the inference from some stories, it cannot be verified.

General media coverage

3.15 Coverage of the Panama Papers in both the local and overseas media has been extensive since the initial stories broke on 3 April 2016. Not surprisingly, reports around the world focus on stories most topical in the country in which the story is written. Politicians, wealthy individuals and high-profile citizens whose names (or those of family or associates) are mentioned in the Panama Papers feature prominently.

3.16 The Inquiry has searched the websites of a wide range of overseas publications looking for mentions of New Zealand. With the exception of Australia, where the *Australian Financial Review* has run two in-depth articles,[5] references to New Zealand appear to be very limited.

3.17 In contrast to other countries, the media coverage in New Zealand does not focus on individuals who are involved as investors or beneficiaries in the structures highlighted by the Panama Papers. Based on the articles written about the database, very few New Zealanders are mentioned as having any financial interest in the entities that are disclosed.[6] Rather, the stories are around the use of New Zealand's foreign trust regime in structures described in the Panama Papers, and the appropriateness and potential reputational implications of that.

3.18 Part 9 of the report considers the media coverage, and the resulting reputational impact on New Zealand, in more detail.

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5 These articles are reproduced in Appendix 2 and considered in Part 9 of the report.

6 The low numbers may be attributable to the wide scope of New Zealand's international tax regime, which taxes New Zealand residents on their worldwide income, including on notional returns on interests held in foreign investment funds.

OECD and European Finance Ministers' response

3.19 On 4 April 2016, the day following the release of the Panama Papers, the OECD Secretary General, Angel Gurria, issued a statement condemning Panama for back-tracking on international transparency standards and urging the country to 'put its house in order'.[7] The Secretary General used the opportunity to emphasise the work of the OECD's Global Forum (of which New Zealand is a member) in leading a global crackdown on practices that allow funds to be hidden offshore from tax and law enforcement agencies. He also stressed the importance of effective implementation of global standards and commitments.[8]

3.20 The following week a special meeting of the OECD's Joint International Tax Shelter Information and Collaboration Network (JITSIC),[9] which consists of senior tax administration officials (including from New Zealand) was held in Paris. The meeting was described as being *to consider possibilities for cooperation and information-sharing, identify risks and agree on a collaborative response.*[10]

3.21 The Panama Papers also prompted the United Kingdom Chancellor of the Exchequer and his counterparts from France, Germany, Italy and Spain to write to their G20 colleagues to 'stress the critical importance of the fight against tax evasion, aggressive tax planning and money laundering'.[11] They also urged progress towards a fully global exchange of beneficial ownership information in order to 'remove the veil of secrecy under which criminals operate'. The letter stated-

> *On beneficial ownership, it is essential that all jurisdictions apply enhanced standards of transparency. In this spirit, we commit to establishing as soon as possible registers or other mechanisms requiring that beneficial ownership of companies, trusts, foundations, shell companies and other relevant entities and arrangements are identified and available for tax administration and law enforcement authorities. We call on other jurisdictions to do so.*

3.22 Prior to the release of the Panama Papers, the OECD and major groupings such as the G20 were already well advanced in advocating and implementing initiatives to increase the flow of information to counter tax evasion and other illicit activities. The Panama Papers have provided added impetus. The Inquiry considers the direction of travel is clear, and it is unambiguously toward much more information having to be collected from taxpayers and shared on a cross-jurisdictional basis. The question that all countries, including New Zealand, need to address is whether regimes within their tax code (such as the foreign trust rules in New Zealand's case) need to be refined to reflect this new era.

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7 http://www.oecd.org/tax/statement-from-oecd-secretary-general-angel-gurria-on-the-panama-papers.htm

8 The Inquiry understands that Panama has now agreed to commit to the Common Reporting Standard, which is the standard set by the OECD Global Forum for countries to implement Automatic Exchange of Information (AEOI) among tax authorities. AEOI is considered in Part 6 of the report.

9 In May 2016 this organisation changed its name to Joint International Taskforce on Shared Intelligence and Collaboration.

10 Rumney, Emma, (11 April 2016), 'OECD schedules expert meeting to respond to Panama Papers tax revelations'. *Public Finance International*. Retrieved from http://www.publicfinanceinternational.org/news/2016/04/oecd-schedules-expert-meeting-respond-panama-papers-tax-revelations.

11 https://www.gov.uk/government/publications/g5-letter-to-g20-counterparts-regarding-action-on-beneficial-ownership

Part 4 Foreign Trusts in New Zealand

Principles of trusts

4.1 Some reports on the Panama Papers, and comments such as *trusts should be banned*, reflect confusion over the role and purpose of trusts. The Inquiry considers an understanding of why trusts exist is important in the context of the foreign trust disclosure debate.

4.2 A trust relationship is created automatically when a person (person A) provides money or other property to another person (person B) and asks them to look after it for the benefit of another person (person C) or group of persons (persons C to G). Often such a trust relationship occurs informally and is not documented. However, in principle a casual arrangement of this kind is no different from the thousands of trusts set up in New Zealand and other common law countries around the world to own private homes, rental properties, investments for the benefit of families, farms and other businesses.

4.3 Although trusts typically have their own names and are referred to as if they are a separate entity like a company, they are not. The example above illustrates this. There are three parties involved. Person A is known as the settlor (or grantor) because he/she has made money or other property available to be looked after. Person B takes on the responsibility for managing the funds, and is known as the trustee. Persons C to G are the people who will benefit from the funds being managed for their benefit, and are known as the beneficiaries. The settlor might also be a beneficiary.

4.4 Trusts are a legitimate and popular way of owning and managing assets. There is no reason why they should be banned. The simple example above shows that doing so would in fact be impossible, because of the way they are created.

4.5 Although trusts are legitimate vehicles, they may be used to conduct illegal activities or to take actions that are considered inappropriate by Parliament or the broader community. In this sense they are no different from individuals or companies. However, the options available to remedy an issue identified with trusts are more complex than for individuals or companies because there are multiple parties involved. At a minimum there will be the settlor, trustees and beneficiaries. There may be others in a position to control the trust, for example, by having the power to appoint and dismiss trustees.

4.6 For example, because a trust is a fiduciary relationship rather than an entity with its own legal personality, the deceptively simple question *Who really owns and controls this trust?* might be answered in several different ways, all of which are correct-

- The trust itself has no owners as such.
- The legal owner of the trust's property is the trustee, who holds legal title and has a legal duty to deal with and administer the property in the interests of the beneficiaries.
- The beneficial owners of the trust property are the beneficiaries, who may be named individually or described as a group (or class), such as the children of the settlor. They do not control the trust's assets, and they may not necessarily receive any distributions from the trust.
- While the trustees will normally control the trust, another party such as the settlor may have the right to make key decisions concerning buying and selling investments and determining distributions. This might give them effective control of the trust.

What is a foreign trust?

4.7 The term *foreign trust* is used to describe a trust that is established in New Zealand but where no settlor is resident in New Zealand at any time. The term was developed specifically for New Zealand tax purposes (see section HC 11 of the Income Tax Act 2007 (ITA)). This sometimes creates confusion, as a trust in Australia, for example, may be viewed from New Zealand as a foreign trust, but it would not be a foreign trust for New Zealand tax purposes.

4.8 A foreign trust may have one or more trustees resident in New Zealand. Most New Zealand foreign trusts have one resident trustee, often a limited liability company that provides professional trustee services. Some also have one or more trustees who are resident offshore.

4.9 It is normal for all of the beneficiaries of a foreign trust to be resident offshore, but there is no prohibition against having New Zealand beneficiaries.

Tax treatment and underlying tax policy

4.10 Foreign trusts which do not derive New Zealand source income or distribute income to New Zealand resident beneficiaries are exempt from New Zealand tax.[12] The tax exemption is one of the key features of New Zealand law that is attractive to offshore investors looking to establish foreign trusts in this country. The tax status of such trusts features prominently on the websites of firms providing services to foreign investors.

4.11 Commentary in the media around the Panama Papers has caused some observers to describe the exempt tax status foreign trusts enjoy in New Zealand as a *loophole*, and it has been suggested that this should be closed by imposing tax. The Inquiry considers such suggestions are relevant to the question of reputation included in its terms of reference. If the use of foreign trusts by foreign investors relies on a loophole to achieve tax exempt status rather than on principled tax policy that underpins the tax system, then some reputational damage can be expected and may be justified. Changes to disclosure rules would be unlikely to change that impression. The logical (and simple) remedy would be to repeal the tax exemption.

4.12 Before 1988, New Zealand's rules for taxing trusts followed the residence of the trustees. This led to concerns in relation to the taxation of income derived by New Zealand residents from offshore. A trust established overseas with non-resident trustees was not liable to New Zealand tax on its foreign sourced income, even where the settlor and the beneficiaries were New Zealand residents.

4.13 As a result, the old trust tax rules made it relatively easy for New Zealand residents to escape tax on their offshore income. This could be achieved by establishing a trust offshore and settling investment assets on it. The trustee, who would be a non-resident of New Zealand, would invest the funds and accumulate income. No New Zealand tax would be payable on the income except where it was distributed within six months of the trust's tax year end to beneficiaries resident in New Zealand. Distributions after that time were capital, and not taxable. Unsurprisingly, distributions of income were rare.

4.14 Like many aspects of the New Zealand tax system at that time, the trust tax rules were wholly deficient. They were overhauled in 1988 as part of a comprehensive overhaul of New Zealand's international tax rules. As was the case with the other international tax reforms, the changes were designed to protect the domestic tax base.

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12 The exemption is in ss. CW 54 and HC 26(1) ITA.

4.15 The reforms were based on the core principle of taxing New Zealand residents on their worldwide income and non-residents on income sourced from New Zealand. It follows from this principle that non-residents should not be taxed on non-New Zealand sourced income. This was, and remains, orthodox international tax policy.

4.16 For trusts, the residence of the settlor was chosen as the basis for determining the liability (through the trustee[13]) for New Zealand tax. This was because, although the settlor has no right to receive income from the trust, in reality he/she typically has substantial influence over the trustees, either through specific provisions in the trust deed or on an informal basis. The economic substance of a trust may differ from its legal form.

4.17 The Consultative Committee[14] that recommended the settlor regime in 1988 specifically recognised that one consequence of this approach would be that New Zealand would not tax the foreign source income of a resident who was the trustee of a trust with a non-resident settlor. The Committee noted[15]-

> *In our view, this is the appropriate treatment since such income has no definite connection with New Zealand apart from the existence here of the trust administrator … who will … have no beneficial interest in the income.*

4.18 The Inquiry considers that the current tax treatment of foreign trusts is based on design considerations that are entirely consistent with the coherent set of core principles that underpin New Zealand tax policy. It is clear from the history that the primary driver of the international tax reforms, of which the trust regime is an important subset, was to protect the New Zealand tax base. The reforms appear to have been very effective in achieving that goal.[16] New Zealand's attractiveness as a place to invest from offshore was a by-product of the reforms and the primary reason for this (the foreign trust tax exemption) was identified at the time. While it seems unlikely that policy makers predicted the size of the New Zealand foreign trust industry that would emerge, the Inquiry doubts that it would have created any concerns had they done so.

Disclosure requirements enacted in 2006

4.19 Until 2006 no disclosure requirements were imposed on foreign trusts. This was because they had no liability for New Zealand tax other than on New Zealand source income, of which there would typically be none or very little.

4.20 The absence of information disclosure requirements was identified as an area of concern by the Australian authorities. The Inquiry understands that their concerns resulted from the use of New Zealand foreign trusts by Australian residents to avoid Australian tax. Other countries raised questions around the status of trusts, including foreign trusts, in the context of tax treaty negotiations.

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13 If the trustee does not pay the tax (because it is not resident in New Zealand) the tax liability for trustee income falls to the New Zealand settlor as agent.

14 Prebble, John. (1988). *International Tax Reform Part 1. Report of the Consultative Committee*. New Zealand Government Printer. Available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1580354

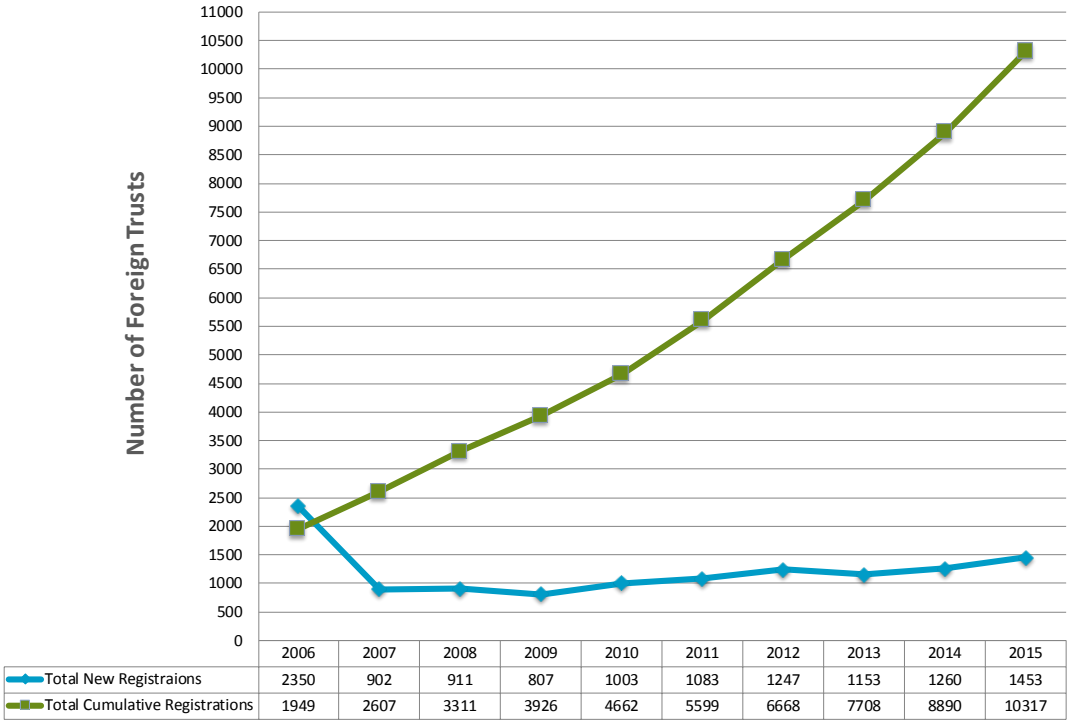
15 Ibid, para 5.25.

16 The fact that very few New Zealanders have been named as investors in the entities in the Panama Papers is probably attributable to the scope and effectiveness of the international tax rules.

4.21 In response to these concerns, disclosure requirements were introduced in 2006 through the enactment of section 59B of the Tax Administration Act (TAA). Record keeping requirements were also introduced at that time.[17] These rules, and their effectiveness, are discussed in Part 6 of the report.

Trend in foreign trust registrations

Figure 1: Foreign Trust Registrations



	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Total New Registraions	2350	902	911	807	1003	1083	1247	1153	1260	1453
Total Cumulative Registrations	1949	2607	3311	3926	4662	5599	6668	7708	8890	10317

Notes:

1. The years in the graph above are calendar years (1 January – 31 December).
2. 2006 is when registration commenced, hence the large numbers at the beginning as it includes pre-existing trusts.
3. The 2015 year has been normalised to exclude an 'extraordinary event' with 958 registrations coming from one provider (this event reflected a change in ownership of the provider itself).
4. The total cumulative registrations factor in any terminations and migrations for the year in question.

4.22 No data is available on the number of foreign trusts established in New Zealand prior to the introduction of the disclosure and reporting requirements which took effect from 1 October 2006.

4.23 Annual foreign trust registrations[18] each year are shown in Figure 1. Two points are notable-

- The numbers have increased steadily since 2010.
- There is now virtually no participation in foreign trusts from Australia.[19]

4.24 As at 31 May 2016, there were 11,671 foreign trusts registered with IRD.

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17 Through amendments to s.22 TAA.

18 These statistics show the number of IR 607 disclosure forms filed with IRD. Although this is not a registration form as such, both IRD and the industry refer to a trust as being 'registered' when the IR 607 is filed.

19 As discussed in Part 6 of the report, the current disclosure form, IR 607, requires a box to be checked if the settlor of a foreign trust is from Australia. No details are required for settlors from other countries.

Reasons for favouring New Zealand

4.25 The significant number of foreign trusts registered shows that New Zealand is seen as an attractive place to establish and operate from. A review of websites of New Zealand and offshore providers of trust services in New Zealand provides insights into how New Zealand is portrayed to interested parties. Frequently cited advantages in relation to New Zealand foreign trusts are-

- no tax on offshore income
- no stamp duty, gift duty or similar imposts
- stable political environment
- safe and secure country
- Reliable legislation
- respected, independent and well-functioning judiciary
- experienced and professional support infrastructure (accountants, lawyers etc)
- low disclosure requirements and strict adherence to confidentiality and secrecy
- minimal compliance costs (registration, annual reporting, audit etc)
- no government registration of the foreign trust required
- not regarded as a tax haven, so avoids associated stigma
- no restrictions on distributions of income or capital
- trust law allows settlor control and flexibility.

4.26 One provider's website observes-

> *New Zealand provides all the advantages of a traditional offshore financial centre, but remains primarily recognised as a mainstream onshore financial centre.*

4.27 Successive New Zealand governments have worked to make New Zealand an attractive and welcoming environment for international investors, financial service providers and migrants. Most of the features listed above and cited in advertorials seeking to attract investor interest are consistent with that objective. However, two aspects have received unfavourable comment in the context of the debate about foreign trusts. They are the tax exemption and secrecy/lack of disclosure.

4.28 For the Inquiry, the key question is whether the disclosure rules, and associated enforcement actions, are sufficient to ensure New Zealand's reputation is maintained when considered alongside its commitment to international agreements and action plans to cooperate with other countries to deter money laundering, abusive tax practices and other illicit activities. In short, are the rules fit for purpose? This is considered in Part 10 of the report.

What are foreign trusts doing in New Zealand?

4.29 Based on submissions to the Inquiry, IRD files[20] and examples cited in media reports on the Panama Papers, foreign trusts in New Zealand typically exhibit the following characteristics-

a) representation in New Zealand by a Trust and Company Service Provider (TCSP), lawyer or accountant, who also acts as the resident foreign trustee either directly or (more commonly) through a company established for that purpose

b) ownership, of substantial assets offshore, often through a New Zealand Look Through Company (LTC) or Limited Partnership (LP), or offshore entity, but little in the way of investments or other assets actually in New Zealand

c) overseas assets that are in one or more of the following categories-
- shares in an active foreign company (eg a trading company)
- shares in a foreign investment company
- passive investments (eg shares, bonds, cash) held directly
- foreign real estate (eg rental properties or a personal dwelling)

d) assets contributed by settlor or an associated person

e) settlement of assets either when the trust is formed or, more often, subsequently

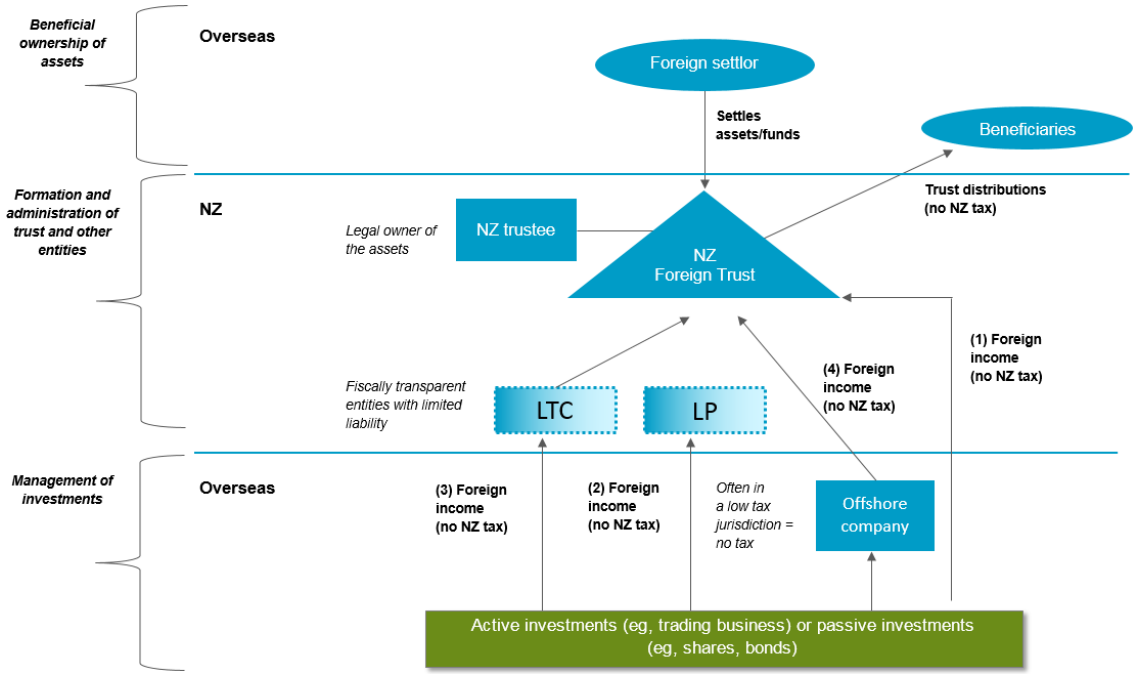
f) infrequent distributions of income or capital to beneficiaries

g) no external audit of financial statements

h) no or minimal debt.

Figure 2 Foreign Trust Structures

Different ways a NZ trust can earn foreign income. Directly, or (2) through an NZ LP (3) through an NZ LTC or (4) through an offshore company



See Appendix 3 for full explanation of each scenario.

20 The Inquiry was provided access to IRD files containing information collected on foreign trusts for the purpose of information exchanges with foreign tax authorities.

4.30 Figure 2 summarises alternative structures typically used to set up foreign trusts and to own the underlying investments. Four ways a New Zealand foreign trust can earn foreign income are shown: directly, through a New Zealand LP, through a New Zealand LTC and through an offshore company.

4.31 An expanded description of the four scenarios, and a summary of the New Zealand tax treatment and registration requirements for each, is in Appendix 3.

4.32 The tax treatment of flows of income and capital in the country of residence of the settlor, others who might control the trust and beneficiaries is not considered in Appendix 2. The treatment will vary widely depending on the country involved. However, the Inquiry considers there are likely to be three broad categories-

a) ***Compliant*** – income taxable in the home country. Taxpayer includes it in their tax return and pays tax.

b) ***Non-compliant*** – income taxable in home country. Taxpayer relies on non-disclosure/secrecy and does not include the income.

c) ***Opportunistic*** – income not taxable in home country because of a mismatch between the laws of New Zealand (or the laws of another country in the structure) and the laws of the home country.

4.33 Many offshore parties who use New Zealand as a safe haven to hold their family wealth will fall within the *compliant* category. Based on submissions to the Inquiry, TCSPs handle a significant number of such files. The Inquiry sees no reason to alter policy settings to make New Zealand less attractive. Doing so would seem inconsistent with the Government's commitment to making New Zealand attractive for new investment and being globally recognised as a safe place to invest and undertake business,[21] including financial services.

4.34 Non-compliant taxpayers will primarily be of concern to the offshore taxing authority rather than to New Zealand. If a tax liability is imposed but is not disclosed, self-assessed or paid, this would generally constitute evasion, a criminal offence in the home country. No New Zealand tax is being evaded. However, under its tax treaty arrangements IRD must either have or be able to obtain information to provide to the offshore treaty country if it is requested. Further, under its broader international obligations (described in Part 8 of the report) New Zealand should not be or be seen as a country that effectively facilitates evasion through having disclosure and reporting requirements that are sufficiently weak to cause offshore parties to conclude that detection is highly improbable.

4.35 *Opportunistic* taxpayers take advantage of mismatches in tax laws to achieve an overall rate of return (after tax) from their investment that is higher than would otherwise have been the case. Whether the structure succeeds in doing that will depend on the strength of the offshore country's tax laws, including the tax avoidance provisions, and on the scope and effectiveness of audit activity by the offshore tax authority.

4.36 One submission to the Inquiry stressed that IRD should not be tasked with identifying evasion or other illicit activities of non-residents. The Inquiry agrees that it is inappropriate for New Zealand to assume the role of international tax policeman, and it is not suggesting that this occur. However, as another submission observed, New Zealand is part of a global tax police force in the context of OECD initiatives to clamp down on aggressive tax practices. These initiatives bring with them responsibilities that necessarily and increasingly shape the approach to disclosure and information sharing.

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[21] See, for example, *New Zealand welcomes investment*, Ministry of Business, Innovation and Employment, http://www.mbie.govt.nz/info-services/business/business-growth-agenda/pdf-and-image-library/towards-2025/mb13078-bga-investment-a3-v2-5.pdf

Impact of changes to the Look Through Company (LTC) rules

4.37 LTCs are not within the Inquiry's terms of reference. However, because LTCs are common in foreign trust structures, and have featured in a number of media reports on the Panama Papers, the report would be incomplete without reference to the significant impact of legislative changes to be passed by Parliament later this year.

4.38 Scenario 3 in Appendix 3 sets out a typical foreign trust/LTC structure. As noted, because the LTC is a transparent entity for New Zealand tax purposes, any foreign source income is treated as being derived by the foreign trust itself. No New Zealand tax is payable assuming no beneficiaries are resident.

4.39 Although an LTC is 'looked through' for New Zealand tax purposes it will retain its status as a company in some other countries. Depending on the tax treaty between New Zealand and the other country involved, argument has been made that the LTC has technically been taxed in New Zealand (at a rate of 0%) on the income derived and therefore the income ultimately repatriated to the home country of (say) the settlor may not be taxed.[22]

4.40 The opportunity to use LTCs in this way will be closed by amendments currently before Parliament.[23] These will limit to $10,000, or 20% of total income if higher, the amount of foreign source income that a foreign controlled LTC will be able to earn annually. The new rules will apply from 1 April 2017.

4.41 The Inquiry anticipates that this change will result in a restructuring of foreign trust structures currently using LTCs, and on different approaches when new foreign trusts are formed. This may increase the importance of the Inquiry's suggested changes to the disclosure rules for foreign trusts themselves.

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22 The grounds for this argument seem doubtful. Each case would need to be considered on its own facts and on the wording of the treaty and of the domestic law of the foreign jurisdiction involved.

23 Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Bill.

Part 5 Existing Disclosure and Registration Requirements

Three levels of disclosure

5.1 In the public debate around the Panama Papers, many reports on the foreign trust disclosure rules have focused only on the form, known as the IR 607, required to be submitted to IRD generally within 30 days of a foreign trust being established in New Zealand. There are in fact three levels of disclosure requirements for foreign trusts-

- the IR 607, sometimes referred to as the registration form, required to be filed with IRD on establishment (Figure 3)
- the record keeping requirements prescribed by s.22 of the Tax Administration Act 1994 (TAA)
- information required to be supplied to comply with the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (the AML rules).

5.2 Determining the adequacy of the current disclosure rules and their enforcement requires all three levels to be considered. Changes arising from New Zealand's proposed implementation in 2017 of the globally initiated Automatic Exchange of Information (AEOI) requirements also need to be considered.

5.3 Details of the existing tax disclosure rules and reporting requirements and enforcement are in Appendix 4, and the AEOI proposals are in Appendix 5. The AML reporting requirements are outlined in Appendix 6. A summary and analysis of each is in Parts 6 and 7 of the report.

5.4 The amount of disclosure required to satisfy New Zealand's obligations under non-tax-related international agreements, such as those relating to anti-money laundering and corruption, are increasing significantly. Much of this information is not directly relevant to IRD's functions. In time, it may be appropriate for an agency other than IRD (for example, the Companies Office) to assume responsibility for registration and oversight of foreign trusts. The Inquiry recommends that this be kept under review.

Registration of foreign trusts

5.5 Although the IR 607 and supporting legislation does not use the term *registration*, and there is no specific requirement on foreign trusts to register in New Zealand, in practice completion of this form is termed the *registration process* by both the industry and IRD.

5.6 Similarly, there is currently no formal register of foreign trusts, but IRD maintains a log of IR 607s, which it calls a register.

5.7 The Inquiry considers a more formal registration process is appropriate. It recommends that maintenance of a register of foreign trusts be a formal requirement imposed on IRD, and that the existing disclosure form be re-titled *Foreign Trust Registration and Disclosure.*

Figure 3: IR 607

Inland Revenue
Te Tari Taake

Foreign trust disclosure

IR 607
October 2012

This disclosure form is to be completed by resident foreign trustees (including qualifying resident foreign trustees) as defined in the Tax Administration Act 1994.

Please read the notes on the back before completing this form. Once completed, remember to sign the declaration.

1. Full name of foreign trust
(where no name exists please state other identifying particulars)

2. Trustee details

Full name of resident foreign trustee

Address of resident foreign trustee

Street address

Suburb or RD | Town or city | Postcode

Contact phone ( )

3. Is the settlor resident in Australia? ○ No ○ Yes

4. Are you a qualifying resident foreign trustee? ○ No—go to Question 5 ○ Yes—complete details below

Name of the approved organisation

Full name and contact details of the natural person who belongs to the approved organisation

Name

Street address

Suburb or RD | Town or city | Postcode

Contact phone ( )

5. Does the foreign trust have more than one resident foreign trustee? ○ No—go to 7 ○ Yes—complete Question 6

6. Has one resident foreign trustee been appointed as an agent for the purposes of making disclosures and keeping records? ○ No—go to 7 ○ Yes—complete details below

Full name of the trustee appointed as agent

Full name of the appointing trustee

7. Declaration

Full name of authorised person

Designation or title

I declare that the information given on this form is true and correct.

Signature

/ /
Date

Part 6 Tax Disclosure Rules

Information required to be disclosed on establishment

6.1 The information provided on the form (Figure 3) required to be filed with IRD when a foreign trust is established in New Zealand is extremely limited.[24] No details of the names, addresses or country of residence of the settlor, protector (if there is one), non-resident trustees, other persons who may control or influence the trust, or beneficiaries are required. An exception is where the settlor is resident in Australia, in which case a box to this effect must be ticked 'yes'. The background to this requirement is explained in Part 4 of the report.

6.2 Box 1 in the IR 607 requires identifying particulars to be supplied only where no name for the trust exists. The way s.59B of the TAA is drafted supports this approach to the design of the form. However, the end result is that the identifying information provided is limited to a detail (being the name of the trust) which is of no real relevance.

6.3 The back of the IR 607 contains brief information on who is required to complete the form. It also provides definitions of 'resident foreign trustee' and 'qualifying foreign resident trustee', references the penalty section that may apply if the information supplied is in breach of the TAA, and explains that a new disclosure form is required within 30 days if there is any change to the information previously disclosed.

6.4 In practical terms the current IR 607 requires just two pieces of information – the name of the trust and the name of the resident foreign trustee, who will typically be the professional person or firm in New Zealand who assists in setting the trust up and attending to administrative and other matters. No details of any of the offshore persons involved with the trust, such as settlor or beneficiaries, are required.

6.5 Changes the Inquiry recommends be made to the disclosure requirements on establishment are summarised in the recommendations in Part 12 of the report.

Record keeping requirements

6.6 The record keeping requirements for foreign trusts are outlined in Appendix 4. The requirements are quite extensive, and include constitutional documents (such as the trust deed), particulars of settlements or distributions, and the name and address (if known) of settlors and recipients of distributions. There is also a requirement to keep in New Zealand 'sufficient records in the English language to enable the ascertainment readily by the Commissioner of … the financial position of the foreign trust'.[25]

6.7 All of the above records are required to be made available to IRD on request. IRD advised the Inquiry that such requests are typically met without difficulty, and that the standard of records provided is consistent with the standard for business taxpayers.

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[24] The form is based on the requirements in s.59B TAA, *Disclosure of foreign trust particulars.*

[25] s.22(2)(m) TAA.

Enforcement and compliance

6.8 An explanation from IRD of the way the existing tax disclosure rules are administered is included in Appendix 4. In summary, in relation to the IR 607-

- The forms are received by IRD's International Revenue Strategy group in Wellington, and the content downloaded into a database.
- Checks are undertaken to ensure all boxes are complete, with follow-up with the foreign resident trustee if they are not.
- If the IR 607 is accompanied by a request for consent to hold the records offshore, that is processed. Less than 10% of foreign trusts request this.
- Where the *settlor resident in Australia* box is ticked, IRD automatically provides the details recorded on the IR 607 to the Australian Tax Office.

6.9 IRD estimates an average of 1,000 to 1,200 registrations are submitted each year.

6.10 No specific protocols are in place for the review or audit of the record keeping requirements for foreign trusts, and no annual tax or other returns are required. This is because foreign trusts very rarely derive New Zealand source income. As income derived by foreign trusts from offshore is exempt from tax, they are under no obligation to file New Zealand tax returns.

6.11 IRD audits of foreign trusts typically arise from an audit of a TCSP. Over the past seven years, 26 TCSPs[26] have been reviewed or audited by IRD. A number of these reviews have led to audits of the foreign trusts that they administer. Audits check that the trust in fact qualifies as a foreign trust,[27] whether any New Zealand tax payable has been paid and confirm compliance with record keeping requirements. They also check for information that might usefully be exchanged with tax treaty partner countries.

6.12 IRD advised the Inquiry that the approach normally taken with audits of TCSPs is to review a sample of underlying client files to check that the appropriate systems and procedures are in place to comply with the TAA, and that the foreign trust has integrity. In-depth audits are unusual, and are not designed to verify that the funds invested by the trust are from legitimate sources or that income is being returned in the relevant offshore jurisdiction.

6.13 The Inquiry does not consider the limited scope and number of IRD audits to be surprising or an indication of lack of enforcement. As there is no New Zealand tax to verify or pursue, dedicating audit resources to this sector is justified only to the extent required to discharge obligations to foreign tax authorities. IRD advised that it has not received any requests from tax treaty partners that it has been unable to fulfil.

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26 These include the larger providers, who have a significant number of clients.

27 Cases have been identified by IRD where a trust is held out to be a foreign trust but is determined on audit as being a New Zealand trust and therefore not entitled to the exemption from tax on foreign source income.

Exchanges of information

6.14 Over the past seven years there have been 142 exchanges of information between IRD and foreign tax authorities across 23 countries in relation to foreign trusts. Of these, about 80% have been proactive releases (known as 'spontaneous exchanges') where IRD identifies a matter that may be of interest to an offshore authority and sends information to them. About 20% are in response to requests from foreign tax authorities.

Sanctions for non-compliance

6.15 If a foreign trust does not have a *qualifying resident foreign trustee*[28] for an income year, and information requested by IRD is not provided, the trust is subject to New Zealand tax on its worldwide income if a conviction occurs. IRD advised that no convictions have occurred to trigger this sanction.

6.16 An intentional breach of the information requirements can result in a fine of up to $50,000 and imprisonment for up to five years. IRD advises that there have not been any cases where these sanctions have been applied.

Observations on current tax disclosure rules and enforcement

6.17 The Inquiry considers that the existing tax-related disclosure requirements can be fairly described as very light-handed. As a practical matter, although quite extensive records are required to be maintained, very little information about foreign trusts is ever actually provided to IRD or to any other government agency. In summary-

- For persons establishing a foreign trust in New Zealand the only direct touch-point with any government agency is the disclosure form submitted to IRD on establishment.
- The information on the disclosure form is extremely limited. For most foreign trusts the only information provided is the name of the trust and of the resident foreign trustee.
- Although the record keeping requirements are significantly more extensive than the disclosure form, this information is provided only if requested by IRD. Because foreign trusts generally have no New Zealand tax liability there is no reason for IRD to request access to records unless they are either asked to do so by a foreign tax authority, or have a reason to believe that the trust is undertaking transactions that should be notified to an overseas tax authority.
- Foreign tax authorities will typically not know to ask for information about a New Zealand foreign trust that has connections with their jurisdiction because they have no way of knowing that it exists.
- Where records are requested, the name and address of the settlor or settlors, and of the recipients of distributions from the trust, are required to be maintained (and therefore able to be provided) only *if known*.[29] While there is a requirement to hold documents that evidence the creation and constitution of the trust (typically this would be the trust deed), this may not contain the names and contact details of the settlors and would not normally describe beneficiaries in the detail necessary to determine the names, addresses and tax residency of recipients of trust distributions.

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[28] The sanctions are explained in more detail in Appendix 4.

[29] s.22(7) TAA.

- The disclosure form is required to be sent to IRD only at the time the trust is established, and updated if and when there are changes to information previously provided. Foreign trusts have no annual reporting requirements.

6.18 The sanctions for non-compliance also appear to be modest. The Inquiry's view is that the exemption foreign trusts enjoy from New Zealand tax on foreign source income should apply only where the registration and associated disclosure obligations at that time have been complied with. This approach contrasts with the current rule which results in the exemption ceasing to apply only where and when there is no *qualifying resident foreign trustee*[30] and there has been a conviction for knowingly failing to keep or supply information.[31]

6.19 The basis for foreign trusts with a *qualifying* resident foreign trustee being exposed to lesser sanctions than other foreign trusts is not clear, and the Inquiry recommends that this be reviewed.

Consequences of limited tax disclosure requirements

6.20 The Inquiry is confident that a significant proportion of foreign trusts established in New Zealand do maintain the records required under the TAA, and will provide those to IRD on request. Submissions received from TCSPs emphasised these obligations and their adherence to them. Several noted their professional obligations under the code of conduct provisions imposed by their professional organisations such as the New Zealand Law Society and Chartered Accountants Australia and New Zealand. IRD advised that records are generally available when requested.

6.21 Despite this, the Inquiry notes that a number of websites of both overseas and New Zealand suppliers of services to trusts place significant emphasis on what they describe as 'New Zealand's very limited disclosure requirements around foreign trusts'. For example-

- Each New Zealand foreign trust must only disclose its name and details of its trustee to the New Zealand tax authorities.
- Financial records are not filed with New Zealand authorities.
- New Zealand has minimal reporting requirements.
- No government registration of the foreign trust is required.
- One of the principal benefits of New Zealand foreign trusts is the limited reporting requirements and compliance obligations.

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30 A 'qualifying resident trustee' is a resident foreign trustee which is a member of an 'approved organisation'. Approved organisations are determined by the Commissioner of Inland Revenue on the basis of criteria such as the requirement on members to have certain qualifications.

31 s.HC 26(3) ITA.

6.22 Surprisingly, several of the websites reviewed by the Inquiry make no reference to the record keeping obligations. They focus only on the very limited disclosures required when a foreign trust is established. In some cases this may be oversight or negligence. In others it may be attributable to the not unfair assessment that in practice such underlying records will be required to be disclosed to IRD only very rarely. This could lead some parties to take a calculated risk that not reporting income from a New Zealand foreign trust in the tax return in the country of residence of the person who has received it is highly unlikely to ever be detected. Similarly, an aggressive tax structure that results in capital that would otherwise be known to the home tax authority being housed in a New Zealand foreign trust is unlikely to be identified by the offshore tax authority.

6.23 The Inquiry considers that the impact of disclosure requirements on the propensity of persons resident overseas to use New Zealand foreign trusts to carry out illicit activities such as money laundering and tax evasion is a significant and legitimate factor to take into account in any review of the design of such rules. If the disclosure rules are light-handed and the risk of detection is low then the risk of use of foreign trusts for inappropriate purposes is high.

6.24 Confidentiality is an entirely legitimate objective in the arrangement of a person's private affairs. Complex issues need to be considered in determining the balance between ensuring that privacy is protected while not allowing New Zealand's tax or other laws or those of overseas jurisdictions to be undermined. However, the paucity of information currently disclosed when a foreign trust sets up in New Zealand appears to limit IRD's ability to proactively provide assistance to foreign revenue authorities.

6.25 In summary, the Inquiry concludes that the existing tax disclosure requirements around foreign trusts, considered particularly in terms of information actually provided to IRD and other government agencies, are inadequate. The implications of this conclusion, and potential remedies, are considered later in part 10 of the report.

6.26 Before proceeding further, however, it is pertinent to consider if increased disclosure that may result from international agreements to which New Zealand is a signatory will address any concerns over the current disclosure rules.

Impact of automatic exchange of information proposals

6.27 In 2014 New Zealand committed to implement the *G20/OECD Standard for Automatic Exchange of Information in Tax Matters*. AEOI is a global response to concerns that individuals and entities can evade their tax obligations relatively easily by concealing their wealth in offshore accounts. Earlier this year Cabinet decided that in New Zealand AEOI obligations would commence from 1 July 2017. Legislation will be introduced and passed through Parliament in the second half of this year.

6.28 Many submissions to the Inquiry noted the increased disclosures and transparency required under AEOI and concluded that these might alleviate any disclosure concerns in respect to New Zealand foreign trusts. A few submissions considered that AEOI was the complete solution to disclosure concerns.

6.29 The Inquiry has worked closely with IRD in examining the scope and impact of AEOI. The overall conclusion is that for a significant number of foreign trusts AEOI is likely to result in only limited, if any, additional disclosures in New Zealand.

6.30 Appendix 5 discusses AEOI and its application to foreign trusts. As legislation has yet to be introduced, the analysis is based on the OECD Common Reporting Standard (CRS) and the related commentary and IRD's interpretation of how AEOI will apply.[32]

6.31 AEOI is designed to counter tax evasion through requiring-

a) financial institutions in participating jurisdictions to carry out due diligence on their account holders and (in certain circumstances) controlling persons[33] to identify any non-residents[34]

b) financial institutions to report information on financial activity, such as gross amounts paid or credited and account balances (including distributions to beneficiaries in the case of trusts) as well as identification information about each reportable person, annually, to the local tax authority (for New Zealand, the IRD)

c) the local tax authority to provide that information automatically to offshore tax authorities in participating countries throughout the world. The information will be provided to the countries in which persons identified by the *reporting financial institutions* are tax resident.

6.32 There are two main ways in which AEOI may apply to a foreign trust-

- through the foreign trust itself constituting a *reporting financial institution* for AEOI purposes
- through the foreign trust holding an account with a New Zealand bank or other *financial institution*.

6.33 For the reasons outlined in Appendix 5, it is concluded that the activities of foreign trusts in New Zealand and the way they are operated means that in a significant number of cases they are unlikely to constitute *financial institutions* under the guidance set out in the CRS and therefore that they will not be *reporting financial institutions*.

6.34 Foreign trusts that maintain accounts with a bank or other financial institution in New Zealand are likely to be classified under the CRS as *passive non-financial entities*[35] for AEOI purposes. In these cases, the financial institution (for example, the bank) will be required to carry out due diligence and to report to IRD information on the trust, and on its controlling persons. Importantly, however, financial information such as income and account balances will be limited to the account held with the financial institution.[36] It will not extend to the foreign trust's overall financial position or to distributions to beneficiaries.

6.35 In summary, based on the information presently available, the Inquiry concludes 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 IRD. Therefore AEOI is not regarded as a solution to the tax disclosure issues identified above.

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32 OECD. (2014). *Standard for the Automatic Exchange of Financial Account Information in Tax Matters.* https://www.oecd.org/tax/automatic-exchange/common-reporting-standard/

33 For trusts this will generally include settlors, trustees, beneficiaries and other controlling persons.

34 Account holders and controlling persons who are non-residents are known as *reportable persons* under the CRS.

35 Explained in Appendix 5.

36 Due diligence will not be required on accounts already in existence at 30 June 2017 if they are below, and at all times remain below, a threshold of $US250,000.

Part 7 Disclosures under Anti-Money Laundering Rules

Background

7.1 As part of its obligations as a member of the Financial Action Task Force (FATF) New Zealand enacted the Anti-Money Laundering and Countering of Financing of Terrorism Act 2009 (the AML/CFT Act). The Act took effect from 30 June 2013 and contains a number of regulatory obligations (referred to in this report as the *AML rules*) that are relevant to foreign trusts and should mitigate the risk of them being used for illicit purposes. In an overview of the legislation, DIA's website notes[37]-

> *The Act will ensure that businesses take appropriate measures to guard against money laundering and terrorism financing. This enhances the reputation of individual businesses, and of New Zealand as a safe place in which to do business.*

7.2 The detection of money laundering is one of the primary purposes of the AML rules. In principle, these rules (rather than the tax disclosure rules) should be the primary deterrent to illicit funds being held by New Zealand entities, including foreign trusts. This should be achieved through the New Zealand party (typically a TCSP, lawyer or accountant) that acts to assist in the establishment and ongoing administration of a foreign trust conducting customer due diligence (described in the financial services industry as *know your client* or *KYC*). Customer due diligence includes-

- verifying the identity and background of key individuals establishing and controlling the foreign trust
- determining and, in many cases, verifying the source of funds that are settled on the trust
- reporting suspicious transactions to the FIU of the New Zealand Police.

7.3 The AML rules are operated under a joint supervisor model, with the Reserve Bank of New Zealand, the Financial Markets Authority and DIA each being responsible for different sectors captured by the legislation. For TCSPs that provide foreign trust services, DIA is the supervising agency.

7.4 It is important to note that, unlike the tax disclosure and record keeping requirements outlined in Part 6 of the report, the AML rules do not require information to be disclosed to any government agency.[38] AML is a regulatory regime that imposes obligations on reporting entities, which in the case of foreign trusts will typically be TCSPs. DIA's role as supervising agency is to review and monitor reporting entities, not their customers.

Information required to be obtained under the AML rules

7.5 A detailed explanation of the AML rules and their practical application and enforcement is provided in Appendix 6. Key aspects relevant to the disclosure and verification of information on foreign trusts are-

a) The rules apply to *reporting entities*, which are defined by the types of transactions they conduct or services they provide.

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37 https://www.dia.govt.nz/Services-Anti-Money-Laundering-Index

38 Except in the area of suspicious transaction reporting, covered later in this part of the report. Also, from 1 July 2017 all international funds transfers of $1,000 or more and all cash transactions of $10,000 or more through a reporting entity will also be reported to the FIU.

b) For the most part a foreign trust itself will not be a *reporting entity*. That role will be held by the TCSP that assists the trust to establish and operate in New Zealand. TCSPs are specifically included in the definition of reporting entity.[39] In contrast, lawyers, conveyancers, accountants and real estate agents who provide similar services in the ordinary course of their business are currently excluded.[40]

c) Although most lawyers and accountants are presently not subject to the AML rules, they are required to comply with the Financial Transactions Reporting Act 1996. These include some customer due diligence and suspicious transaction reporting obligations. However, these are less prescriptive than the AML rules and are not subject to supervision.

d) Most foreign trusts will have no direct contact with any government agency in connection with the AML rules. Instead they will be answering questions from and providing information to the professional acting in New Zealand on their behalf. Most of this information will be provided at the time the trust is established, but TCSPs also have ongoing monitoring and reporting obligations.

e) Reporting entities are required to conduct customer due diligence at one of three levels – standard, simplified or enhanced. Because trusts are considered to be higher risk, where the customer is a trust (including a foreign trust) the enhanced due diligence procedures apply.[41]

f) If a reporting entity is unable to conduct customer due diligence then they must not establish a business relationship with that party and are required to terminate any existing business relationship. They will also need to consider filing a *suspicious transaction report* (considered in more detail below) with the FIU.

g) Enhanced due diligence requires (among other information) the following details about a trust-

- name, address and date of birth of the beneficial owners
- for other than a discretionary trust, the name and address of each beneficiary
- for a discretionary trust, a description of each class of beneficiary
- the source of funds or wealth of the trust, with reasonable steps being taken to verify that information according to the level of risk involved[42] and in all cases[43] where the customer or a beneficial owner is a *politically exposed person*.[44]

h) Where the customer or a beneficial owner is a *politically exposed person*, senior management approval to continue the business relationship must be obtained.[45]

Information on beneficial ownership

7.6 Determining who is considered to be classified as a *beneficial owner* under the AML rules is critical. The Inquiry encountered a variety of views on the scope of the term, which is defined as *the*

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39 Regulation 17 of the Anti-Money Laundering and Countering Financing of Terrorism (Definitions) Regulations 2011.

40 Ibid, Regulation 20.These parties will come into the AML regime in *phase 2*. The Government announced on 30 May 2016 that legislation to implement phase 2 will be enacted in 2017. No application date has been specified at this time.

41 s.22(1)(a) AML/CFT Act.

42 s.24(1)(b) AML/CFT Act

43 s.26(2)(b) AML/CFT Act.

44 Defined in s.5 AML/CFT Act.

45 s.26 AML/CFT Act.

individual who has effective control of a customer or person on whose behalf a transaction is conducted.[46]

7.7 The supervising authorities' *fact sheet*[47] on customer due diligence on trusts notes that *for a trust beneficial ownership may include the trustees and any other individual who has effective control over the trust, specific trust property, or with the power to amend the trust's deeds, or remove or appoint trustees. This might include as a protector or special trustee (if there are any), or one or more of the beneficiaries of the trust*.

7.8 A review of foreign trust files held by IRD for exchange of information purposes illustrates the challenges that can occur in applying the *effective control* test.

7.9 The structure from one file is shown in Figure 4. In determining who may be a beneficial owner it is necessary to work out who has effective control. Depending on the trust deed, it is likely that the mother, as settlor, would have effective control, as would the trustee. But what of the daughter? She has gifted funds to the settlor, and is also a discretionary beneficiary of the trust. Prima facie this does not give her control, but further facts are needed to confirm this. It may also be necessary to obtain details of the gift from the undisclosed donor to ascertain if they may have some control over the trust.

7.10 The Inquiry considers that the explanation in the supervising authorities' Beneficial Ownership Guideline, and in the Customer Due Diligence fact sheet, on how the effective control element of the beneficial ownership test applies to a trust should be expanded[48]. Worked examples that show the customer due diligence work expected to be carried out to determine effective control in more complex fact situations that involve trusts would be helpful.

7.11 Officials from the Ministry of Justice informed the Inquiry that this month FATF is discussing whether further work on transparency and beneficial ownership is required 'to address recent, important developments on beneficial ownership that have strategic implications for FATF as the global standard setter.' This work may be of assistance to the supervising agencies.

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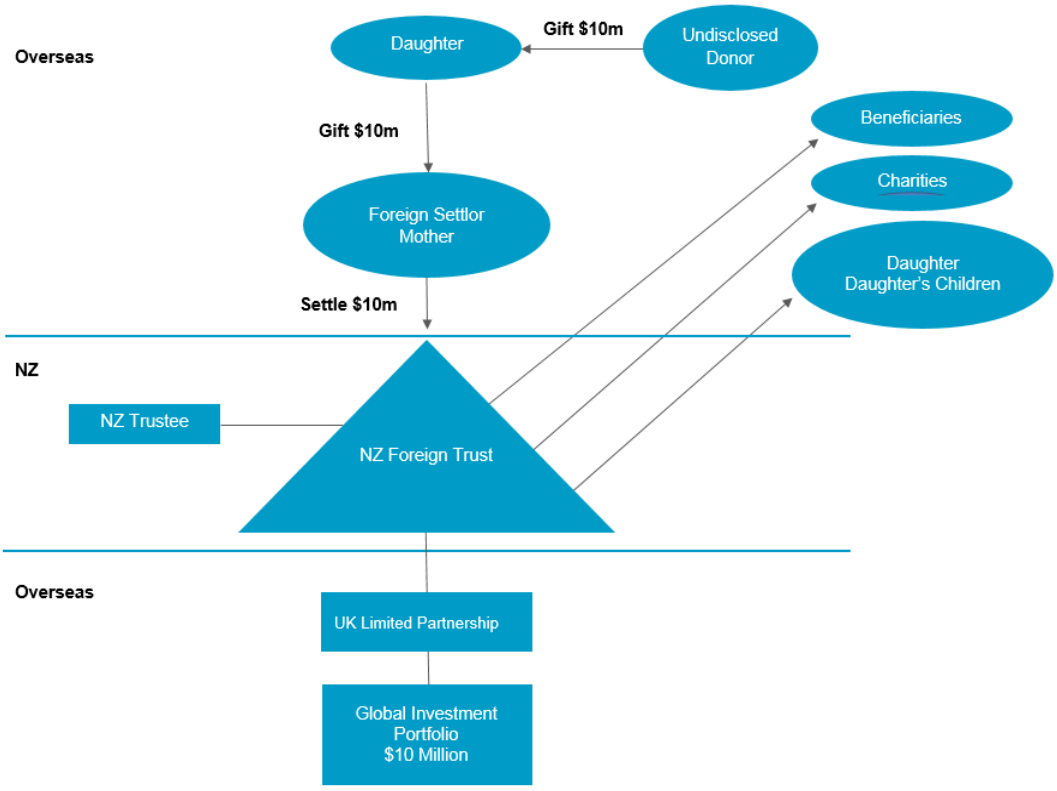
46 s.5 AML/CFT Act. The definition also includes an individual who owns a prescribed threshold (25%) of the customer, but this cannot generally be applied in a discretionary trust context. It may apply in a fixed trust where a beneficiary has a vested interest of more than 25% in the trust property.

47 https://www.dia.govt.nz/diawebsite.nsf/wpg_URL/Services-Anti-Money-Laundering-Codes-of-Practice-and-Guidelines#BEN

48 Ibid. The Guideline and *fact sheet* are explained in Appendix 6.

Figure 4: Source of Funds



Source of funds requirements

7.12 Similar complications arise in applying the verification of source funds requirements. A key objective of the AML rules is to ensure that the funds held (in this case by the foreign trust) are from a legitimate source. To facilitate this, where enhanced due diligence applies, the AML/CFT Act[49] requires reporting entities to obtain information relating to *the source or funds or wealth of the customer and, according to the level of risk involved, to take reasonable steps to verify the information*.[50]

7.13 In the file reviewed by the Inquiry and depicted in Figure 4 the deed of gift from daughter to mother was on file as evidence of the source of funds. No questions had been asked about the source of the gift to daughter, or the origin of those funds. Should questions have been asked?

7.14 The AML rules require reasonable steps to be taken to verify the source of funds (as opposed to simply establishing the source) according to the level of risk involved. Mandatory verification is required only if the customer is a *politically exposed person.* In the example above this is not the case. Unless their assessment of risk causes them to go further, the TCSP may conclude, not unreasonably, that the deed of gift is sufficient to establish source. However, is this level of inquiry sufficient to protect New Zealand from being used as a conduit for illegitimate funds? The Inquiry thinks not.

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49 s.23 AML/CFT Act.

50 s.24(1)(b) AML/CFT Act.

7.15 From files reviewed and discussions held with advisors to TCSPs and DIA it is clear that source and verification practices vary in sophistication. The Inquiry thinks it is reasonable to conclude that not all funds held by foreign trusts will be from legitimate sources if the source of funds is traced beyond gifts and loans and the origin of the underlying wealth is established.[51]

7.16 The risk of illicit funds not being identified as part of customer due diligence would be reduced if the AML rules were amended, or a regulation introduced, to require the source of funds to be verified in all cases where the enhanced due diligence procedures apply. The Inquiry recommends that this requirement be introduced for foreign trusts. While some TCSPs will be doing this already, files reviewed by the Inquiry show that this is not always the case.

AML rules – compliance and enforcement

7.17 Details of compliance obligations under the AML rules and enforcement of the rules are in Appendix 6.

7.18 The rules are less than three years old. For this reason, in carrying out its review and audit functions DIA has taken what it described to the Inquiry as a progressive approach, with the initial focus being an educative approach, with the emphasis being on ensuring that reporting entities such as TCSPs understand their obligations and have appropriate risk-based controls and procedures in place. As the regime has evolved the reviews have been more detailed, with controls and procedures being expected to reflect a thorough risk-based assessment of the customer base. Remediation plans are issued and monitored where areas of non-compliance are identified.

7.19 DIA's role does not include auditing the underlying customers of reporting entities. Because the AML regime is based around reporting entities such as TCSPs the reviews undertaken by DIA primarily involve an assessment of TCSP systems to test whether they are meeting their obligations under the AML/CFT Act. This means that DIA does not obtain information on the way in which, for example, the *effective control* aspect of beneficial ownership is determined or the extent to which tracing is undertaken when ascertaining (and verifying where required) the source of funds.

7.20 DIA advised that their reviews of TCSPs' written policies and procedures indicate a generally reasonable level of compliance with the obligation to undertake risk assessments of their business and to maintain appropriate AML/CFT policies, procedures, controls and training. TCSPs who made submissions to the Inquiry also emphasised the strength of their compliance systems, and the screening procedures in place to ensure the legitimacy of clients' credentials, and source of wealth.

7.21 As the AML regime matures, DIA anticipates undertaking more in the way of thematic reviews and sampling of records to ensure reporting entities are meeting their obligations. They also plan a less tolerant approach to non-compliance now the regime is through its infancy.

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[51] DIA advised the Inquiry that a guideline on *enhanced due diligence* is to be prepared that outlines the work expected to be carried out concerning the source of funds (and verification where necessary) where gifts are involved.

Financial Intelligence Unit

7.22 As outlined in Appendix 6, where a transaction is conducted through a reporting entity, and there are reasonable grounds to suspect that the transaction may be relevant to the enforcement of legislation concerning money laundering, drugs, terrorism or crime, a suspicious transaction report must be submitted to the FIU New Zealand. This is the one exception to the general rule in the AML/CFT regime that there are no direct disclosure obligations to government agencies.[52]

7.23 Two matters came to the Inquiry's attention that point to the effectiveness of current AML rules and their enforcement being constrained-

- Since the new AML/CFT rules took effect from 30 June 2013, the FIU has received only 26 suspicious transaction reports from entities that identify themselves as professions that provide TCSP services. This appears low in the context of the average number (approximately 9,000) of foreign trusts in existence over this period.
- One TCSP submitted that it is not possible to submit a suspicious transaction report if the transaction did not go through a New Zealand bank. Discussions with the FIU indicate that it is in fact difficult to report where no transaction has actually occurred, or if the transaction has occurred but not through a local financial institution, as there is no legislative mechanism to report suspicious matters that are not transactions made through the reporting entity.

7.24 The Inquiry recommends that these issues be addressed through-

a) DIA giving the obligation to report suspicious transactions greater profile within the trust service industry

b) considering a new reporting obligation to report suspicious financial matters notwithstanding that there may be no actual transaction through a local financial institution.

7.25 Another area the Inquiry recommends be reviewed is the extent to which the FIU is able to share information with IRD. Under the AML/CFT Act[53] the FIU, through powers granted to the Commissioner of Police, may disclose information (obtained under the AML/CFT Act) with any government agency for law enforcement purposes. In practical terms this requires someone within the FIU to assess whether information in (for example) a suspicious transaction report points to possible evasion of New Zealand or foreign tax. This would be a difficult task for a person without tax training to undertake.

7.26 The current legislative arrangements for sharing FIU information preclude systematic exchanges of information to allow IRD to detect patterns indicative of tax evasion and/or link reports to other tax information. Concurrently, the TAA prevents IRD from sharing strategic intelligence, information relating to entities, or private information systematically with the FIU. This hinders collaboration between the two agencies to target offending such as tax evasion through New Zealand foreign trust structures, leading to IRD and the FIU working in silos without complete information.

7.27 The proposed introduction of phase 2 of the AML rules provides a timely opportunity to review the information sharing arrangements, and the Inquiry recommends that this be done. This could

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52 From 1 July 2017 all international fund transfers of $1,000 or more and all cash transactions of $10,000 or more through a reporting entity will also be reported to the FIU.

53 s.139 AML/CFT Act.

include consideration of the extent to which the relevant supervising agency (DIA in the case of the TCSP sector) should also have widened access to information from the FIU and IRD. The overall objective is to make the disclosure rules more effective by coordinating the information currently collected by different agencies. The issue is naturally broader than foreign trusts, but it would contribute to the aim of ensuring that illicit funds are not held within these vehicles.

7.28 The Inquiry notes that the OECD is also undertaking work in this area.[54]

Observations on regulatory requirements and enforcement under the AML rules

7.29 The Inquiry can understand why the rules and their current enforcement could be viewed from afar as being reasonably benign and why one trust services firm quoted in the press around the Panama Papers described the rules as very weak.[55] In particular-

- Offshore parties involved in establishing a foreign trust can be advised legitimately that none of the information provided during customer due diligence is required to be provided to any government agency.[56]
- The likelihood of information obtained during customer due diligence being requested by a government agency is very low.
- Lawyers and accountants providing services similar to a TCSP are not required to comply with the AML/CFT customer due diligence and reporting obligations (although some have said that they comply voluntarily).
- For some foreign trusts, information on the source of funds needs to be obtained by the TCSP, but not verified. Mandatory verification is only required if the customer is a *politically exposed person,* and in other cases according to the level of risk involved.
- The circumstances in which someone might be considered to be a beneficial owner of a trust, triggering the requirement that customer due diligence be performed on them, requires a determination of whether that person has *effective control* of the foreign trust. This is difficult to apply in complex situations such as where a person appears to have no control on the basis of the trust's constitutional documents, but seems to be the source of funds ultimately settled on the trust. Technical arguments to the effect that a person does not have effective control are reasonably easy to put forward to justify taking the position (which might be at the request of the client) that due diligence on a particular individual is not required.

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54 OECD. (2015). *Improving Cooperation Between Tax and Anti-Money Laundering Authorities*. https://www.oecd.org/ctp/crime/report-improving-cooperation-between-tax-anti-money-laundering-authorities.pdf

55 Chenoweth, Neil. (10 April 2016). The Panama Papers: Malta's leaders turned to Mossack Fonseca five days after election. *Australian Financial Review*. Reproduced in Appendix 2. See reference on p.3 to advice provided by Nexus Trust.

56 Except where the reporting entity files a suspicious transaction report. This is very rare.

7.30 Other factors that could leave an impression of a relaxed customer due diligence process in New Zealand are the fact that the beneficiaries of a discretionary trust do not need to be disclosed as part of the customer due diligence process, other than by class, and the identification requirements for persons who do undergo customer due diligence can be satisfied through the provision of a certified copy of a passport photo page and a utilities bill, which does not have to be certified.

7.31 The Inquiry is not suggesting that these factors are evidence that the AML/CFT Act is inadequate or that poor levels of customer due diligence are being undertaken.[57] Files seen by the Inquiry show reasonably robust screening processes. Some TCSPs go further than is required to (for example) satisfy themselves as to the credentials of the customer and the source of funds. Others are less thorough. The important point for purposes of the Inquiry is that the overall level of information that is required to be obtained for AML purposes when a foreign trust is set up is modest.

7.32 The guidelines and fact sheets issued by the supervising agencies to assist TCSPs and others in the practical application of the AML rules are helpful. However, they do not provide in-depth insights into how to establish beneficial ownership or to interpret effective control, or the extent of due diligence work that should be carried out in establishing source of funds, in complex multi-layered trust structures. The Inquiry considers detailed worked examples would be helpful, and could be expected to increase the depth and quality of customer due diligence in more complex scenarios. These examples should include guidance on the extent to which funds said to be sourced from gifts should be traced to their origin in various scenarios.

[57] It is also important to note that the AML/CFT legislation does follow the FATF requirements.

Part 8 New Zealand's Obligations under International Agreements

Wide range of agreements

8.1 The Inquiry's terms of reference require consideration of the existing foreign trust disclosure rules when considered alongside New Zealand's commitments under a range of international agreements relevant to taxation and to anti-money laundering/countering of financing of terrorism.

8.2 The tax-related agreements arise from New Zealand's membership of the OECD. The AML/CFT-related agreements arise from its membership of the Financial Action Task Force. FATF is an inter-governmental body established to set standards and to promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system.[58]

8.3 As an overall observation, the Inquiry was surprised and struck by the significant practical impact (on domestic legislation, and operational compliance) of four emerging issues that arise directly from the international agreements-

- the sheer volume of initiatives and programmes to which New Zealand (with all other OECD and FATF member countries) is committed
- the extent and pace of legislative and other changes that are directly attributable to the coordinated global action to clamp down on money laundering, terrorism financing, tax evasion, aggressive tax behaviour and corruption
- the major role that financial intermediaries, such as banks, are expected to play in scrutinising their customers and transactions to assist authorities to detect corrupt practices
- the radical changes some countries are having to make to their domestic laws to maintain trading and investment relationships.[59]

OECD agreements and initiatives

8.4 The agreements and initiatives that arise from New Zealand's membership of the OECD are outlined in four appendices.

Automatic exchange of information proposals – Appendix 5

8.5 The AEOI proposals, which are scheduled to come into effect in New Zealand in 2017, are considered in Part 6 of the report. As noted, for foreign trusts the increased information disclosures arising under AEOI are expected to be limited. This would not, however, make New Zealand non-compliant with the requirements imposed by the CRS.

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58 The FATF is hosted by the OECD and is situated in its headquarters in Paris, but it is not technically part of the OECD. The two bodies work together closely to ensure their policies complement each other.

59 For example, Switzerland previously had strict bank secrecy rules which effectively meant that financial information was not exchanged. Switzerland has now signed up to full exchange of information (including AEOI).

New Zealand's tax treaty network – Appendix 7

8.6 New Zealand currently has treaty arrangements that allow for full information exchange (on request, spontaneous and automatic) with 86 jurisdictions. Another four agreements provide for information to be exchanged on request only, and there are 19 agreements that are not yet in force.

8.7 The treaties are the legal authority for IRD being able to exchange information (including on foreign trusts) with other countries.

8.8 Part 6 of the report notes that one of the challenges posed by New Zealand foreign trusts is that offshore tax jurisdictions will often not know of their existence, so they do not know what information to ask for. The Inquiry considers it important to note that this situation, which can apply equally to any entity in any offshore country, does not make New Zealand non-compliant with its treaty obligations.

8.9 New Zealand has an excellent reputation for fulfilling its exchange of information obligations with treaty partners, and IRD advised the Inquiry that all information requests in respect of foreign trusts have been fulfilled.

OECD's Forum on Harmful Tax Practices (FHTP) – Appendix 8

8.10 A key focus of the OECD's FHTP has been the identification of harmful preferential regimes in OECD and non-OECD jurisdictions. New Zealand has been an active contributor to this work.

8.11 As outlined in Appendix 8, the FHTP conducts reviews of OECD member countries to identify harmful tax regimes. New Zealand was reviewed in 2000 and again in 2011/12. On both occasions it was not found to have any harmful preferential regimes. Aspects of New Zealand's tax regime were queried in the later review, and subsequently cleared. The queries did not involve the foreign trust regime.

New Zealand's involvement in OECD bodies and initiatives – Appendix 9

8.12 In addition to the agreements and initiatives covered above, New Zealand is actively involved in a range of other OECD initiatives as outlined in Appendix 9. This includes work on the major Base Erosion and Profit Shifting (BEPS) project.

OECD hybrid recommendations

8.13 One aspect of the OECD BEPS project may require New Zealand to increase the amount of information a foreign trust discloses to IRD, regardless of whether any changes result from the Inquiry.

8.14 Action 2 of the BEPS project recommends that countries adopt tax rules in domestic law that prevent double non-taxation (DNT). DNT generally arises where transactions that involve countries with different tax rules result in no tax. For example, income that is exempt from New Zealand tax may also be exempt or excluded from the tax base of the county in which the beneficial owner of that income is tax resident because of a mismatch of the two countries' tax rules.

8.15 In one of 12 recommendations that arise from Action 2, jurisdictions are encouraged to *maintain appropriate reporting and filing requirements for tax-transparent entities established within the jurisdiction.* Recommendation 5.3 deals with 'reverse hybrids', and it is not yet clear whether New Zealand foreign trusts would fall into this classification.

8.16 If foreign trusts are classified in this way New Zealand would be expected to amend its domestic tax law to require foreign trusts to maintain records of-

- income allocations to beneficiaries (currently records only need to be maintained of distributions in certain circumstances)
- the identity of the settlor, and of the beneficiaries who are allocated income. Currently, information regarding the identity of the settlor and of beneficiaries must be retained only if known to the trustee.[60]

Global Forum review of information exchanges by New Zealand

8.17 Following a direction from the G20, the OECD established the Global Forum on Transparency and Exchange of Information for Tax Purposes (the Global Forum) in 2009. A core activity of the Global Forum is to conduct peer reviews of members in order to ensure compliance with international standards on transparency and tax-related exchanges of information.

8.18 The Global Forum reviews assess the quality of each member's legal and regulatory framework for the exchange of tax information (phase 1) and examine the practical implementation of that framework (phase 2).

8.19 New Zealand was reviewed by the Global Forum in 2011 and a peer review report issued, but without ratings.[61] The final report was issued in 2013.[62] New Zealand was graded compliant, which is the highest rating. The Executive Summary to the report provides useful insights into how New Zealand is perceived from within the OECD[63]-

> *New Zealand fully endorses the implementation of the international standards for transparency and exchange of information for tax purposes. As an OECD country New Zealand has been an active member of the Global Forum ... In taxing residents generally on their worldwide income New Zealand considers transparency and information sharing to be essential to tax compliance management.*

Financial Action Task Force agreements

8.20 New Zealand's primary obligation as a member of FATF is to implement the international standards on combating money laundering and the financing of terrorism.

8.21 FATF has issued a series of recommendations – currently numbering 40 – that are recognised as the international standard for combating money laundering and other illicit activities. In New Zealand these recommendations form the basis of the AML/CFT Act.

8.22 Details of the AML regime and its enforcement are in Appendix 6. The regime includes important measures to combat the use of foreign trusts for illicit activities.

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60 s.22(7)(d) ITA.

61 The Global Forum did not issue ratings until sufficient countries had been reviewed to achieve consistency.

62 OECD. (2013). Global Forum on Transparency and Exchange of Information for Tax Purposes: Peer Reviews: Combined: Phase 1 + Phase 2 New Zealand, incorporating phase 2 ratings. OECD Publishing. http://www.oecd-ilibrary.org/taxation/global-forum-on-transparency-and-exchange-of-information-for-tax-purposes-peer-reviews-new-zealand-2013_9789264205864-en;jsessionid=d6ah021k0mi38.x-oecd-live-02

63 Ibid p.7.

8.23 New Zealand is engaged in a number of FATF bodies and initiatives. Details are in Appendix 10. Linked to its commitment to FATF, New Zealand is also a member of the Egmont Group of Financial Intelligence Units. Details are outlined in Appendix 11.

Peer review of compliance with FATF recommendations

8.24 FATF undertakes reviews (known as Mutual Evaluations) of countries to determine compliance with the recommendations. Following each review a detailed Mutual Evaluation report is issued containing one of four ratings (Compliant, Largely Compliant, Partially Compliant or Non-Compliant) alongside each recommendation.[64] Follow-up evaluations are undertaken where areas of partial or non-compliance are identified, and a follow-up report is issued.

8.25 The most recent mutual evaluations of New Zealand by FATF were conducted in 2009 and 2013. In the 2009 report[65] New Zealand was assessed as either partially or non- compliant in a number of areas, and was placed on follow-up and directed to report back regularly to FATF on progress. It is important to note that the 2009 evaluation was carried out before the AML/CFT Act came into force. The legislation had been enacted but had not commenced at that time. Ratings by FATF cannot take account of legislative measures that are not in force.

8.26 One area where New Zealand was rated non-compliant in 2009 related to beneficial ownership of trusts. FATF noted[66]-

> *New Zealand should develop requirements to ensure that information on the beneficial ownership and control of trusts is readily available to competent authorities in a timely manner. Such measures could include, for example, requiring trustees to maintain information on the trust's beneficial ownership and control, requiring the location of such information to be disclosed, or requiring the trust service providers to obtain and maintain beneficial ownership information. Such information would then be available to the law enforcement and regulatory/supervisory agencies upon proper exercise of their existing powers.*

8.27 At the time of the second follow-up report in October 2013 New Zealand sought removal from the follow-up process on the basis that many of the significant deficiencies had been addressed through the AML/CFT Act, which came into effect on 30 June 2013. In the follow-up report issued by FATF in October 2013 these submissions were accepted.[67] However, with regard to trusts, the FATF Secretariat determined that, while significant progress had been made, concerns remained over the lack of information on beneficial ownership. The FATF Secretariat was primarily concerned by the lack of coverage of key sectors, such as lawyers and accountants, in the AML regime.[68] This lack of coverage meant that *it could not be determined that information on the ultimate beneficial owners is accessible and/or up-to-date in all cases.*[69]

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64 The next round of reviews will include ratings for effectiveness in achieving immediate outcomes.

65 APG and FATF *Mutual Evaluation Report of New Zealand*, 16 October 2009. http://www.fatf-gafi.org/media/fatf/documents/reports/mer/MER%20New%20Zealand%20ful.pdf

66 Ibid, para 772, Recommendations and Comments on Compliance with Recommendation 34.

67 FATF *2nd Follow-Up Report Mutual Evaluation of New Zealand*, October 2013. http://www.fatf-gafi.org/media/fatf/documents/reports/mer/FUR-New-Zealand-2013.pdf

68 It was described (p.25) in the 2013 Follow-up Report as a *serious scope issue.*

69 Op Cit p.42. http://www.fatf-gafi.org/media/fatf/documents/reports/mer/MER%20New%20Zealand%20ful.pdf

8.28 It seems likely that the proposal to extend the AML/CFT regime to lawyers and accountants in 2017 will satisfy the concerns noted by FATF.

8.29 After the follow-up presentation in October 2013 New Zealand was removed from the follow-up process. Under the current schedule, New Zealand's next mutual evaluation is in 2019–20.

Conclusions on international commitments

8.30 New Zealand takes its commitments and obligations under the international agreements relevant to the Inquiry seriously. It rates well in peer reviews, and moves to address issues that are identified. It has a reputation, well-deserved based on the material reviewed by the Inquiry, as a country with integrity that is both committed to and actively involved in global initiatives to address money laundering, terrorism financing, tax evasion and aggressive tax behaviour.

8.31 The foreign trust regime does not appear to be inconsistent with any specific obligations under current international agreements to which New Zealand is a signatory. 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 international treaty partners would have a legitimate expectation that some action will be taken. There is clear potential for reputational damage in the eyes of some countries if no action is taken.

Part 9 New Zealand's Reputation

Strong global reputation

9.1 The Inquiry is required to consider the adequacy of foreign trust disclosure rules in ensuring New Zealand's reputation is maintained when considered alongside its commitments and obligations under international agreements.

9.2 The international agreements of key relevance are summarised in Part 8 of the report, and details are in Appendices 7 to 10. The Inquiry has also had regard to the country's support for the United Nations Convention against Corruption. It is clear from these agreements that New Zealand is committed to-

- active involvement in global initiatives to clamp down on crime, money laundering, terrorist financing, the hiding of illicit funds, tax evasion and aggressive tax practices
- integrity, openness and transparency
- ensuring that its legislation and enforcement activities meet or exceed global best standards
- taking a leadership role on these initiatives
- acting to address and rectify issues of concern.

9.3 The Inquiry met with officials from IRD, the Treasury and the Ministry of Justice who represent New Zealand on global forums responsible for overseeing policy and practice around the relevant international agreements. The consistent feedback from them is that New Zealand is well regarded at these forums, with a reputation for being actively involved, speaking up and working to ensure that, wherever possible, the country leads by example.

9.4 Officials who represent New Zealand on OECD forums noted that the country has a reputation for articulating principled views that other countries are willing to support but may not be in a position to lead for various reasons. New Zealand provides the platform for others to build on.

9.5 As outlined in Part 8 of the report, peer reviews of New Zealand's tax system, information exchange frameworks and compliance with FATF recommendations support the conclusion that New Zealand meets it international obligations.

9.6 New Zealand also performs consistently well in commonly used survey rankings that measure a country's integrity either directly or as sub-components of business environment surveys. The results from a selection of surveys are in Appendix 12.

9.7 Transparency International's Corruption Perceptions Index shows a drop in New Zealand's ranking from 1st to 4th between 2012 and 2015. While it is not clear what has caused this drop, the downwards move is regrettable and demonstrates that there is no room for complacency.

9.8 There is sometimes a delicate balance between performing well in one area while not putting others at risk. New Zealand has consistently ranked either 2nd or 3rd in the World Bank's Ease of Doing Business survey. One contributor to that could be the ease with which a new company can be established in New Zealand. In some circumstances these entities may be used to undertake illicit activities, putting pressure on other reputational criteria.

9.9 The surveys summarised in Appendix 12 support the view that New Zealand is a largely corrupt free nation with a strong global brand and a reputation for integrity, transparency and openness.

9.10 Not surprisingly, submissions to the Inquiry and views expressed by persons spoken to (both within and outside of the business community) reflected strong support for the view that maintenance of New Zealand's reputation as a country of high integrity is critical.70 It is seen as being of significant commercial benefit to global trade and investment. There was concern that reputations are hard won and easily lost, and that action should be taken to address issues that could have a negative impact.

Reputational impact of the Panama Papers

9.11 The first international and New Zealand media reports on the Panama Papers appeared on 3 April 2016. From that date until around 13 May the radio, television, print and social media coverage in New Zealand was extensive. Coverage was also widespread in the international media but, with the exception of Australia, references to New Zealand were very limited. The focus in the international media was understandably on high-profile politicians and wealthy individuals whose names were said to appear in the Papers and who lived or had connections with the country in which the media outlet was based. Mentions of New Zealand were made in passing in a few cases where the individuals were said to have an interest in a New Zealand foreign trust or company.

9.12 Within New Zealand, significant profile was given to statements from the ICIJ that-

- New Zealand is a well-known tax haven and a nice front for criminals.[71]
- A very easy jurisdiction to operate in. It's very secretive.[72]
- The New Zealand Government does not ask the identity of either the settlors or the beneficiaries of these trusts and thus ownership remains secret, hiding the funds from the trust-holder's home jurisdiction.[73]

9.13 At a local level the messaging in the media focused in particular on concerns that New Zealand was being described as a tax haven, the reputational consequences of that and the unfairness associated with wealthy individuals being able to escape tax through using offshore trusts. One academic expressed the view that *It's shameful for New Zealand to be caught up in international tax avoidance*.[74]

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70 Integrity is also one of three core values that form the basis of 'The New Zealand Story', a Government project described as 'an initiative that defines the distinctly Kiwi attributes that make us unique and provides a framework to help us better communicate our value to the world'. http://www.nzstory.govt.nz/what-is-nz-story

71 RNZ news interview with Gerard Ryle, director of ICIJ, on 8 April 2016.

72 Ibid.

73 Panama Papers, from Wikipedia, para 7.24, content on New Zealand, retrieved on 23 April 2016 from https://en.wikipedia.org/wiki/Panama_Papers

74 Fletcher, Hamish. (29 April 2016). *Panama Papers: New Zealand is 'complicit' in tax avoidance – expert,* quoting Deborah Russell from Massey University's School of Accountancy. *The New Zealand Herald* online edition. Retrieved from www.nzherald.co.nz

9.14 Two *Australian Financial Review* articles received a particularly high level of comment. The articles are reproduced in Appendix 2. The first of these gave prominence to structures involving the use of New Zealand foreign trusts and companies by prominent individuals from Malta,[75] including statements that-

- The papers held by the ICIJ show how Mossack Fonseca bragged to clients how easy New Zealand laws made it for foreign investors to hide their tax-free profits.
- There was no need to register who put assets into a foreign trust …In other words you never have to explain who gets the money – and Mossack Fonseca never need to know either.

9.15 The *Australian Financial Review* article also drew attention to a *combo* pack said to be offered by Mossack Fonseca to clients investing through New Zealand. Based on the article, the combo pack consists of a foreign trust and a 100% owned New Zealand incorporated LTC, which would (like the trust) pay zero tax on offshore earnings.

9.16 A second high-profile article in the *Australian Financial Review*[76] contained a prominent sub-title *Cashing In on NZ's Reputation,* under which it was stated that *Mossack Fonseca had been on a marketing drive, cutting its prices to build up its New Zealand office. 'Chase the Money', head office in Panama urged its New Zealand staff.*

9.17 This article goes on to describe the LTC structure, explaining-

> *but there was another advantage because technically the LTC was taxed, but it's just that the rate was set at zero … New Zealand has a double tax treaty with France, which meant that he could repatriate the profit to France where it was not taxable because it had already been 'taxed' in New Zealand. While New Zealand's tax laws are a major plus for foreign investors, it's not the only attraction. They also come to use New Zealand's good reputation.*

9.18 The first of the two Australian Financial Review articles was reproduced in New Zealand with substantially the same content on 11 April 2016 in the Stuff news website's Business Day section under the headline: 'The Panama Papers: Mossack Fonseca bragged about NZ's easy trust system'. The second article appeared on the same website on 6 May 2016 under the headline: 'The Panama Papers: New Zealand link revealed'.

9.19 Assessed objectively, the media coverage outlined above, and other articles with a similar tone, have the potential to be reputationally damaging to New Zealand. The coverage conveys the impression of a country that has loose tax laws, inadequate disclosure rules and weak due diligence requirements. Key questions are whether the stories are factually accurate and whether any of the structures described have actually resulted in the evasion of tax or the hiding of illicit funds. To some extent, however, reputational damage can occur regardless of the factual accuracy of media reports.

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75 Chenoweth, Neil. (10 April 2016). *The Panama Papers: Malta's leaders turned to Mossack Fonseca five days after election*. Australian Financial Review. Reproduced in Appendix 2.

76 Chenoweth, Neil. (6 May 2016). *The Panama Papers: Behind Mossack Fonseca's secret New Zealand deals*. Australian Financial Review. Reproduced in Appendix 2.

9.20 In the absence of access to the Panama Papers themselves, and full details on the source of funds and the extent to which tax that should have been paid in offshore jurisdictions has or has not been paid, the Inquiry cannot determine whether the inferences in the *Australian Financial Review* and other articles are accurate.

9.21 If the customer due diligence required by the AML rules has been thorough there should not be illicit funds involved. If New Zealand's tax record keeping requirements were satisfied then the individuals involved would be taking a risk in not disclosing income in the tax return in the country where they are tax resident. This is because IRD could request the information and disclose it to the foreign tax authority if the country involved has the necessary tax agreement with New Zealand.

9.22 Parts 6 and 7 of the report conclude with the Inquiry's observations on the existing tax and AML disclosure rules. If the examples in the *Australian Financial Review* articles are examined in the context of those observations it can be seen that there is the potential for the hiding of funds and the evasion of tax, and a reasonable likelihood that this is occurring. If this is the case then prima-facie there is the potential for justified reputational damage if no action is taken.

Informal feedback from OECD

9.23 Officials from IRD have attended meetings at the OECD in Paris since the Panama Papers were released. The Inquiry asked whether the New Zealand foreign trust issue was raised and, if so, whether there is any sign of it having a negative impact on reputation. In response, officials noted-

- OECD Secretariat officials and some country delegations are aware of the foreign trust issue.
- They see it as akin to look through (otherwise known as disregarded) entities in other countries (for example, LLCs in the USA).
- New Zealand continues to be regarded as principled, ethical and compliant with best standards, and the foreign trust issue is unlikely to change that.
- When informed that the New Zealand Government was undertaking a review of foreign trust disclosure rules, persons spoken to at the OECD were supportive of this development.

The tax haven question

9.24 The Panama Papers have generated significant debate in the local media over whether New Zealand is a tax haven.[77] The Inquiry considers this debate to be a good illustration of why the OECD has moved away from using the expression *tax haven*, because in the context of a 21st century global economy it is wholly inadequate.[78] Debates that focus on it tend to be futile in throwing light on the core issues or resolving them, as has been the case in New Zealand.

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77 For example, the RNZ Checkpoint programme on 28 April 2016 reported a UMR poll that found 57% of respondents concerned over the *tax haven* tag. In the same programme an opposition politician opined that *New Zealand had now been associated with the mega rich who pay no tax and they don't like that.*

78 An illustration of this is a recent article *The World's Favorite New Tax Haven Is the United States*, Bloomberg Businessweek, 27 January 2016, which argues that, by resisting new global disclosure of information standards, the US is *creating a hot new market, becoming the go-place to stash foreign wealth*.

9.25 In 1998 the OECD issued a report on harmful tax competition.[79] The report set out four key factors used to define tax havens-

- no or only nominal taxes
- lack of effective exchange of information
- lack of transparency
- no substantial activities.

9.26 These factors, and in particular the first three of them, remain the signpost in the OECD's eyes as to whether a country is a tax haven. However, a country that is not a tax haven may have features of its tax system that are considered harmful to other countries. In recognition of this, the OECD set out in the 1998 report eight factors to determine whether a preferential regime was considered harmful-

- an artificial definition of the tax base
- failure to adhere to international transfer pricing principles
- foreign source income exempt from residence country taxation
- negotiable tax rate or tax base
- existence of secrecy provisions
- access to a wide network of tax treaties
- the regime is promoted as a tax minimisation vehicle
- the regime encourages operations or arrangements that are purely tax-driven and involve no substantial activities.

9.27 Applying the OECD framework, New Zealand is not a tax haven. It might be argued that the foreign trust regime is a preferential tax regime, and this is sufficient to make it a tax haven. However, a large number of countries have tax systems with features that could be styled preferential. For example, countries that have offshore banking unit legislation to encourage banks to establish in their country through low or zero tax rates, or countries with concessionary rules for the taxation of savings or superannuation. The absence of a comprehensive capital gains tax in some countries, including New Zealand, could be considered preferential.

9.28 As outlined in Part 8 of the report, the OECD has considered the foreign trust regime as part of its reviews of the New Zealand tax system and has not categorised it, or any other aspect of the tax system, as preferential or harmful. This is probably because the foreign trust regime is not targeted at providing concessions to income actually diverted to New Zealand. In contrast, the United Kingdom's 'patent box' rules, for example, have been categorised as potentially harmful.

9.29 The fact that New Zealand is not a tax haven is not a basis for leaving the foreign trust disclosure rules as they are. However, as a classification, *tax haven* is an ambiguous label that is now only of historic relevance and is best not used as a basis for decision making without much deeper inquiry.

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[79] OECD. (1998). *Harmful Tax Competition: An Emerging Global Issue*. OECD Publishing, Paris. http://www.oecd.org/tax/transparency/44430243.pdf

Conclusions on reputation

9.30 The Inquiry concludes that-

- New Zealand has a strong reputation within the OECD and more broadly as a country with integrity that is committed to clamping down on crime, money laundering, terrorist financing, the hiding of illicit funds, tax evasion and aggressive tax practices.
- The Panama Papers and associated debate concerning foreign trusts are unlikely to have any significant impact on that reputation, particularly if action is taken to tighten disclosure rules.
- Some reputational damage to the integrity of the tax system seems likely to have occurred domestically as a consequence of the tone of the intensive media coverage in April/May 2016. This results from perceptions that the tax system is inherently unfair if wealthy individuals can escape tax through the use of foreign trusts, and from the picture painted of New Zealand acting as a tax haven and as a place where overseas persons hide illicit funds and evade tax.

Part 10 Are the Existing Disclosure Rules Adequate?

Conclusions on adequacy of existing disclosure rules

10.1 The Inquiry's overall conclusion is 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. The Inquiry considers that a significant expansion of the rules, and some changes to their enforcement, will satisfactorily address the issues identified. It does not consider banning foreign trusts or removing the current tax exemption is necessary or justified.

10.2 New Zealand requires a regulatory and enforcement framework that is sufficient to protect its own tax base while also ensuring that international confidence is not undermined through entities in this country being used to hide funds or to facilitate the evasion or avoidance of taxes in other countries. For foreign trusts, in theory-

- the AML rules and the associated due diligence should ensure that the funds held are from legitimate sources, and
- the tax disclosure and associated record keeping rules should provide IRD with sufficient information to enable it to fulfil its obligations under multilateral tax agreements.

10.3 The AML and tax legislation appears consistent with international standards and, based on the limited files available for review,[80] the Inquiry did not identify evidence of inadequate compliance or enforcement.[81] Tax information exchange requests are responded to comprehensively and efficiently. However, the Inquiry does not consider the mere existence of these regimes is a sufficient basis to conclude that foreign trusts are not used or able to be used for illicit purposes such as hiding funds or evading or avoiding tax. There is an important additional question: Is there a risk that the likelihood of detection by either New Zealand or offshore authorities is sufficiently low that some offshore parties are prepared to take that risk, resulting in a breach of New Zealand or foreign tax or AML rules?

10.4 If the answer to this question is yes, then as part of its commitment to the global initiatives described in this report, including not facilitating the hiding of funds or the evasion or avoidance of tax, action is required.[82] The Inquiry concludes that this question needs to be answered yes for the reasons outlined in the concluding sections of Parts 6 and 7 of the report. In summary-

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80 Because foreign trusts do not normally have any New Zealand tax liability they are not required to file a tax return and from the perspective of domestic law there is no reason for IRD to maintain files on them. The files that are held (and which were available to the Inquiry) relate to foreign trusts that have been the subject of an information exchange. For AML, because the regime is based around reporting entities rather than underlying customers, DIA does not typically access foreign trust records and, like IRD, has no reason to maintain files.

81 Although the Inquiry did review one independent audit report that concluded that a TCSP's risk assessment and establishment, implementation and maintenance of an AML/CFT programme was non-compliant in a number of material areas with the requirements of the AML/CFT Act.

82 Action would also be appropriate to protect the integrity of the tax system as seen from a domestic perspective.

a) The information required to be provided to IRD (or any other government agency) when a foreign trust is established is minimal, with no meaningful data on the name or contact details of settlors, foreign trustees, others who may control the trust, or beneficiaries.

b) There is no obligation to report distributions to beneficiaries.

c) No annual returns of any kind are required.

d) There is a low likelihood of IRD requesting records and exchanging any information with offshore authorities.

e) No information obtained under the AML rules as part of customer due diligence is likely to be disclosed to any government agency.

f) Information on the source of funds in foreign trusts is required to be obtained but in many cases verification is not mandatory.[83]

g) The definition of beneficial ownership, and in particular the concept of effective control, is complex and may not be well understood or consistently applied.

10.5 The above framework is consistent with the messages in some websites that advertise foreign trusts, which stress minimal disclosure and reporting requirements.[84] The Inquiry concludes that offshore parties might justifiably conclude that New Zealand has light-handed disclosure requirements and is a very easy place to set up in without any material likelihood of information being requested by a New Zealand government agency and provided to a tax or other authority offshore.

10.6 Some submissions noted that there has been no evidence that trusts have been used to facilitate evasion of other countries' taxes or money laundering. As far as the Inquiry can ascertain, that is correct. It does not follow from this that there has not actually been any evasion or money laundering, and that the case for change is unproven. That argument is akin to saying that no speeding tickets have been issued on a particular road, so speeding in that area is not a problem. As a purely practical matter, because foreign trusts do not pay New Zealand tax or file tax returns, the extent of IRD audit work on them is generally limited to when a request is received from another country for information. Those occasions are few in number because offshore countries typically do not know that a foreign trust that they may have an interest in even exists in New Zealand.

10.7 Other submissions argued that any concerns over the existing disclosure rules will be fully dealt with when the AEOI rules come into effect in 2017. As outlined in Part 6.7 and Appendix 5 of the report, based on the information presently available about the new regime there will be a number of foreign trusts that will not experience any material increase in disclosure requirements under the AEOI rules. The Inquiry does not consider the AEOI regime will solve the problems identified.

Options for enhancement

10.8 Dealing with this issue requires a balancing of interests. On the one hand, there are offshore parties who want to use New Zealand as a genuine safe haven for the holding of family wealth. Their interest is consistent with government policy that encourages and welcomes offshore investment

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83 The exception being for a *politically exposed person*.

84 See Part 4 of the report. The first of the two *Australian Financial Review* articles reproduced in Appendix 2 also refers to the perceived weak due diligence rules.

and a vibrant financial services sector. On the other hand, from both a global and local reputational and ethical perspective, New Zealand needs to protect against the risk of unwitting facilitation of money laundering, tax evasion and other illicit activities.

10.9 The Inquiry has considered a range of options-

a) minor changes to the existing tax disclosure rules

b) licensing of resident foreign trustees

c) extending the AEOI proposals so that all foreign trusts are covered by them

d) more substantial changes to the tax disclosure rules, coupled with some changes to the way the AML regime is applied and a register of trusts

e) as for (d), coupled with a publicly searchable register of interests

f) repeal of the exemption from tax on foreign source income.

10.10 The Inquiry has concluded that a significant expansion of the disclosure rules, and some changes to their enforcement, can satisfactorily address the issues identified. A number of supporting changes are also recommended to improve the overall effectiveness of the tax and AML disclosure rules. The changes proposed are outlined in Part 12 of the report. The reasons for not recommending the other options are outlined in Part 13.

10.11 In developing the recommendations in Part 12 of the report the Inquiry has endeavoured to strike a balance that will allow people with legitimate reasons for using a New Zealand foreign trust to continue to do so.

10.12 If implemented, the expanded disclosure rules should achieve several objectives-

- The rules should act as a deterrent to non-residents who rely on non-disclosure to achieve tax or other outcomes that conflict with New Zealand or offshore laws.
- The perception in some quarters offshore that New Zealand has weak disclosure rules and due diligence requirements should dissipate.

10.13 IRD will be better placed to determine if there are indicators of evasion of tax or aggressive tax structuring that they may wish to exchange with a tax treaty partner.

10.14 The Inquiry is not recommending that the information obtained by IRD would be automatically exchanged with foreign tax authorities. The protocols IRD would apply in determining if information is exchanged would be the same as those that currently apply.[85] These include careful consideration of data protection laws and practices as well as ensuring that information is not used by other countries for purposes beyond those specified in the relevant information sharing agreements.

10.15 Of the above objectives, the deterrent (or signal sending) effect is of particular importance. The tax and AML rules do not operate in isolation. The obligation to provide information to IRD, particularly when a trust is set up, acts as a buttress to the AML regime. Offshore parties are less likely to view a New Zealand foreign trust as a suitable vehicle in which to house illegally obtained funds if they know that details of the trust are required to be provided to IRD.

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[85] Appendix 7 contains a detailed outline of the rules that apply to exchange of information arrangements.

Part 11 Summary of Submissions

Submission process

11.1 The Inquiry sent out 25 invitations to interested parties to make submissions. The Inquiry's page on the Treasury's website also invited submissions. The Inquiry received 19 submissions responding to the invitation, and four unsolicited submissions. Of the 23 submissions received, there were 19 original submissions and four indicating support for another submission.

Trust tax regime generally

11.2 Most of the submissions that commented on the trust tax regime acknowledged the logic of and supported the current 'settlor' regime; that is, that the taxing nexus for New Zealand should be based on New Zealand residence of the settlor rather than the trustee. Most submissions thought the settlor regime should continue but with some changes to disclosure requirements.

11.3 Two submissions, while still acknowledging the logic of the settlor regime, supported also subjecting the trust to New Zealand tax on its world-wide income if the trustee is resident as well. This is to prevent the mismatch with how most other countries tax trusts and to discourage New Zealand being used as a jurisdiction for non-resident settlors to establish trusts and, owing to the alleged nature of some of the trusts, causing reputational harm to New Zealand.

11.4 One submission doubted there are benefits from New Zealand offering foreign trusts and supported abolishing them unless a convincing case could be made for retaining them.

Adequacy of disclosure

11.5 Most submissions that commented on the adequacy of the current disclosure rules indicated that they thought the current disclosure regime is inadequate. While some information is collected by IRD and available for sharing, the information obtained is not sufficient to link a taxpayer with a trust and therefore not enough to give anyone a basis to seek information about a particular trust.

11.6 Not all submissions were explicit about what disclosure obligations should be changed. One thought providing the extra information that is obtained for Australian settlors would be sufficient, while others wanted more extensive disclosure including details of settlor and beneficiaries (in one submission through a public register), and annual income statements and distribution information.

11.7 A number of submissions noted that the upcoming requirement to provide information under the AEOI/CRS standard should help address shortfalls in disclosure. Some thought this may be a complete solution, while others concluded that the Inquiry or the Government should understand where there might be gaps in applying AEOI to foreign trusts.

Verifying source of funds

11.8 A number of submissions commented on the AML/CFT regime and how this should provide a good framework for performing due diligence on the trust settlor and verify the source of funds, but noted that there is one large gap. The most common single recommendation made in the submissions was that the exemption for lawyers and accountants having to comply with the AML rules should be repealed.

Enforcement of law

11.9 Most submitters who commented indicated that any gaps were with how the law applies rather than how it is enforced (with the gaps mentioned above). One submitter thought there was a problem being able to make a suspicious transaction report in some situations involving foreign trusts engaging in overseas transactions.

Other actions

11.10 The most common comment under other actions was a recommendation to establish a licensing or a regulation regime for resident trustees of foreign trusts. This is discussed in Part 13 of the report.

Part 12 Inquiry's Recommendations

The Inquiry recommends that-

Registration process

12.1 Foreign trusts be required to register on establishment using an expanded version of the current disclosure form, IR 607.

12.2 A register of foreign trusts, searchable only by regulatory agencies, be maintained.

12.3 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).

12.4 The registration requirement apply to all trusts formed after enactment of the enabling legislation.

12.5 A transitional rule that requires existing foreign trusts to register, and to supply the information required by 30 June 2017.

12.6 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

12.7 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.

12.8 For discretionary trusts, each class of beneficiary be described in sufficient detail to enable identity to be established at the time of a distribution or when vested rights are exercised (the naming of discretionary beneficiaries being impractical).

12.9 The trust deed be required to be filed with the registration form.[86]

Ongoing tax obligations

12.10 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.

12.11 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.

12.12 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.

12.13 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

12.14 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

12.15 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.

12.16 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.

12.17 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

12.18 The legislation or regulations that govern suspicious transaction reporting to FIU be revised to facilitate the reporting of actual or proposed transactions that have not or will not necessarily go through a New Zealand bank.

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[86] This mirrors the requirements on ordinary New Zealand trusts that apply for an IRD number.

12.19 Greater profile, coupled with training recommendations, be given to the obligation on trust service providers to report suspicious transactions.

Information sharing

12.20 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.

Part 13 Other Options Considered

Public register of foreign trusts

13.1 The Inquiry is recommending that the information supplied for foreign trusts be increased and maintained in a register. Many submitters also recommended that the information be maintained in a register. Most were silent as to whether the register be accessible to the public, some were explicit that it should not be accessible to the public and one submission indicated that the information should be publicly accessible.

13.2 Reasons given for advocating that the register of foreign trusts be private were that making it public was not necessary to prevent harm, which is largely done through the AML and AEOI processes. Privacy is a human right, and, for many people using foreign trusts, privacy is important. A public register would also add unnecessary administration costs.

13.3 One submission supported a public register of foreign trusts. The main reason given was that private victims of abusive behaviour may need to know of the existence of foreign trusts.

13.4 New Zealand currently has a public register of companies. The public register is searchable, but it does not provide beneficial ownership information. Following the May 2013 Anti-Corruption Summit in the UK, New Zealand stated that it 'commits to exploring the establishment of a public central register of company beneficial ownership information'.[87] Although the UK, together with France, Italy, Germany and Spain had earlier made a statement that they were exploring creating a public register of beneficial ownership of trusts[88] there was no mention of developing a public register for trusts in the Communique from the Anti-Corruption Summit.[89]

13.5 The Law Commission, in its review of trusts, considered whether there should be a public register of trusts.[90] It made the following observations-

- Trusts are in most cases an inherently private arrangement, they do not transact with the public as commonly as companies so there is less need for a public database.
- A public register of companies must be available to establish the company's existence as a legal entity.
- Creditors need to know they are dealing with a limited liability entity.
- Compliance costs for a register of trusts would be excessive, as trust documents are changed much more frequently than company documents.

13.6 The Inquiry considers that many of the reasons for a public register of companies do not apply to trusts. Trusts are often used to structure personal and family arrangements, and a public register would be inappropriate for these. Individuals are entitled to privacy in relation to their own affairs.

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87 https://www.beehive.govt.nz/release/new-zealand-strengthens-commitment-combat-bribery-following-london-anti-corruption-summit

88 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/516868/G5_letter_DOC140416-14042016124229.pdf

89 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/522791/FINAL_-_AC_Summit_Communique_-_May_2016.pdf

90 *Review of the Law of Trusts – Preferred Approach Paper.* Law Commission Issues Paper, 31; NZLC IP31, pp 261–264.

13.7 One submitter indicated the victims of abusive behaviour would need to know of a trust's existence, but it is not clear that this would apply in a situation that did not also involve disclosure to authorities who would have a right to access the register. For example, some of the allegations in the Panama Papers have been about tax evasion, which is a crime against governments that would have access to the register. Other uses of the register by authorities would be to ascertain beneficial ownership information in cases of money laundering. Authorities would be able to access the register and take any action appropriate to address issues involving fraud.

13.8 Consistent with the recommendation of the Law Commission, the Inquiry does not recommend a public register of foreign trusts. In reaching this conclusion the Inquiry has been mindful that on matters of privacy, New Zealand law and practice starts with the presumption that a person's financial affairs are that person's own business.

Licensing of resident foreign trustees

13.9 A number of submitters raised the idea of a licensing or regulatory regime of resident foreign trustees. One of the suggested benefits is that it would help to ensure that disclosure and reporting requirements are adhered to.

13.10 There is currently no explicit regulatory framework for resident foreign trustees. However, resident foreign trustees (like all New Zealand trustees) are subject to a well-established legal framework of fiduciary responsibility as well as contract obligations that will arise in creating the settlor–trustee–beneficiary relationships. In addition, while not strictly a criteria, a large number of resident foreign trustees are professional accountants or lawyers and are subject to the governance and disciplinary rules of their professional bodies.

13.11 The TAA already embodies a concept of a *qualifying resident foreign trustee* for foreign trusts. This is broadly a trustee who, if an individual, is a member of a body such as those governing chartered accountants and practising lawyers. (If the trustee is a company, at least one director must be a New Zealand resident who is a member of such a body.) The only effect of having such a status is that penalties for some information reporting deficiencies are lighter for qualifying resident foreign trustees than for other foreign trustees.[91] The status has no meaning outside of the Tax Acts so there is no requirement that such a standard be met in order to act as a resident foreign trustee.

13.12 Some submitters have suggested that meeting a standard such as that for a qualifying resident foreign trustee be required in order to act as resident foreign trustee at all. Some suggest that there could also be alternative avenues to membership for competent trustees who are not currently members of professional bodies, and another suggests that, while being a member of a body may initially be sufficient to be qualified, there could be reasons for some to be excluded. One other goes further and suggests a more comprehensive licensing and regulatory regime could be required, such as that applying to financial advisors under the Financial Markets Conduct Act.

13.13 Regulation tends to add administration and compliance costs, which are borne by consumers. It can also create barriers to entry which can reduce competition. Taking account of these factors, the Inquiry considers a reasonably high benefit test needs to be applied to justify such a regime.

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[91] It is not clear why trustees who are considered to meet higher professional standards should be subject to lower penalties if they do not meet their obligations compared to other trustees.

13.14 Sometimes regulation is necessary to prevent harm to the public. A clear example is licensing medical practitioners to meet minimum standards of competence before they may practise on the public. In the case of regulating financial activities, it is usually the case of protecting investors who are small and unsophisticated and have little power or knowledge compared to the advisors and managers who are selling, promoting or managing investment schemes.

13.15 In addition to protecting the parties to the trust, some submitters also suggested that registered providers would be more certain to act with integrity and thus protect New Zealand from suffering reputational harm by ensuring safeguards such as AML checks were complied with. The Inquiry considers that the changes it is recommending to the disclosure rules should be sufficient to encourage trustees to comply with the regulatory requirements.

13.16 The Law Commission, in its review of trusts, considered submissions recommending greater regulation of trustees, in particular resident foreign trustees. The Law Commission considered that professional trustees are already subject to a significant amount of regulation and legal obligations. It concluded that the costs of additional regulation would be likely to exceed the benefits.[92]

13.17 The Inquiry does not see a compelling case for regulation of trustees, particularly resident foreign trustees. Existing laws should sufficiently protect the consumers of trustee services and the changes the Inquiry is recommending should ensure appropriate monitoring of the trust to protect the integrity of the regime.

Extension of AEOI proposals

13.18 Based on the analysis in Appendix 5, the report concludes (in Part 6) that, although AEOI will result in increased reporting in New Zealand for some foreign trusts, a significant number of them are unlikely to experience any material increase in the information required to be disclosed.

13.19 The Inquiry considered whether the AEOI rules when enacted in New Zealand should be extended to deem foreign trusts to be financial institutions, which would generally result in them being reporting entities. One submission also suggested that this be considered.

13.20 This approach is not recommended because it is inconsistent with the underlying design of the AEOI regime, which is that this is a global set of rules that should follow the common standard prescribed under the CRS. Country variations are generally not permitted. Further, this approach may not result in increased disclosure in all cases and would potentially create confusion in others.

13.21 In particular, the definition of *financial institution* is a fundamental building block in these rules. Deeming foreign trusts to be financial institutions has the potential to affect other key building blocks of AEOI.

13.22 For example, if a foreign trust that is not itself a financial institution opened an account with a New Zealand bank, the bank would generally be required to do AEOI due diligence on the trust. If any non-resident controlling persons[93] were identified, the bank would need to report identity information and financial account information relating to that account to IRD.

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92 Review of the Law of Trusts – Preferred Approach Paper. Law Commission Issues Paper, 31; NZLC IP31.

93 These are settlors, trustees, protectors, beneficiaries and any other natural person who controls the trust.

13.23 However, if instead that same foreign trust was deemed to be a reporting New Zealand financial institution, this would mean that the bank would not have any substantive due diligence obligations in relation to the trust. Instead, the trust would need to carry out AEOI due diligence and possible reporting on its own account holders and controlling persons.

13.24 Because the AEOI obligations vary depending on what type of account is held with a financial institution (for example, the account held by an entity compared to an account held by an individual), changing the definition of financial institution could inadvertently change which accounts are subject to AEOI due diligence, the due diligence procedures that need to be carried out on the accounts and the information that is reported about the accounts. This may result in different (and in some cases potentially lower) AEOI obligations. Accordingly, extending the AEOI rules to deem foreign trusts to be financial institutions is unlikely to fully resolve the problem, and may create problems for New Zealand's compliance with the AEOI regime.

Repeal of tax exemption

13.25 During the early stages of the Inquiry there was considerable media comment, particularly on talk-back radio and in the social media, that the foreign trust regime should be 'closed down'. Some suggested this could be achieved by banning trusts. Others suggested that the tax exemption be removed. Comment was made that changing the disclosure rules would never be enough to prevent money-laundering or other illegal activities. Removing the vehicle would be the only fail-safe solution.

13.26 One submission to the Inquiry raised the repeal of the tax exemption as an alternative solution to beefing up the disclosure rules, but acknowledged that it would not raise any revenue because those affected would most likely rearrange their affairs in another country. The submission noted that this would lead to a decrease in revenue in New Zealand because the foreign trust industry would lose this line of work, but pondered if that might be a price worth paying for protecting the country's reputation.

13.27 The Inquiry concludes in Part 4 of the report that the current tax treatment of foreign trusts, including the exemption from tax on foreign source income, is based on design considerations that are entirely consistent with the coherent set of core principles that underpin New Zealand tax policy[94]. A repeal of the tax exemption, or other legislative changes aimed at closing the foreign trust industry down, would not be justified on policy grounds unless it was concluded that other options could not deal adequately with any problems identified.

13.28 The Inquiry considers that, if adopted by the Government, the changes recommended to the disclosure rules will deal adequately with the problems identified, including reputational risk. It does not recommend the repeal of the tax exemption or other changes aimed at preventing the operation of foreign trusts in New Zealand.

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[94] The tax treatment of non-resident partners in limited partnerships and of non-resident investors in variable-rate portfolio investment entities (PIEs) similarly follows this core policy. No New Zealand tax is imposed on foreign sourced income such parties derive.

Appendix 1: Terms of Reference

Establishment of the Government Inquiry into Foreign Trust Disclosure Rules

Pursuant to section 6(3) of the Inquiries Act 2013, The Honourable Simon William English, Minister of Finance, and The Honourable Michael Woodhouse, Minister of Revenue, hereby establish the Government Inquiry into Foreign Trust Disclosure Rules ("Inquiry").

Background

The OECD Global Forum on Transparency and Exchange of Information for Tax Purposes, in its combined Phase 1 and Phase 2 Peer Review Report of 2013, rated New Zealand "compliant" – the highest possible ranking.

As a result of the recent release of documents known as the 'Panama Papers', concerns have been raised about rules covering foreign trusts registered in New Zealand.

Cabinet has decided to initiate a review of New Zealand's disclosure rules relating to foreign trusts registered in New Zealand to ensure New Zealand's reputation is maintained.

Membership

John Shewan is appointed to and constitutes the Inquiry.

Terms of Reference

The Inquiry will inquire into, report upon, and make any recommendations it considers appropriate relating to:

a) New Zealand's existing foreign trust disclosure rules in the following areas:

   i. record-keeping requirements, including records required to be provided to the New Zealand Government;
   ii. enforcement of the rules;
   iii. exchange of information with foreign jurisdictions; and
   iv. practices for complying with the rules;

b) whether the existing foreign trust disclosure rules and the enforcement of those rules are sufficient to ensure New Zealand's reputation is maintained, when considered alongside New Zealand's:

   i. commitment to the OECD action plan on base erosion and profit shifting (BEPS);
   ii. commitment to the Convention on Mutual Administrative Assistance in Tax Matters;
   iii. commitment to implementing the global standard for the automatic exchange of information (AEOI);
   iv. existing and planned bilateral tax treaty network (including tax information exchange agreements);
   v. anti-money laundering and countering financing of terrorism laws; and
   vi. other related regimes; and

c) options for enhancements to New Zealand's foreign trust disclosure rules and enforcement of those rules, including any practical improvements that could be made or other actions that could be taken.

In these terms of reference:

- **foreign trust** has the meaning given to that term by the Income Tax Act 2007; and
- **foreign trust disclosure** rules means:
  - any laws of New Zealand requiring trustees of a foreign trust, or their agents or advisors, to provide information to any New Zealand government agency, and includes (without limitation):
    - laws for the enforcement of those requirements; and
    - the reporting and disclosure obligations of a resident foreign trustee (as defined in the Tax Administration Act 1994) of a foreign trust; and
  - the New Zealand Government's obligations to provide information it holds about foreign trusts to tax authorities from other jurisdictions.

Restrictions on Access to Certain Evidence or Submissions Presented to the Inquiry

To recognise the longstanding statutory limitations applicable to provision of information from or on behalf of the Commissioner of Inland Revenue, public access is restricted to any evidence or submissions received by the Inquiry from or on behalf of the Commissioner which identifies any person or their affairs or which the Commissioner otherwise identifies as confidential, as if sections 81 and 87 of the Tax Administration Act 1994 applied to the evidence or submission. The Inquiry must make such orders under section 15 of the Inquiries Act 2013 as are necessary, and take other steps as are necessary (including having any officers of the Inquiry or other persons assisting the Inquiry enter into appropriate confidentiality agreements), to give effect to that restriction.

For the same reasons the Inquiry must not identify in its report, and must not otherwise disclose or report on (including to appointing Ministers), the identity of any persons whose affairs may have been disclosed by the Commissioner as part of any evidence or submission or disclose confidential evidence or submissions from the Commissioner.

Reporting

The Inquiry is to report findings and opinions to the appointing Ministers in writing by **30 June 2016**.

Before that date, there shall be at least one interim meeting with one or both appointing Ministers to discuss progress.

Consideration of Evidence

The Inquiry may begin considering evidence on and from **19 April 2016**.

Relevant Department

For the purposes of section 4 of the Inquiries Act 2013, the Treasury is the relevant department for the Inquiry and responsible for administrative matters relating to the Inquiry.

Dated at Wellington this 18th day of April 2016.

Hon SIMON WILLIAM ENGLISH, Minister of Finance.

Hon MICHAEL WOODHOUSE, Minister of Revenue.

Appendix 2: Australian Financial Review Articles

The Panama Papers: How Malta's leaders turned to Mossack Fonseca five days after election

Published on 10 April 2016 and updated (in the web version) on 11 April by Neil Chenoweth/Fairfax Syndication

A Malta advisory firm began setting up Panama companies for senior members of Malta's Labour Party five days after they won power in the March 2013 election, leaked documents of Panama law firm Mossack Fonseca show.

Malta's opposition called a national protest on Sunday over revelations in *The Australian Financial Review* last week that detailed how Malta's Energy Minister, Konrad Mizzi, and the prime minister's chief of staff, Keith Schembri, set up secret holdings in Panama and New Zealand linked to a Dubai bank account.

Panama Papers documents show a wider group of Maltese business figures who are regarded as allies of Prime Minister Joseph Muscat used offshore companies.

They include an invoice for close to $US1 million that Maltese businessman Pierre Sladden assigned to a British Virgin Islands company, Blue Sea Portfolio Ltd, last November.

New Zealand Prime Minister John Key with British Prime Minister David Cameron at CHOGM in Malta on November 27 last year. Both have faced criticism in the wake of the Panama Papers leak. *MATT CARDY / POOL*

How easy NZ laws made it

The records, among 11.5 million documents leaked in a global media investigation led by the International Consortium of Journalists, show how Mossack Fonseca bragged to clients how easy New Zealand laws made it for foreign investors to hide their tax-free profits.

New Zealand Prime Minister John Key was forced to defend the country's tax laws last week, dismissing an Australian Financial Review report that detailed the offshore trusts set up in New Zealand for Mr Schembri and Mr Mizzi.

The saga in Malta began with an email on March 14, 2013, from Karl Cini, a partner at Maltese financial adviser Nexia, to Mossack Fonseca's Panama office.

Five day earlier, Mr Muscat's Labour Party had swept to power after 15 years of Nationalist Party rule, thanks to a strong campaign run by Keith Schembri, who made Mr Muscat's chief of staff.

Mossack Fonseca didn't reply to Cini's first email and he tried again on March 21.

"When you can please send me details for setting up a Panama company and possibly a trust," he wrote.

The ultimate beneficial owner (UBO) for the Panama company and trust "will be an individual and I will speak to Luis on Skype to give him more details", Mr Cini wrote.

Next he turned to three companies in the British Virgin Islands that Mossack Fonseca managed.

"From now on I need to be the person of contact for these companies," Mr Cini wrote.

On January 24, 2011, an American financial intermediary, Michael Del Vecchio, had set up a British Virgin Islands company for Mr Schembri called Colson Services Ltd.

Mr Del Vecchio had also set up Selson Holding Corporation for Malcolm Scerri, who runs Mr Schemri's Kasco industrial group.

On May 10, 2011, Adrian Hillman, the managing director of Malta's leading media group, Allied Newspapers Ltd, also got a BVI company, Lestor Holdings Group Ltd, from Mr Del Vecchio.

These were all long-term account clients of Nexia BT—and now Nexia was cutting out the middleman, so to speak. Exit Del Vecchio.

And there would need to be some changes. "I need for each company a [nominee] director and a nominee shareholder is appointed," Cini wrote.

This would remove Mr Schembri's and Mr Hillman's name from the records, making them even harder to find.

Mr Cini also needed a new British Virgin Islands' company, Blue Sea Portfolio.

The British Virgin Islands companies exploded into the news last month, when Mr Hillman stood down from Allied Newspapers after Malta blogger Daphne Caruana Galizia reported that Mr Schembri had been making payments to the Hillman company as an inducement for Allied to buy newsprint from Kasco.

Mr Hillman and Mr Schembri have strenuously denied the claim.

Dormant companies

On August 8, 2013, Mossack Fonseca came through with Mr Cini's original order for a Panama company. But by now the order had grown to three Panama companies: Tillgate Inc, which would be controlled by Schembri, Hearnville Inc, which would be controlled by the newly appointed Energy Minister, Mr Mizzi, and a third company, Egrant, but this one had no details of its owner.

On paper all three were controlled by Mr Cini and a Nexia senior partner, Brian Tonna, under a power of attorney. But who was the third player behind Egrant?

It didn't matter, in the short term. The companies would lie dormant for a year, as the Maltese investors contemplated the next step: New Zealand trusts.

"Can you send me ASAP the quote for the COMBO Pack ... This is high priority," Mr Del Vecchio emailed Mossack Fonseca's New Zealand office in March 2014.

Mr Del Vecchio might have lost his high-profile Malta clients but he still had a solid clientele, including several offshore online gambling operators.

The combo packs he was chasing were a combination of New Zealand foreign trusts (which pay no tax on foreign income) and what is described as Look Through Companies (LTCs), which could be owned by the trusts, and which also pay zero tax on offshore earnings.

Buy them in combination and Mossack Fonseca would cut $1900 off the price. Mr Del Vecchio ordered four combos.

Cutting prices was part of Mossack Fonseca's marketing drive in New Zealand. "Chase the money," head office in Panama had ordered.

In 2012 Mossack Fonseca's New Zealand staff reported advice they received from an executive at Nexus Trust: "NZ has very weak laws in regard to due diligence; they only require utility bill and passport. Trust companies are not required to hold a licence."

You never have to explain in New Zealand

There was no need to register who put assets into a foreign trust (known as the "settlor") and a Staples Rodway lawyer explained another advantage: "The New Zealand definition of 'beneficial owner' is different to that of many other jurisdictions, in that we do not require due diligence on the person/s who will benefit from the funds."

In other words, you never have to explain who gets the money – and Mossack Fonseca never needed to know either.

Setting up a bank account was just as easy. "Sparkasse Bank Malta Plc is an excellent private bank," Mossack told a client. Its fee for opening the account was $US1500.

Mossack Fonseca's clients included a French family hiding money through Luxembourg, another hiding profits in San Marino, and an Argentinian wanting to send money to his children in the US.

"I had no idea about these people's backgrounds," Mr Del Vecchio told The Miami Herald. "I can't really vouch for clients."

On December 4, 2014, Mr Cini told Mossack Fonseca he would be setting up two New Zealand foreign trusts, which would own the Panama companies set up for Mr Schembri and Mr Mizzi.

It wasn't until May last year that Mr Cini's clients had their document ready to go ahead with the trusts.

Haast Trust was set up for Mr Schembri's company, Tillgate, while Rotorua Trust was set up for Hearnville, which was Mr Mizzi's.

While Schembri and Mizzi were the settlors of the trust (putting assets into it, in the form of the Panama companies), this did not necessarily mean they would be the only beneficiaries of the trust. New Zealand law did not require such details. Even so, the paperwork would take months to work through.

Mossack Fonseca's compliance division had realised that Mr Schembri and Mr Mizzi were Politically Exposed Persons.

Haast and Rotorua trusts

The due diligence procedure this required involved copies of passport for Mr Schembri and Mr Mizzi, and letters of recommendation, before Haast Trust was set up for Tillgate and Rotorua Trust set up for Hearnville.

It all took time and the clock was running. On August 8, with the trust formation still in place, Mr Cini wrote to Panama: "We are in the process of opening a bank account in Dubai for two of our Panama companies.

The bank is asking as for the following documents which need to be attested from the UAE Embassy of Panama. They will then attest them further in Dubai."

Mr Cini wrote again on August 20: "How are the documents coming? I have a meeting with the BOs [Beneficial Owners] this coming Tuesday."

That would be Mr Schembri and Mr Mizzi that Mr Cini wanted to show the finalised trust documents to, on August 25.

But the combination of two Politically Exposed Persons and a Dubai bank account set off alarm bells at Mossack Fonseca.

"As both Settlors are PEP, our NZ colleagues need to be comfortable that sufficient due diligence has been carried out to ascertain that funds being settled are not subject to any corruption risk, and ideally that they come from income generated prior to the Settlors´ political appointment," Mossack Fonseca Panama told Mr Cini.

Perhaps he could get more information about the source of funds when he met the clients.

"With respect to Haast Trust, it would appear that there was some negative coverage regarding the tender process for supply of paper to the government shortly after the settlor's appointment as Chief of Staff, so if you could also include a detailed information about this," Mossack Fonseca's New Zealand wrote.

And what would the companies be doing? The clients' description, "'Management consultancy and brokerage' does not explain this," the New Zealand operative complained.

Remuneration for Mizzi's wife

Again on August 24, the day before Cini was to meet the Beneficial Owners, Schembri and Mizzi, Mossack Fonseca NZ noted: "There is also some negative publicity regarding the amount of remuneration for [Konrad Mizzi's] wife."

Mr Cini was still pressing for the documents for Hearnville and Tollgate for the Dubai bank, and now he wanted docs for Schembri's BVI company, Colson Services, as well. And he needed them by Friday, August 28.

Mr Cini didn't say what was happening on the Friday, but by the Sunday he was asking how the application for a bank account for the two companies in Panama was going.

On September 10 Panama came back: "Please note that the FPB Bank, have decided to not proceed with the opening of the bank account for the companies Hearnville Inc and Tillgate Inc for some reasons, the principal of them it's that the UBOs of the said companies are PEP."

Mossack Fonseca noted, “We have contacted two persons who will help us with these bank accounts.”

It’s not clear from the documents whether the attempt to open a Dubai account was successful. Mr Mizzi last week said no account was ever opened, and that the accounts were the initiative of Nexia. He never signed anything.

Meanwhile in this period when the attempt to open a bank account for the Panama companies had apparently failed, Nexia was working on another deal.

British Virgin Islands

This one involved Blue Sky Portfolio, the British Virgin Islands company that Mr Cini had set up in 2013 at the same as the Panama companies.

In November Nexia asked Mossack Fonseca’s British Virgin Island’s office to have the nominee directors certify an assignment of debt between companies linked to Pierre Sladden, another Nexia client and strong supporter of the government.

The documents showed that Sladden’s company, Redmap Constructions Ltd, owed a Cyprus company A2Z Consulta, €900,000 for “the provision of services consisting in quality checks and negotiation with suppliers”.

Apparently A2Z Consulta had sub-contracted the quality checks and negotiations to Blue Sea Portfolio in the British Virgin Islands, which was now due $US978,150 – and it turns out it was another Sladden company that would pay the debt.

This convoluted series of transactions was actually dated December 2014, the month that the New Zealand trusts were first ordered by Nexia.

Mossack Fonseca records show that behind a nominee holding it is Mr Sladden himself who owns the 50,000 shares in Blue Sea, though it’s held in four blocs of 12,500 shares apiece. It’s not clear if he is the ultimate owner of all the blocs.

“Kindly treat this email as urgent,” a Nexia partner wrote on November 24 with another request to rush the documents.

On November 27 the prime minister, Mr Muscat, together with Mr Schembri and Mr Mizzi were mingling with heads of state, hosting the Commonwealth Heads of Government Meeting, including New Zealand’s prime minister, who remained unaware of just how valued his tax laws were.

More coverage: ATO calls an emergency OECD meeting over files

The Panama Papers: Behind Mossack Fonseca's secret New Zealand deals

Published 6 May 2016 Fairfax Syndication

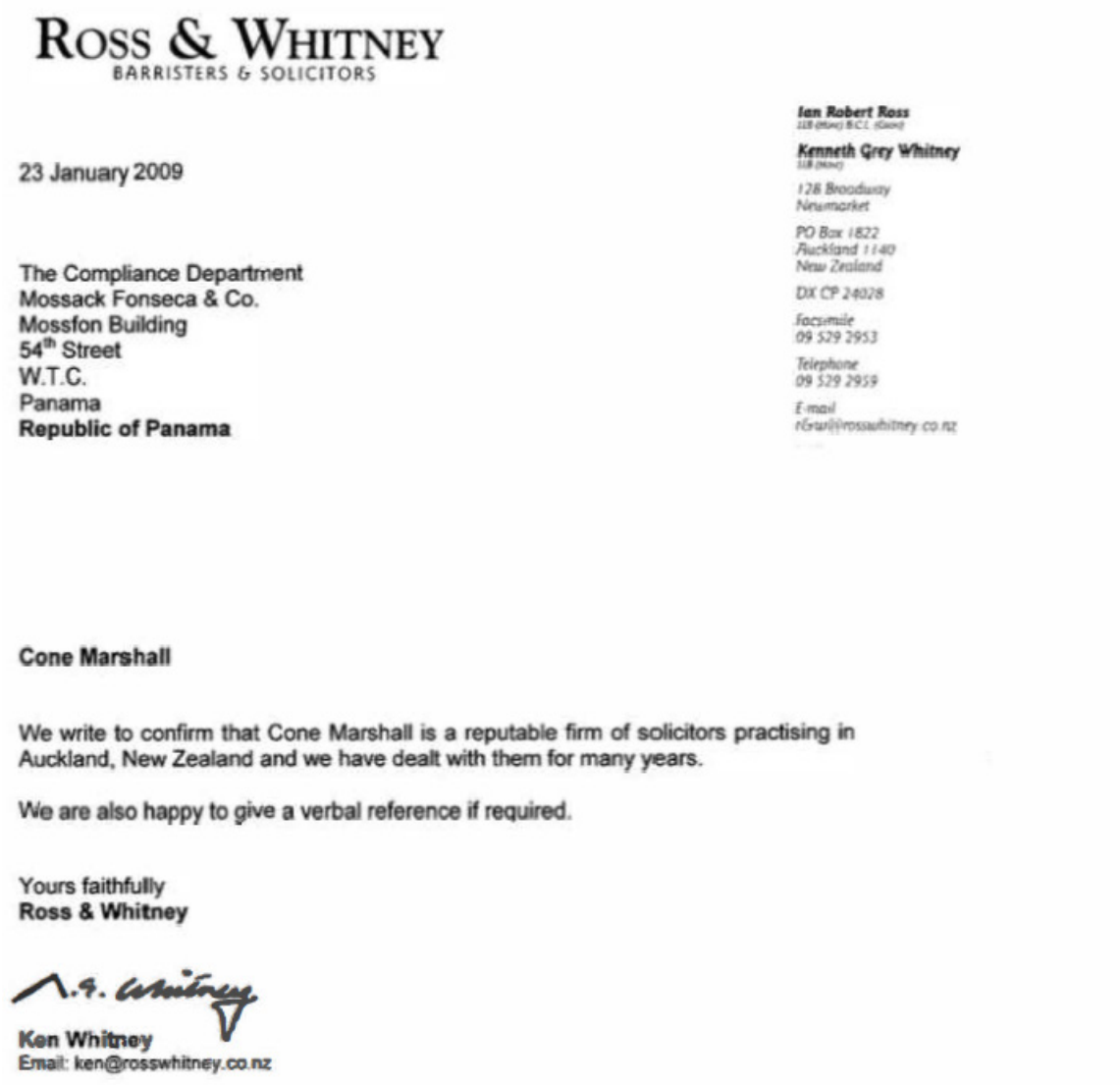
'John Doe', the anonymous source who handed German newspaper Suddeutsche Zeitung internal data belonging to the Panamanian law firm Mossack Fonseca, wants whistleblowers to have immunity from government retribution.
Joe Raedle/Getty Images

On July 1 last year, opportunity came knocking for Panamanian law firm Mossack Fonseca: they had a new client—and a big one—ready to push $100 million into the tax-free obscurity of some New Zealand foreign trusts.

That figure was just for starters, the client's Miami lawyer promised, "only a small part of the client's portfolio".

The client, Juan Armando Hinojosa Cantu, was one of Mexico's construction tycoons. But there was a problem.

In fact there was a problem with a string of Mossack Fonseca's clients who were coming to New Zealand, as prime minister John Key's government has discovered, thanks to a global investigation led by the International Consortium of Investigative Journalists based on 11.5 million Mossack Fonseca documents obtained by Süddeutsche Zeitung.



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23 January 2009

The Compliance Department
Mossack Fonseca & Co.
Mossfon Building
54th Street
W.T.C.
Panama
Republic of Panama

Cone Marshall

We write to confirm that Cone Marshall is a reputable firm of solicitors practising in Auckland, New Zealand and we have dealt with them for many years.

We are also happy to give a verbal reference if required.

Yours faithfully
Ross & Whitney

Ken Whitney
Email: ken@rosswhitney.co.nz

Ken Whitney's professional reference for New Zealand law firm Shone Marshall addressed to Mossack Fonseca January 23 2009. *Panama Papers*

The roiling controversy in New Zealand triggered by the Panama Papers has focused on just one Mossack Fonseca client—an Argentinian family behind a sensitive New Zealand land purchase.

New documents obtained by The Australian Financial Review challenge parts of the government's account of the sale, as well as revealing other deals with a cast of controversial players ranging from senior members of the government of Malta to Panama lawyer with an outstanding arrest warrant in Brazil on money laundering charges.

And then there was Hinojosa Cantu's little problem.

"Unfortunately due to his success and high profile, he has quite a number of people who greatly dislike him and unfortunately there is a great deal of negative publicity surrounding the client," Hinojosa Cantu's Miami lawyer, Filipe Miguel Fernandes de Matos Marcelo, wrote in an email to Mossack Fonseca on July 1, reported in the Mexican news site Proceso.

From: EdM
Sent: Wednesday, July 01, 2015 2:38 PM
To: 'Olga Santini'
Subject: Prospect Client (014) !!!URGENT!!!
Importance: High

Dear Olga,

Hope this email finds you well. Please note that we have been working together with the advisor of a very high profile client for some time and we envision that we will be appointed to assist in the restructure of his patrimonial vehicles outside his country of residence.

The restructure would involve:

(1) Transfer of six (6) companies – four (4) BVI and two (2) Nevis from current provider (Trident);
(2) Appointment of nominee director & nominee shareholder for above mentioned companies;
(3) Formation of three (3) NZ Trusts – which will be the beneficiaries of a Dutch foundation (STAK) and subsequent settlement of assets (portfolio accounts in four banks - JP Morgan, UBS, DB and MS – of circa USD 100M) owned by the before mentioned six (6) companies;
(4) Once the transfer is complete, dissolution of the six (6) companies.

This is only a small part of the client's portfolio and we see great potential of growth as he is one of the most prominent businessman in Mexico. Unfortunately due to his success and high profile, he has quiet of number of people whom greatly dislike him and unfortunately there is a great deal of negative publicity surrounding the client.

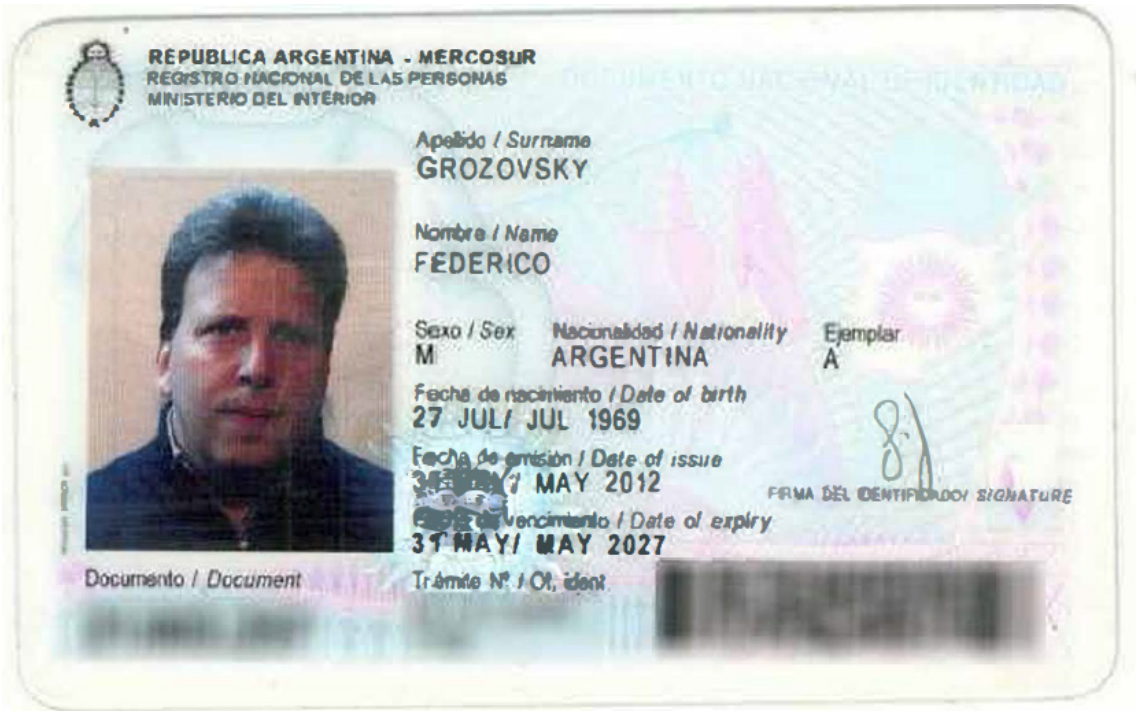
Email to Mossack Fonseca July 1 2015 by the Miami lawyer for Juan Armando Hinojosa Cantu explaining the deal. *Panama Papers*

Hinojosa Cantu, who had built his fortune from billions of dollars in government contracts, was under investigation for influence-peddling. In Mexico they called him the Duke of Privilege.

On February 3 2015 Mexico's president, Enrique Peña Nieto, had called an inquiry after media revelations that Hinojosa Cantu built a $US7 million home for Nieto's wife, and sold another house to the Finance Minister, Luis Videgaray Caso, just before they won government in 2012.

By March last year Hinojosa Cantu had begun restructuring his finances. The key would be New Zealand.

Ken Whitney's Letter



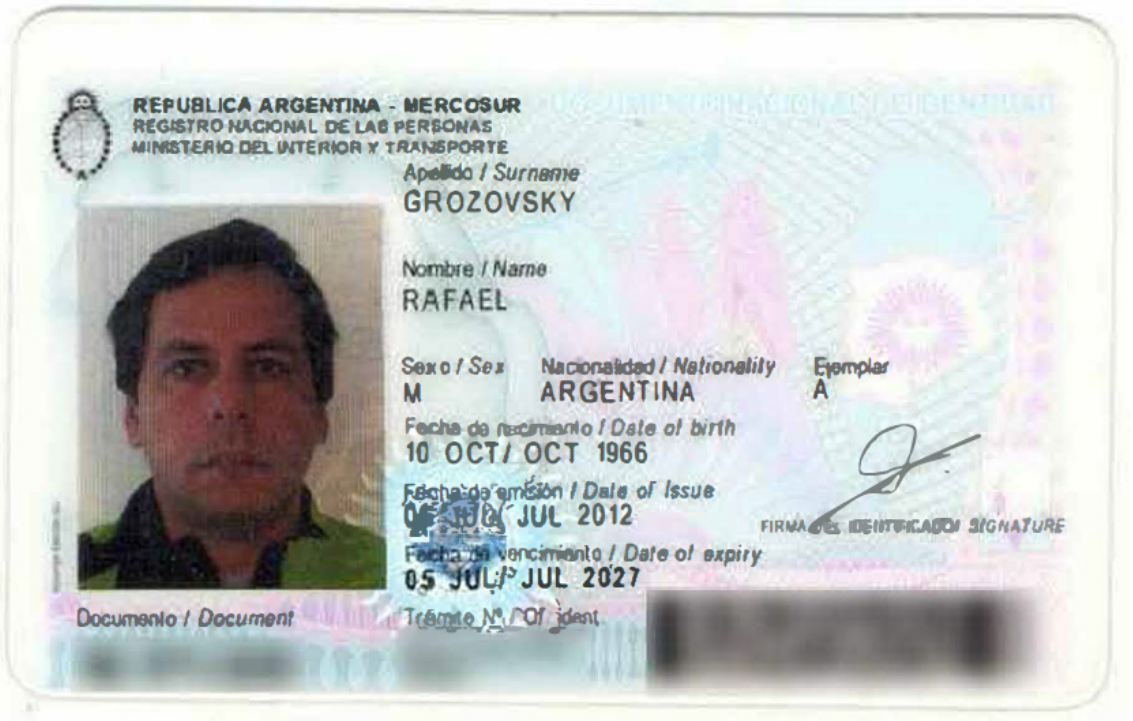
Federico Grozovsky, one of the Argentinian brothers behind Ceol & Muir Inc.

Hinojosa Cantu wasn't the only Mossack Fonseca client heading for Auckland.

The ICIJ on Monday will release the names and shareholders of 240,000 corporate entities (and their shareholders) administered by Mossack Fonseca in more than 20 low-tax jurisdictions around the world.

The data includes 368 shareholders with New Zealand addresses, but 189 of the shareholders are trusts and another 12 companies have bearer shares, which will prove hard to track.

Mossack Fonseca were outsiders in New Zealand's outbound market—locals investing overseas—but they were well known.



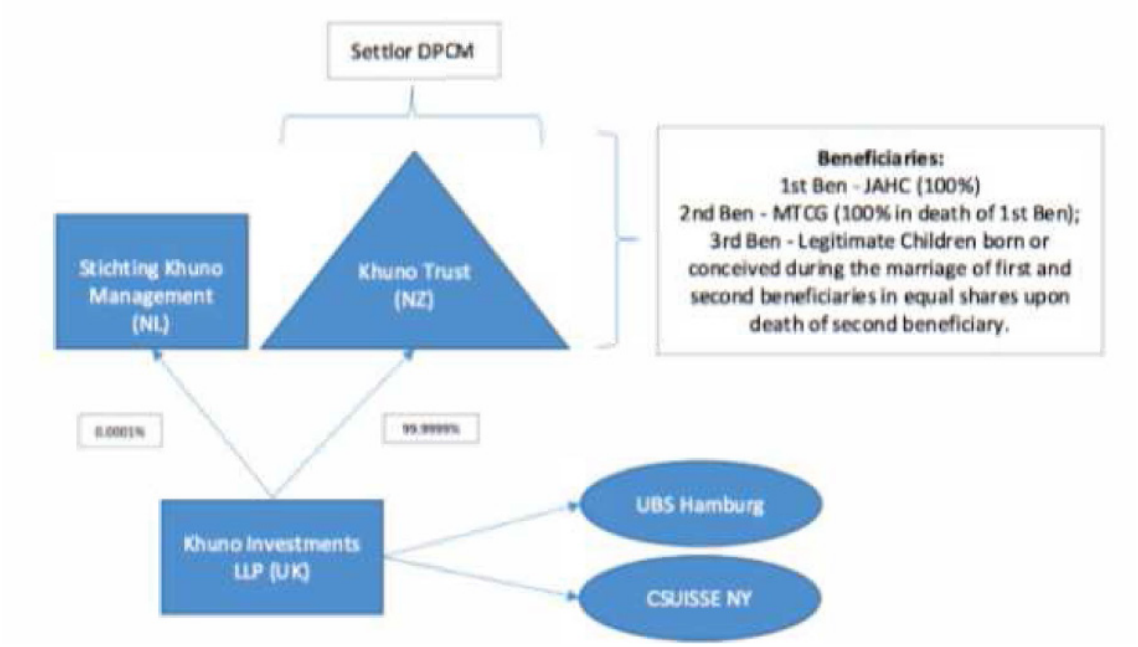
Rafael Grozovsky, one of the Argentinian brothers behind Ceol & Muir Inc. *Supplied*

In January 2009 when law firm Cone Marshall was seeking accreditation with Mossack Fonseca, Ken Whitney, of Ross & Whitney, provided a professional reference.

Unusually for a professional reference in the Panama Papers files, Whitney, whose clients include Prime Minister John Key, did not address it To Whom It May Concern. He was able to cite the street address of Mossack Fonseca's Compliance Department.

"We write to confirm that Cone Marshall is a reputable firm of solicitors practising in Auckland, New Zealand and we have dealt with them for many years," he wrote on Ross & Whitney letterhead.

"We are also happy to give a verbal reference if required," Whitney wrote.



A structure diagram by Juan Armando Hinojosa Cantu's lawyer. Hinojosa Cantu gifted $50 million in assets to his mother, who gifted them to Khu no Investments LLP in the UK, which passed funds to Khuno Trust in New Zealand, where Hinojosa Cantu was the main beneficiary. *Panama Papers*

Behind the Ceol & Muir deal

The Overseas Investment Office has found itself having to defend its decision to approve the $6 million sale of sensitive waterfront farmland near Auckland to another company set up by Mossack Fonseca called Ceol & Muir Inc.

Media reports in 2013 said the buyers of Onetai Station were Austrian. When the OIO approved the sale in February 2014 the buyers were described as 50 per cent Argentinian and 50 per cent Italian.

In a statement last week the OIO said it was satisfied that due process had been followed in assessing the sale.

Fernando Cardenas Echeverri submitted this copy of his passport to Mossack Fonseca which had his name misspelt with three Rs. Apparently he had been travelling for six years without realising it was the wrong name.

“Regardless of what ownership structure an investor uses, the OIO looks closely at the bona fides of the people who will control the investment, who in this case were Rafael and Federico Grozovsky,” the OIO said.

“Rafael Grozovsky is a citizen of Italy and his brother Federico Grozovsky is a citizen of Argentina.”

This week the OIO apologized for not informing Land Information Minister Louise Upston that the Grozovskys had been involved in a pollution incident in Argentina and announced that it was appointing “a dedicated and experienced person to undertake all the web searches for information to inform the good character test”.

The Panama Papers suggest that Google searches have their limits, as a government assessment procedure.

The files show that Mossack Fonseca’s Uruguay office was contacted on July 3 2013 by a Uruguay law firm and asked to set up a Panama company called Ceol & Muir, with MossFon staff serving as nominal directors.

On August 7, the directors of the newly minted Ceol & Muir Inc were asked to provide a power of attorney for Rafael and Federico Grozovsky, who operate Magromer, a major textile company in Argentina.

It was founded in 1929 by León Grozovsky, who moved to Argentina from Minsk, Belarus.

ID cards provided to Mossack Fonseca on August 15 2013 show both brothers as Argentinian nationals with no suggestion of Italian citizenship or link to Italy.

It may be that Rafael Grozovsky holds dual nationality. It’s not clear why two brothers in Argentina would use the Uruguay office of Mossack Fonseca to set up a Panama company to invest in New Zealand, but there are tax considerations if Argentinians do not hold a majority share.

It’s difficult to know who owns Ceol & Muir because the company has no share registry.

On July 17 2013 the Uruguay law firm acting for the ultimate clients instructed Mossack Fonseca that Ceol & Muir should issue 100 shares, but only as bearer shares.

Bearer shares are certificates, pieces of paper which provide ownership to whoever physically holds that paper at any given moment.

Ceol & Muir's bearer shares would be in seven certificates each with 10 shares, and six certificates with 5 shares, a division that suggests it was already intedned for there to be multiple owners—perhaps other family members.

The feature of bearer shares is that because there is no record of who holds them, there is no direct evidence of who the shareholders are at this moment—or indeed, who will hold them in five minutes time.

It appears that the Grozovsky brothers have given an affidavit to the OIO that they hold all the Ceol & Muir shares, but such commitments may be impossible to verify in the long term.

Cashing in on NZ's reputation

In 2013 Mossack Fonseca had been on a marketing drive, cutting its prices to build up its New Zealand office.

"Chase the money," head office in Panama urged its New Zealand staff.

Mossack Fonseca offered two New Zealand products to its overseas clients: an NZ foreign trust, and a Look Through Company (LTC).

As long as the trust and the LTC had no income in New Zealand and had no New Zealand beneficiaries, then they paid no New Zealand tax.

But there was another advantage because technically the LTC was taxed, it's just that the tax rate was set at zero.

One French investor who moved his holding company from Luxembourg to a New Zealand LTC knew he would pay no tax.

But New Zealand has a double-tax treaty with France, which meant that he could repatriate the profit to France where it was not taxable because it had already been "taxed" in New Zealand.

While New Zealand's tax laws are a major plus for foreign investors, it's not the only attraction. They also come to use New Zealand's good reputation.

Under the Know Your Country protocol that banks use for part of their probity checks, New Zealand has a Transparency International Corruption Index rating of 88.

Australia's rating is 79, while Panama's is 39 and Colombia is 37.

Funds from a New Zealand company or trust is regarded as far more reputable than from most South American countries even though those same funds will never actually come near New Zealand.

By late last year the stream of South American clients setting up New Zealand trusts to channel their money had become a torrent.

It provided a challenge for Mossack Fonseca's compliance procedures.

The Medellin entrepreneurs

One client was linked to a Colombian company called Fly North, that provides surveying and aerial photography. In January 2014 Mossack Fonseca set up Fly North New Zealand Ltd, a name which sounded like it was a local operation, but it was an LTC, which means it couldn't work in New Zealand.

It was a New Zealand lawyer that picked up a problem. One of the three shareholders, Fernando Cardenas Echeverri, born in 1964, supplied a copy of a Colombian passport issued in 2007 by the Consul General in Sao Paolo.

The copy of the passport, which was certified by a Mossack Fonseca lawyer in Panama, spelt Echeverri's name with three Rs. He was Echeverrri.

He had apparently been using the passport for six years without realized it was in the wrong name.

A copy of a new passport was promptly supplied, also certified by the lawyer in Panama, but Mossack Fonseca had difficulty extracting documents to show where the three shareholders lived for the Know Your Customer rules.

"Probably you may presume that our client does not want to meet your KYC requirements," one Mossack Fonseca officer wrote to a New Zealand lawyer on January 30 2014.

The difficulty was "they do not have services registered under their name because they are young people that still live with their parents; they are from Medellin and have earned an Entrepreneurs award and are making their efforts to achieve their goals".
The world of aerial photography does not always fly smoothly. By December 2014 the entrepreneurs from Medellin had fallen out with their associates in Miami, at Fly North Florida LLC, who now threatened to sue Mossack Fonseca.

Yes there had been recent disputes between Medellin and their associates in Miami, Mossack Fonseca's clients conceded, but they were sure this had all been worked out.

Wave of South American money

Other clients came to Mossack Fonseca New Zealand in a steady stream.

Andres Cadea Venegas, a Mickinsey & Co director in Bogota set up the Adamantium Trust to hold his company Buckingham Investors SA with a $US5 million a year income.

The family of Mexican film producer Marcos Tonatiuh Rodriguez Vega filed documents to set up the Qualcom Trust, complete with Vega's 2013 will and a statement that began, "a few weeks ago I was diagnosed with pancreatic cancer".

Samuel Jaramillo Restrepo, 80, the head of Colombian used car sales company Ultracar, set up the Arca Trust.

Hernando Lopez Jimenez, who runs the big Autonal Group car dealership and is a director of Colombia's Board of Foreign Trade, set up Olympus Trust to house his Panama company.

The list runs on and on. Setting up a New Zealand trust ensured secrecy and tax advantages but it was not necessarily illegal. There are many legitimate reasons to use such services.

Guatemala alert

Mossack Fonseca New Zealand was also picking up controversial clients.

The first hint of problems came on the other side of the world, in Guatemala, on May 29 last year.

A routine check by Mossack Fonseca's compliance division on a Panama company, Castle Hill Enterprises SA, pulled up an alert.

One of the directors, Carlos Alberto Gonzalez Campo Mencos, was requesting a power of attorney to operate the company accounts in Guatelama where it held property investments.

But Campo was no ordinary client. He was vice president of the Board of the National Electrification Institute and representative of the Ministry of Energy and Mines. He was a government figure, a Politically Exposed Person, as they are called in offshore banking circles.

"I confirm that it is the same person," the MossFon compliance officer emailed on May 29 last year, ordering a full-scale Enhanced Due Diligence profile of Campo.

One of Campo's fellow director on Castle Hill was a familiar name. Juan Armando Hinojosa Cantu was already making headlines for his close relations with political figures in Mexico and here he was in business with another PEP—prudence might suggest taking a closer look.

When queried Mossack Fonseca Compliance said not to query Hinojosa Cantu's position.

Malta and the banking odyssey

In New Zealand meanwhile Mossack Fonseca was facing two more PEPs.

On May 16 Karl Cini from Nexia BT in Malta said his clients were finally ready to move on long-held plans to link two New Zealand trust to two Panama companies.

The clients were Keith Schembri, who was chief of staff to Malta's prime minister, Joseph Muscat; and Energy Minister Konrad Mizzi.

It would take five months of prodding before the two men revealed they planned to use the structure for investments with others in recycling and online gaming.

There then followed increasingly desperate attempts to open up a bank account for the pair's Panama companies. Mossack Fonseca tried nine banks in the Caribbean, Miami and Panama, which were thought most likely to take the Maltese money.

It came to resemble a Homeric quest, an endless odyssey to find a safe haven. All nine banks turned Schembri and Mizzi's companies down because they were PEPs.

In New Zealand the due diligence process took months but in the end they had no such problem.

Hinojosa Cantru's publicity problem

Hinojosa Cantru was a different sort of challenge. On July 1 last year his Miami lawyer said he had "circa $US100 million" to put into new structures based around three New Zealand trusts but mentioned the "negative publicity".

Mossack Fonseca Compliance in Panama did a lightning due diligence and reported by 3.30 that same afternoon that "no negative results were observed".

Like the NZ Overseas Investment Office, they might have done better consulting Mr Google.

In November 2014 Mexican online news site Aristegui Noticias had revealed how Hinojosa Cantru had built a $US7 million house for President Nieto's wife, television actress Angélica Rivera, who paid 30 per cent of the price with the rest as promissory note in 2012.

The Wall Street Journal reported that weeks before Luis Videgaray Caso was appointed Finance Minister on December 1 2012, he bought a house from a Hinojosa company for $US581,000, with the help of $532,000 vendor loan.

Both Rivera and Videray both strenuously denied anything improper in the deals which were before they won government and stressed the loans would be repaid.

"There was no conflict of interest. I did the deal when I was not holding public office, and the deal was within market parameters," Mr. Videgaray said.

The president's office said Nieto didn't disclose details of the house because his wife wasn't a public servant.

Nieto said he had not declared the house as it was his wife's private investment.

But public pressure continued until February 3 when Nieto promoted a public servant, Virgilio Andrade Martinez as head of the Civil Service, with his first job to investigate conflicts of interest in the house sales to Videray and Rivera.

On August 21 Andrade would report there was no conflict of interest, though he previously had conceded that as the deals were done before Nieto and Videray won office he had no power to call for copies of the sale contracts.

Hinojosa Cantu made no public comment but he had not been idle. His lawyer, de Matos Marcelo, laid out the strategy to Mossack Fonseca on July 1.

The New Zealand strategy

On March 20 Hinojosa had gifted his shares in five offshore companies to his mother. He gave other interests to his mother-in-law.

In turn they would gift these interests, worth $50 million, to three Limited Liability Partnerships (LLPs) in England.

Three Dutch stichtings (also known as foundations) would have a 0.1 per cent share of the partnerships, with 99.9 per cent of the partnerships owned by three New Zealand trusts with old Inca names: Huiracocha, Huanca and Khuno trusts.

The chief beneficiary of the two main trusts was Hinojosa Cantu. It was all coming back to him.

Surprisingly, when the deeds for the three New Zealand trusts were signed with Mossack's Orion Trust as the trustee, they were dated April 27, more than two months before Mossack Fonseca was told about the deal.

In a pointed email to Hinojosa's lawyer on August 3, Mossack New Zealand prodded for missing documents, noting that New Zealand trusts had to be filed with authorities within 30 days of signing the deeds, "and both contracts were dated April 27, 2015".

(A New Zealand lawyer told the Financial Review a trust deed only comes into effect on the date that the trust property is given to the trustee to hold, not when a trust deed is signed.)

Meanwhile the New Zealand office had questions. How did Hinojosa Cantu explain all the adverse media about his relationship with the Mexican president, they asked on September 30?

Hinojosa's lawyer explained it as business rivalry from Carlos Slim, the Mexican billionaire who holds shares in The New York Times, which had also covered the story.

"There is indeed adverse information regarding the beneficiary in newspapers (many of these newspapers are owned by some business rivals such as the NY Times Slim). All allegations regarding any conflict of interest were investigated last month and was exonerated by [Andrade] of all allegations."

Arrest warrant

By the end of November, as the demand for New Zealand trusts went into overdrive, with prime minster Key in Malta for the Commonwealth Heads of Government, unaware of the struggles to open a bank account for Schembri and Mizzi's Panama and New Zealand holdings, and Hinojosa Cantu began steps to set up even more New Zealand trusts, there was one more problem looming.

Ruben Goldberg Javkin, the former head of the Republic National Bank of Mexico, was reorganizing his offshore holdings, which he controlled through his NZ Midtown Trust.

Through November and December he was arranging for five people to be authorized to open a bank account for his new British Virgin Islands company, Schofield Company Global Limited—and the board approval was to be backdated, his intermediary requested.

One of the five was a Panamanian lawyer, Edison Teano Ernesto Rivera

An unfortunate choice. In January Rivera was targeted in Operation Triple X, a huge Brazil investigation linked to the Petrobras bribery scandal.

On January 29, Brazil's Justice Department issued an arrest warrant for Rivera on money laundering charges.

Mossack Fonseca has denied any part in money laundering and there is no suggestion that Goldberg was involved.

But it's another scandal that tarnishes New Zealand's reputation.

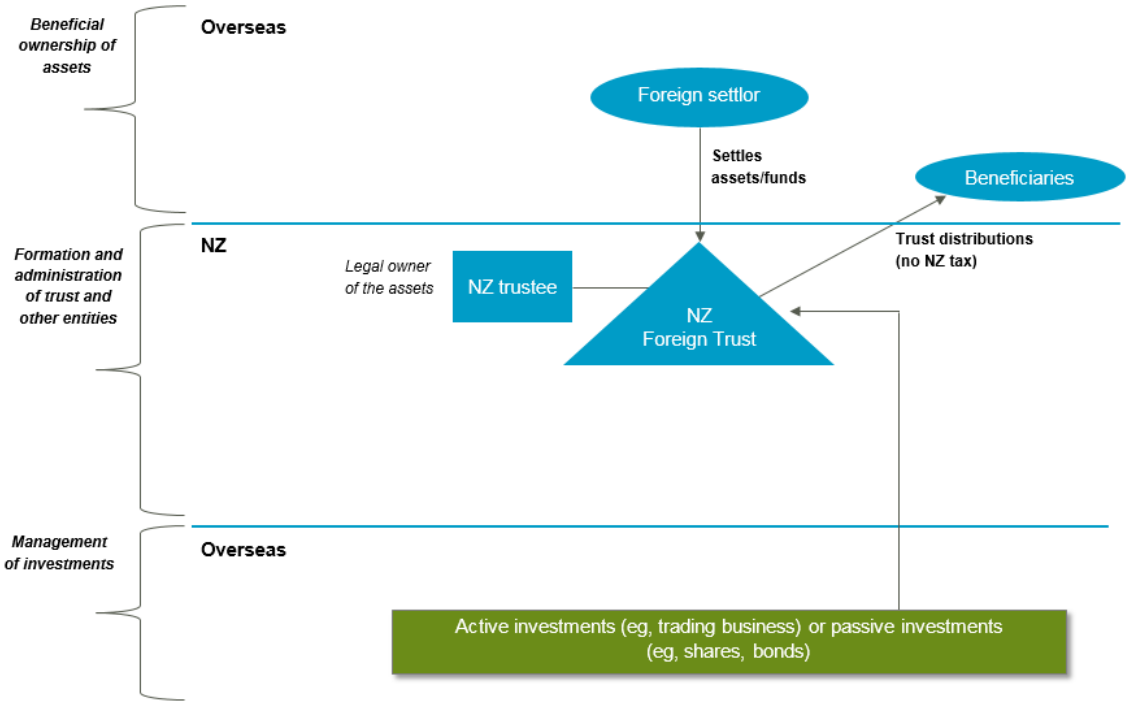
Despite Mossack Fonseca's size elsewhere in the world, it remains a minor player in New Zealand, its files merely an indication of what may be taking place on a much larger scale with bigger operators.

New Zealand's readiness not to tax foreign income of its 12,000-odd foreign trusts is not philanthropy. Its thriving trust sector does well enough out of the exchange from the fees it charges.

The question, given the damage such controversies may inflict on New Zealand's name and its reputation for probity and transparency, is whether the exchange is worth the cost.

Appendix 3: Examples of Foreign Trust Structures

Scenario 1 – NZFT earns foreign income directly



Steps:

1. Foreign settlor settles foreign assets (or cash used to purchase foreign assets) on a NZFT.
2. NZFT has a NZ resident trustee (generally a special purpose corporate trustee to limit the personal liability of the trustee service provider (TSP) in New Zealand).
3. Generally the beneficiaries of the NZFT will be foreigners, but this is not a requirement of the definition of foreign trust.
4. The NZ resident trustee derives foreign-sourced income which is either accumulated in the NZFT or distributed to the foreign beneficiaries.

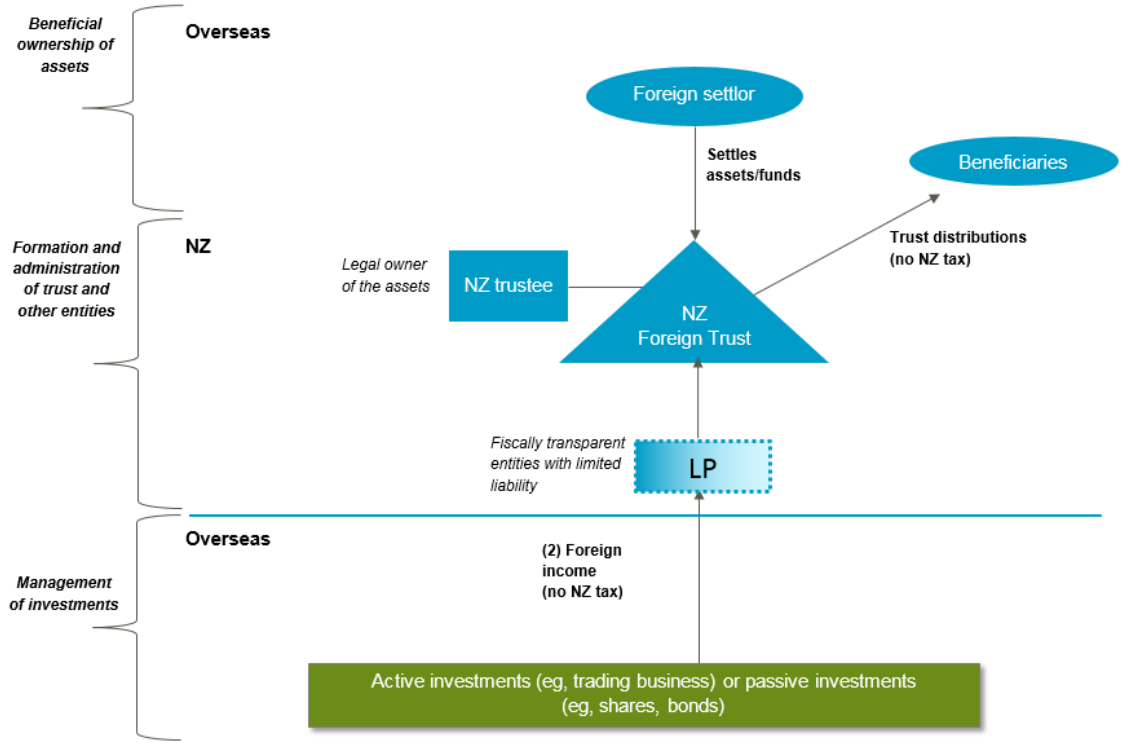
Tax treatment:

- NZ does not impose tax when the assets are settled on the trust, when the foreign-sourced income is derived by the trust or when the trustee distributes the income to foreign beneficiaries.
- This is consistent with the principle that NZ does not impose tax on the foreign-sourced income of non-residents.
- NZ will impose tax on the NZ-sourced income of the trustee and the beneficiary income of any NZ resident beneficiaries.

Registration requirements:

- The NZFT must file form IR 607 with IRD.
- The corporate trustee will be a NZ registered company.

Scenario 2 – NZFT earns foreign income through a NZ Limited Partnership



Steps:

1. Foreign settlor settles foreign assets (or cash used to purchase foreign assets) on a NZFT.
2. NZFT has a NZ resident trustee (generally a special purpose corporate trustee to limit the personal liability of the trustee service provider (TSP) in New Zealand).
3. Generally the beneficiaries of the NZFT will be foreigners, but this is not a requirement of the definition of foreign trust.
4. NZFT has a NZ resident trustee (generally a special purpose corporate trustee to limit the personal liability of the TSP in New Zealand).
5. NZFT is appointed as a limited partner of a NZ Limited Partnership (NZLP). In exchange for its NZLP interest, the NZFT contributes either foreign assets or cash used to purchase foreign assets. As a limited partner, the NZFT's liability for NZLP debts etc. is limited to the assets contributed (ie it has limited liability).
6. NZLP has a New Zealand resident general partner (NZGP). Because the NZGP does not have limited liability, the GP will generally be a special purpose NZ company of the TSP. It will generally have the same directors and shareholders as the NZ trustee company. Or it may be the same company.
7. There is no limit on the number of limited partners that a NZLP can have. Therefore, this vehicle can be used to make widely held investments.
8. The NZLP derives foreign-sourced income which is distributed to the NZFT as limited partner in proportion to its contribution to the NZLP.
9. NZFT either accumulates the income or distributes it to the foreign beneficiaries.

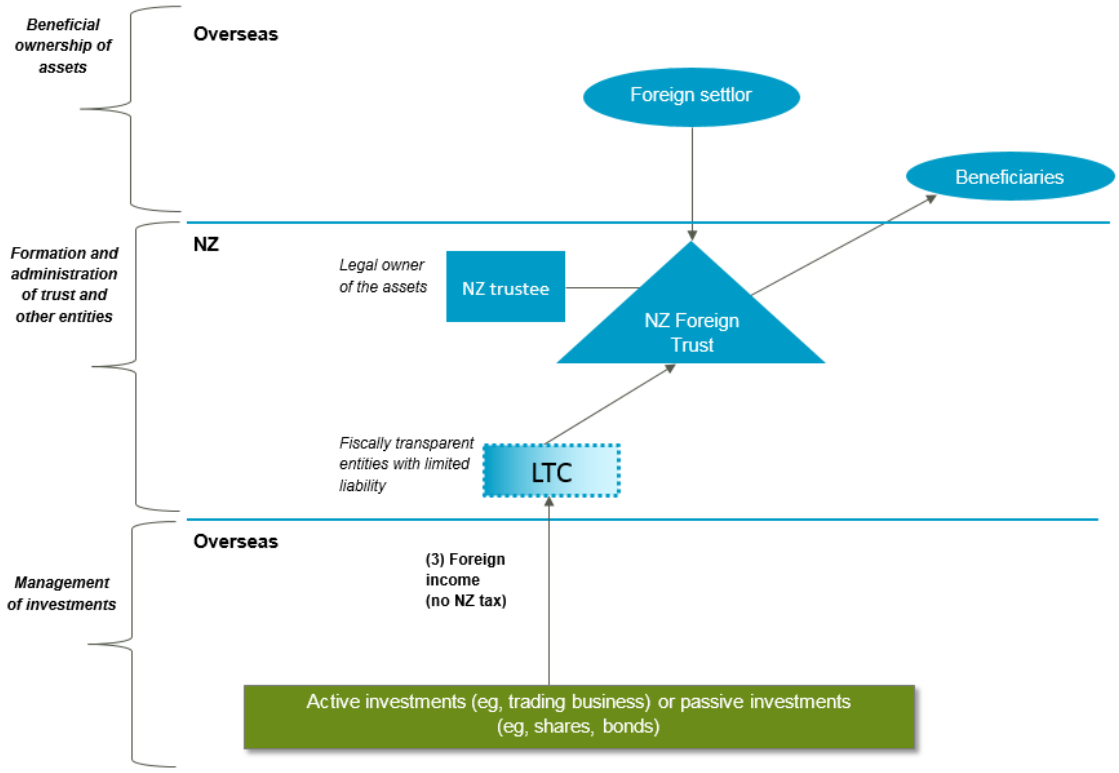
Tax treatment:

- New Zealand does not impose tax when the assets are settled on the trust, when the NZFT contributes the assets to the NZLP on exchange for its partnership interest, when the foreign-sourced income is derived by the NZLP, when it is distributed to the NZFT or when the trustee distributes the income to foreign beneficiaries.
- The NZLP is transparent for NZ tax purposes, so NZ tax law sees the foreign-sourced income as being derived directly by the NZFT as limited partner.
- The foreign-sourced income of the NZFT is not subject to NZ tax.
- This is consistent with the principle that NZ does not impose tax on the foreign-sourced income of non-residents.
- NZ will impose tax on the NZ-sourced income of the trustee, the income of the NZ limited partner and/or the beneficiary income of any NZ resident beneficiaries.
- This example also assumes the NZLP does not carry on a business in NZ – if it did, there may be NZ tax payable.

Registration requirements:

- The NZFT must file form IR 607 with IRD.
- The corporate trustee and the corporate general partner will be a NZ registered company.
- The NZLP must be registered with the NZ Companies Office. This is a publicly searchable register.
- From 1 September 2014, a NZLP must have a NZ or Australian resident general partner.

Scenario 3 – NZFT earns foreign income through a NZ look through company (LTC)



Steps:

1. Foreign settlor settles foreign assets (or cash) on a NZFT.
2. NZFT has a NZ resident trustee (generally a special purpose corporate trustee to limit the personal liability of the TSP in New Zealand).
3. Generally the beneficiaries of the NZFT will be foreigners, but this is not a requirement of the definition of foreign trust.
4. NZFT subscribes for shares in a NZ look through company (NZLTC). In exchange for its shares, the NZFT contributes either foreign assets or cash used to purchase foreign assets. While the NZLTC is fiscally transparent, it is a company at general law and therefore has limited liability.
5. NZLTC must have 5 or fewer counted owners. So this vehicle can only be used in closely held situations (beneficiaries of a trust count as owners if they receive beneficiary income sourced from a LTC interest, and relatives are treated as a single owner).
6. The NZLTC derives foreign-sourced income which is distributed to the NZFT as owner in proportion to its shareholding interest in the NZLTC.
7. NZFT either accumulates the income or distributes it to the foreign beneficiaries.

Tax treatment:

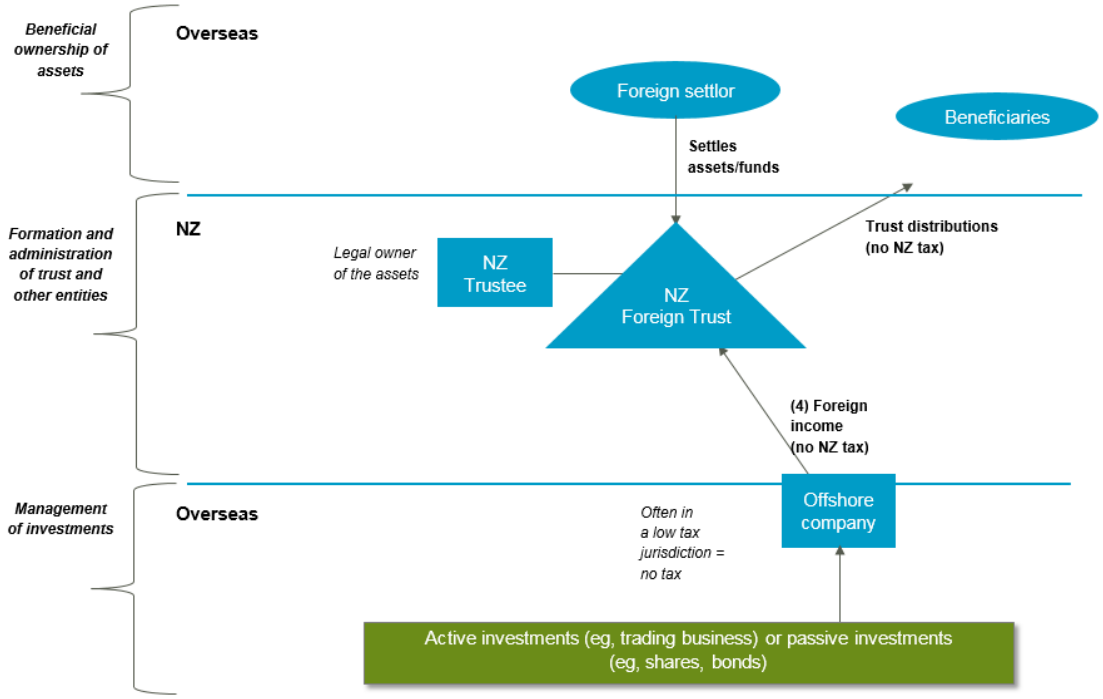
- NZ does not impose tax when the assets are settled on the trust, when the assets are contributed to the NZLTC in exchange for shares, when the foreign-sourced income is derived by the NZLTC, when it is distributed to the NZFT or when the trustee distributes the income to foreign beneficiaries.

- The NZLTC is transparent for NZ tax purposes, so NZ tax law sees the foreign-sourced income as being derived directly by the NZFT as owner.
- The foreign-sourced income of the NZFT is not subject to NZ tax.
- This is consistent with the principle that NZ does not impose tax on the foreign-sourced income of non-residents.
- NZ will impose tax on the NZ-sourced income of the trustee, the income of the NZ owner and/or the beneficiary income of any NZ resident beneficiaries.
- This example also assumes the NZLTC does not carry on a business in NZ – if it did, there may be NZ tax payable.
- **NOTE** – the amendments to the LTC rules contained in the Taxation (Annual Rates for 2016–17, Closely Held Companies, and Remedial Matters) Bill propose measures to prevent LTCs being used in these types of conduit structures by limiting the amount of foreign-sourced income an LTC can earn.

Registration requirements:

- The NZFT must file form IR 607 with IRD.
- The corporate trustee will be a NZ registered company.
- The NZLTC must be registered as a New Zealand company with the NZ Companies Office. This is a publicly searchable register.
- The NZLTC must be resident in New Zealand for tax purposes.

Scenario 4 – NZFT earns foreign income through a foreign company



Steps:

1. Foreign settlor settles foreign assets (or cash) on a NZFT.
2. NZFT has a NZ resident trustee (generally a special purpose corporate trustee to limit the personal liability of the TSP in New Zealand).
3. Generally the beneficiaries of the NZFT will be foreigners, but this is not a requirement of the definition of foreign trust.
4. NZFT subscribes for shares in a foreign company (often resident in a low tax jurisdiction). In exchange for its shares, the NZFT contributes either foreign assets or cash used to purchase foreign assets. The foreign company has limited liability.
5. The foreign company derives foreign-sourced income which is paid as a foreign-sourced dividend to the NZFT.
6. NZFT either accumulates the income or distributes it to the foreign beneficiaries.

Tax treatment:

- NZ does not impose tax when the assets are settled on the trust, when the assets are contributed to the foreign company in exchange for shares, when the foreign-sourced income is derived by the foreign company, when the foreign company pays a dividend to the NZFT or when the trustee distributes the income to foreign beneficiaries.
- The foreign company is outside NZ's tax jurisdiction, so its income is not subject to NZ tax.
- The foreign-sourced income of the NZFT is not subject to NZ tax.
- This is consistent with the principle that NZ does not impose tax on the foreign-sourced income of non-residents.

- NZ will impose tax on the NZ-sourced income of the trustee, the income of the NZ shareholder and/or the beneficiary income of any NZ resident beneficiaries.

Registration requirements:

- The NZFT must file form IR 607 with IRD.
- The corporate trustee will be a NZ registered company. This is a publicly searchable register.
- The foreign company may or may not need to register. Its details may or may not be available on a public register.

Appendix 4: Tax Disclosure Rules and Enforcement

Source: Inland Revenue Department.

Introduction

1 The current disclosure and record keeping rules were introduced for foreign trusts in 2006, with application from 1 October 2006. A New Zealand resident trustee of a foreign trust (referred to as a *resident foreign trustee*) is required to disclose certain information to IRD and keep financial and other records relating to each foreign trust for at least seven years for New Zealand tax purposes. They are also required to provide these records to IRD if requested.

Registration form IR 607

2 Section 59B of the TAA requires that resident foreign trustees must disclose the following information relating to the foreign trust to IRD:

- the name or other identifying particulars (such as the date of settlement) of the foreign trust
- the name and contact details of the resident foreign trustees
- whether a settlor is resident in Australia
- if a resident foreign trustee claims to be a 'qualifying resident foreign trustee', the name of the 'approved organisation' and the name and contact details of the natural person who belongs to the approved organisation
- if a resident foreign trustee has been appointed by another resident foreign trustee as an agent to make disclosure and keep the required records, the name of that trustee and the name of the appointing trustee
- any changes in the particulars referred to above.

3 The information above must be provided on form IR 607 within 30 days of the later of the date of the person's appointment as a trustee or the date of the person's arrival in New Zealand.

Record keeping requirements

4 Section 22(7) of the TAA requires resident foreign trustees of foreign trusts to keep and retain the following records:

- documents that provide evidence of the creation and constitution of the foreign trust (trust deed or similar)
- particulars of settlements made on, and distributions made by, the foreign trust, including the date of settlement or distribution, the name and address (if known) of settlors and the name and address (if known) of recipients of distributions

- a record of the assets and liabilities of the foreign trust, and details of all sums of money received and expended by the trustee in relation to the foreign trust, including evidence of when and where the receipt and expenditure took place
- if the foreign trust carries on a business, the charts and codes of accounts, the accounting instruction manuals and the system and programme documentation which describe the accounting system used in each income year in the administration of the trusts.

5 Administrators of foreign trusts are subject to the same record keeping requirements if they are administering the trust as part of a business or income earning activity.

6 Section 22(8) provides that a person who is required to keep records may apply to IRD for permission to keep records offshore, or in a language other than English. If records are kept offshore they must be provided to IRD on request and at no cost. In addition there may be other conditions imposed depending on the circumstances. Permission to keep records in a language other than English is allowed only in very limited situations.

Administration

7 IR 607 registration forms are lodged centrally with International Revenue Strategy (IRS) at IRD. IRS handles all correspondence on foreign trusts of an administrative nature and actions nearly all incoming and outgoing exchanges of information with tax treaty partners.

8 Checks are made by IRS as to the completeness of IR 607 forms filed. Additional questions may be raised at this initial stage and written requests to keep records offshore answered. Details from the IR 607 forms are entered into a central database for ease of subsequent reference.

Enforcement of disclosure and record keeping requirements

9 IRD operates a comprehensive Offshore Strategy focusing primarily on New Zealand tax residents and addressing the following in particular:

- jurisdictional issues in tracing and capturing foreign-source income
- mass marketed and tailored tax avoidance and evasion schemes
- technical errors and omissions arising from lack of knowledge or misinterpretation of complex tax legislation (including double taxation agreements).

10 In addition to the consideration of foreign trusts and related service providers in the general course of IRD's Investigations & Advice programme of work, one component of the compliance work carried out under the Offshore Strategy has been a specific project on foreign trusts and company service providers which commenced in 2011. The project has covered 26 service providers across a wide spread of operations (large/medium/small). It has addressed the tax affairs of the service providers as well as the systems in place to comply with disclosure/record keeping requirements for foreign trusts.

11 IRD is required to consider the application of its resources to audit these service providers in light of section 6A of the TAA which requires the Commissioner to collect over time the highest net revenue that is practical within the law. As at 29 April 2016, audit discrepancies ascertained from this targeted project total $1,229,399 with additional shortfall penalties arising of $117,498. This translates to a rate of return on closed cases of $99 per audit hour which is less than IRD's target rate of return of $500 per audit hour. This is because in most cases no New Zealand tax is payable in relation to foreign trusts.

12 While there is a lower rate of return in terms of direct revenue from this project, IRD has concluded that applying resources to this project also needs to be considered in light of wider integrity benefits to the tax system. These benefits include promoting compliance by service providers and the potential reciprocity benefits from New Zealand spontaneously exchanging information with tax treaty partners on matters that may be of interest to them. Accordingly, the project on foreign trusts and TCSPs continues to be prioritised by IRD.

Sanctions for non-compliance

13 The main sanction for non-compliance with the foreign trust disclosure rules is the knowledge offence in s.143A TAA. It applies if a resident foreign trustee *knowingly* fails to disclose information or keep or provide records as required by law. If a resident foreign trustee has failed to comply with the foreign trust disclosure rules and the trustee knew or ought to have known about his or her tax responsibilities as a trustee of a foreign trust, the trustee will be in breach of s.143A and, if convicted, will be subject to a monetary fine and/or imprisonment.

14 If a corporate trustee has committed an offence under s.143A, a director or other individual who is in a position allowing significant influence over the management or administration of the corporate trustee may also commit an offence under s.147B. This occurs if the s.143A offence was caused by an act done, or carried out by, or by an omission of, or through knowledge attributable to the director or other person.

15 If a non-compliant resident foreign trustee is not a *qualifying resident foreign trustee* and the trustee has been convicted of an offence under s.143A and has not provided the requested information, the worldwide income of the foreign trust will be subject to tax in New Zealand. However, this tax liability ceases when the resident foreign trustee provides the required information to IRD.

Exchange of information with tax treaty partners

16 Like other tax administrations, IRD is also aware of various financial arrangements that may be employed using New Zealand foreign trusts, companies and limited partnerships. In working closely with tax treaty partners to identify and combat the abusive use of offshore structures and other aggressive tax planning matters, IRD recognises the importance of sharing information under various international instruments – notably Double Taxation Agreements (DTAs), Tax Information Exchange Agreements (TIEAs) and the Convention on Mutual Administrative Assistance in Tax Matters (the Multilateral Convention).

17 Apart from the provision of information in the public domain, IRD is unable to satisfy requests for information from countries that do not have a DTA or TIEA with New Zealand or are not signatories to the Multilateral Convention.

18 When a resident foreign trustee indicates that a settlor of a foreign trust is an Australian resident, IRD shares those details disclosed on the IR 607 form with the Australian Taxation Office under Article 26 of the DTA with Australia. The exchange of such details has tailed off in recent years, reflecting the fact that settlements of New Zealand foreign trusts by Australians have fallen significantly since the introduction of the disclosure requirements in 2006.

19 IRD has also provided information to other DTA and Multilateral Convention partners on a case-by-case on request basis, where the New Zealand competent authority has been satisfied that there has been valid grounds for requesting the information. Following the international standard for exchange of information, IRD does not entertain general *fishing expeditions* from tax treaty partners for information on foreign trusts.

20 Collaboration with tax treaty partners also brings important obligations in terms of reciprocity which is factored into IRD's compliance enforcement activities by way of proactive exchanges of information. In this regard, the project undertaken on trust and company service providers has resulted in 117 spontaneous exchanges of information with 20 tax treaty partners, with these exchanges relating almost exclusively to New Zealand foreign trusts (with additional details concerning shell companies, LTCs and limited partnerships also provided).

21 With the recent expansion in New Zealand's treaty network as a result of the Multilateral Convention, IRD expects the volumes of exchanges to increase.

Appendix 5: Automatic Exchange of Information Proposals

This appendix was prepared by IRD's Policy Advice Division, with some input from the Inquiry.

Background

1 Following on from the worldwide implementation of the FATCA initiative,[95] in September 2013 G20 Leaders announced a new multilateral international initiative: to implement a global standard for the Automatic Exchange of Financial Account Information in Tax Matters (in short, Automatic Exchange of Information, or AEOI).

2 Like FATCA, AEOI is intended to counter offshore tax evasion arising from persons hiding financial assets in offshore accounts to evade home country taxes. FATCA is specific to the United States, whereas AEOI will apply on a global basis.

3 The AEOI Common Reporting Standard (CRS)[96] identifies the financial institutions required to carry out such due diligence and reporting, the different types of accounts covered and the identity and financial account information to be reported. The CRS is a standardised set of international rules.

4 Under the AEOI initiative, most financial institutions in participating jurisdictions (including New Zealand) will be required to carry out due diligence on the accounts they maintain (that are not 'excluded accounts') to identify account holders and (in certain circumstances) Controlling Persons[97] who are tax-resident overseas. If they identify such persons, they will generally be required to gather identity information (such as name, address and, in certain circumstances, date of birth and Taxpayer Identification Number[98]). Also required will be financial account information (such as account balances and income earned from financial assets[99]) in relation to such accounts and non-resident account holders/controlling persons. The financial institution will then be required to report that information to their local tax administration.

5 The tax administration will exchange the information automatically with tax treaty partners that have agreed to AEOI exchanges. The receiving tax administration will use the information for tax compliance purposes such as to confirm that income earned offshore has been returned in tax returns in their jurisdiction.

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95 The Foreign Account Tax Compliance Act (FATCA) initiative was enacted by the United States Congress in 2010. New Zealand entered into an Intergovernmental Agreement with the United States in 2014.

96 The CRS is the element of the AEOI standard that sets out the due diligence and reporting rules to be imposed on financial institutions. These rules must be incorporated into domestic law through implementing legislation.

97 In the context of trusts, *Controlling Persons* covers settlors, trustees, protectors, beneficiaries and any other natural person who has ultimate effective control over the trust. The OECD's commentary on the AEOI Common Reporting Standards provides (at page 199) that settlors, trustees, protectors and beneficiaries must always be treated as controlling persons of a trust regardless of whether any of them exercises control over the trust. However, implementing jurisdictions are permitted to allow financial institutions to treat discretionary beneficiaries as only being controlling persons if they receive a distribution from the trust in the reporting period.

98 This will typically be the equivalent of the person's IRD number in their home jurisdiction.

99 There is also a requirement for distributions to be identified and reported in defined circumstances (for example, a distribution made by a financial institution trust to one of its non-resident beneficiaries).

6 The Multilateral Convention[100] is expected to be the principal tax treaty under which AEOI exchanges take place.

New Zealand's timeline for AEOI

7 International expectations are that participating jurisdictions will complete the first exchanges of information by 30 September 2018 at the latest.

8 New Zealand legislation to implement AEOI is expected to be introduced in the third quarter of 2016, with enactment by December 2016. New Zealand financial institutions will be required to commence due diligence from 1 July 2017 with reporting to IRD occurring in mid-2018. This will allow for the first exchange of information with treaty partners under the Multilateral Convention by September 2018. This timing matches Australia's.

9 The analysis in this appendix is based on the provisions set out in the G20/OECD Standard for Automatic Exchange of Information in Financial Account Tax Matters, which New Zealand has committed to implement.[101] The analysis assumes that the New Zealand legislation will mirror the global standard.

AEOI and foreign trusts

10 In general terms, the New Zealand AEOI due diligence and reporting requirements seem likely to have only limited application to foreign trusts. The provisions are complex, however, and the obligations for each foreign trust will need to be considered carefully based on their own facts.

11 The specific rules and the conditions that would need to be met for a foreign trust to be affected (one way or another) by AEOI are set out below. Broadly speaking there would be no New Zealand reporting of a foreign trust under AEOI if-

- the trust does not primarily carry on a business of providing investment management, other specified investment services for *customers* (ie persons other than just the beneficiaries of a discretionary trust), or is not a custodial institution, and
- no TCSP that acts for the foreign trust has discretionary authority to manage the trust's assets, and
- the trust is not managed by any other financial institution that has discretionary authority to manage the trust's assets, and
- the trust does not have a New Zealand bank account or other account with a New Zealand *reporting financial institution* (RFI[102]) **or** it holds only an excluded account with such an institution.

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100 Described in Appendix 7 of the report.

101 OECD. (2014). *Standard for Automatic Exchange of Information of Financial Account Information in Tax matters*. https://www.oecd.org/tax/transparency/automatic-exchange-of-information/

102 Some financial institutions that pose a low risk of being used for tax evasion can be excluded from complying with AEOI obligations. These are referred to as 'non-reporting financial institutions'. A financial institution trust will also be a non-reporting financial institution if it engages a reporting financial institution trustee to carry out AEOI obligations on its behalf. All other financial institutions are 'reporting financial institutions' (RFIs).

12 Reporting could be required in another jurisdiction if-

- the foreign trust has an account (that is a non-excluded account) with a reporting *financial institution* there, and
- the jurisdiction has implemented AEOI.

13 Such reporting would only be the amount held in the account however. It would not disclose the trust's total assets or the trust's distributions. However, it could involve disclosure of the trust's non-resident controlling persons.

Circumstances where AEOI may apply to foreign trusts

14 A foreign trust would be subject to AEOI due diligence in New Zealand if it holds an account (which is not an excluded account) with a New Zealand *reporting financial institution* (RFI). If it does then it will be in the same position as any other person who has an account with an RFI. The RFI will be required under AEOI to do due diligence on all its account holders, including the foreign trust. Unless the foreign trust is itself a financial institution[103] the RFI would be required to identify the trust's Controlling Persons[104] to determine whether any such persons are tax resident overseas, as it would with other account holders.

15 A foreign trust would also be subject to AEOI due diligence and (if there are any reportable accounts) reporting in New Zealand if the trust is itself a New Zealand RFI.[105] There is a lot of technical detail to step through in determining when a foreign trust would also be an RFI. In substance, however, whether a foreign trust is an RFI will depend on the extent to which the trust is itself in the business of primarily providing financial services for customers or is a custodial institution, or the extent to which it is managed by an entity that is itself a *financial institution*, as well as the extent to which the trust derives its income primarily from financial assets.

16 As a starting point, to be an RFI, the foreign trust must first be a *financial institution*. For AEOI purposes, the term *financial institution* is defined broadly to include custodial institutions, investment entities, depository institutions and specified insurance companies.

17 The categories most likely to be relevant to a trust are the *custodial institution* category and the *investment entity* category, which are broken down further into *Class A investment entity* and *Class B investment entity*. These categories are explored in detail below. The most relevant category for foreign trusts is the 'Class B investment entity' category.

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103 If the foreign trust is not a financial institution it is likely to be classified as a passive non-financial entity (described later in the appendix). The conclusion above proceeds on this basis.

104 In the context of trusts, *Controlling Persons* covers settlors, trustees, protectors, beneficiaries and any other natural person who has ultimate effective control over the trust. The OECD's commentary on the AEOI Common Reporting Standards provides (at page 199) that settlors, trustees, protectors and beneficiaries must always be treated as controlling persons of a trust regardless of whether any of them exercises control over the trust. However, implementing jurisdictions are permitted to allow financial institutions to treat discretionary beneficiaries as only being controlling persons if they receive a distribution from the trust in the reporting period.

105 Or is a *non-reporting financial institution* that is a trustee documented trust (where the trustee carries out due diligence and reporting on behalf of the trust).

18 Finally, if a foreign trust in a participating jurisdiction (as is New Zealand) is a *financial institution* then, unless specifically excluded (as a defined category of non-reporting *financial institution*), it will be an RFI for AEOI purposes.

A foreign trust as a Reporting Financial Institution – Class A investment entity or custodial institution

19 A trust will be a *Class A investment entity financial institution* if, for example, it derives most (50% or more) of its gross income from services provided in investing or managing funds on behalf of a customer (or customers) of the trust. This would typically apply to collective investment vehicles (such as unit trusts) that primarily derive their income from the business of performing specified investment services for customers.

20 Alternatively, a trust may be a *custodial financial institution* if it holds financial assets for others as a *substantial portion of its business*. An entity is treated as holding assets as a *substantial portion of its business* if the entity's custodial services income attributable to holding financial assets and related financial services represents 20% or more of its gross income.

21 It is unlikely that the activities of a Class A investment entity or custodial institution would be undertaken by a foreign trust or in the form of a foreign trust.

A foreign trust as a Reporting Financial Institution – Class B investment entity

22 The category of *financial institution* that could apply to some foreign trusts is the *Class B investment entity* category. In broad terms, the key elements of this category are that-

i the trust's gross income would need to be primarily (50% or more) attributable to investing, reinvesting or trading financial assets, and

ii the trust would need to be managed by a defined type of financial institution.

23 The OECD CRS commentary provides that:[106]

> "(a)n Entity is 'managed by' another Entity if the managing Entity performs, either directly or through another service provider, any of the activities or operations described in subparagraph A(6)(a)" [of the definition of investment entity] "on behalf of the managed Entity. **However, an entity does not manage another Entity if it does not have discretionary authority to manage the Entity's assets (in whole or part)**." (Emphasis added)

24 In broad terms, if a foreign trust derives its income primarily from financial assets, and is managed by a TCSP that is itself an entity that is a *financial* institution (for example, the TCSP may be a *Class A investment entity* that derives most of its gross income from performing specified financial services for customers including foreign trusts), and the TCSP has discretionary authority to manage the trust's assets, then the foreign trust would generally be a financial institution.

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106 OECD. (2014). *Standard for Automatic Exchange of Financial Account Information in Tax Matters*, p.162. http://www.oecd.org/tax/automatic-exchange/common-reporting-standard/common-reporting-standard-and-related-commentaries/

25 However, where the TCSP merely performs administrative services for a foreign trust (either directly or through a corporate trustee service provider) and does not have the discretionary authority to manage the trust's assets, they would not manage the trust under the OECD CRS commentary's view of *management*. Under this view where the TCSP's role simply involves setting up the trust and undertaking routine administrative work, it is likely that the TCSP would not be managing the trust. If this is the case the trust would not be a *Class B investment entity* and therefore would not constitute a *financial institution* (assuming that the trust is not managed by any other financial institution and it does not come within any other category of *financial institution*). Therefore, the trust would not be a RFI.

26 But note that even if the TCSP does not manage the foreign trust as such, if another financial institution manages the trust's assets (regardless of whether they are doing so from New Zealand or elsewhere) then the trust would generally be a *Class B investment entity* and therefore a financial institution. For example, if a foreign trust has an investment portfolio that is managed by a discretionary investment manager (eg a *Class A investment entity*), then that trust will generally be a financial institution. By contrast, if the foreign trust does not directly hold the investment portfolio but instead holds an interest in an intermediary entity that holds the investment portfolio managed by the investment manager, the foreign trust will generally not be a financial institution. Instead it is the intermediary that may constitute a financial institution.

Foreign trust holding real estate

27 Some foreign trusts hold (through direct ownership) real estate, such as a house, apartment or rental property either in New Zealand or, more commonly, offshore as their only asset of any note. These, and other foreign trusts with non-financial assets, would not constitute financial institutions for AEOI purposes. They are more likely to be classified as passive non-financial entities, and would not have AEOI reporting obligations.

Consequences if AEOI rules do apply

28 Based on the above analysis it is possible for AEOI to result in a foreign trust having increased reporting and disclosure requirements in two ways; first, as an RFI itself, and second, as an account holder of an RFI.

29 For the reasons outlined, it appears that a significant number of foreign trusts will not be New Zealand RFIs themselves. However, if they are, the full due diligence and reporting obligations (in respect of reportable accounts) will apply. If a trust is an RFI,[107] it must identify and report on its reportable accounts. In the context of an investment entity these are defined as accounts of non-resident holders of its debt and equity interests.

30 For an RFI trust, equity interest holders are defined as (i) settlors, (ii) mandatory beneficiaries, (iii) discretionary beneficiaries that actually receive a distribution in the relevant period and (iv) any other natural person that has ultimate effective control (which could be, for example, the trustees and protectors). If the trust identifies any relevant non-resident persons it will need to report specified

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107 Or is a *non-reporting financial institution* that is a trustee documented trust (where the trustee carries out due diligence and reporting on behalf of the trust).

information about such persons and account information, such as the total account balance, as well as the total gross amount paid or credited to each account holder (which would pick up distributions to beneficiaries). The income actually derived by the trust from any investment holding would not be reported.

31 In relation to accounts, such as bank accounts held with a New Zealand RFI, it is likely that most foreign trusts (that are not themselves financial institutions) with such accounts would be classified as a *passive non-financial entity* (NFE[108]). If a foreign trust that is a passive NFE holds a non-excluded account with a New Zealand bank or other New Zealand RFI, the RFI will need to perform due diligence on the account to identify the trust's *Controlling Persons*[109]and to determine where such persons are resident for tax purposes. Where relevant non-resident controlling persons are identified the account will be reportable by the RFI to IRD. The identity information to be reported will include name, address, residence and, in certain circumstances, Taxpayer Identification Number and date of birth. The RFI must also report financial information such as the value of financial assets held, and income derived from those financial assets held by the trust.

32 Where reporting is required by an RFI, then the identity and financial account information that is reported will relate only to the trust's account held with that RFI.

Potential AEOI reporting in other jurisdictions

33 While a foreign trust may not be subject to AEOI reporting in New Zealand, it may be subject to reporting in another participating jurisdiction. For example, if the trust does not hold an account with a New Zealand RFI, but holds an account with an RFI in another participating jurisdiction, that RFI will be required to carry out due diligence on that account (unless it is excluded) and provide it to the revenue authority of that jurisdiction. However, once again, the identity and financial account information that is reported will relate only to the trust's account held with that RFI.

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108 A 'non-financial entity' (NFE) covers any entity other than a financial institution. NFEs are classified as 'active' or 'passive'. Non-resident NFEs can be subject to CRS reporting. However, passive NFEs are the only NFEs where non-resident controlling persons can also be subject to CRS reporting.

109 Broadly, the RFI can sometimes rely on those controlling persons it has identified under AML procedures.

Appendix 6: Anti-Money Laundering and Countering Financing of Terrorism Rules and Enforcement

Purpose, timing and supervision

5 The Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (the AML/CFT Act) sets out three purposes-

- To detect and deter money laundering and the financing of terrorism.
- To maintain and enhance New Zealand's international reputation by adopting, where appropriate in the New Zealand context, recommendations issued by the Financial Action Task Force.
- To contribute to public confidence in the financial system.

6 New Zealand has adopted a phased approach to implementation of the AML rules. The first phase came into effect from 30 June 2013. Phase 2 is scheduled to be introduced to Parliament in time for enactment in 2017.

7 The AML regime is a joint supervisor model administered by three agencies, being the Reserve Bank of New Zealand, the Financial Markets Authority and the Department of Internal Affairs (DIA). DIA has responsibility for administering the AML/CFT rules in relation to TCSPs whose principal business is the formation of companies and trusts, including foreign trusts. The Ministry of Justice is responsible for drafting the AML/CFT Act and regulations.

Relevance to Inquiry

8 The AML regime is relevant to the Inquiry in two ways. First, the terms of reference require consideration of the AML rules in evaluating whether the existing disclosure rules (including AML-related disclosures) and their enforcement are sufficient to ensure New Zealand's reputation is maintained. Second, the Panama Papers have prompted a large number of media reports saying that New Zealand is being used to hide or disguise funds obtained from illegal sources. Should this be correct, any disclosure-based remedies may be achieved in part through changes to the AML regime or its enforcement as well as (and in some areas instead of) changes to the tax disclosure rules.

Application of AML rules to foreign trusts

9 Key building blocks of the AML rules relevant to foreign trusts are-

- The rules are activity based. Whether an entity is a *reporting entity* for AML/CFT purposes depends on the types of transactions it conducts or services it provides.

- Trusts (including foreign trusts) are not, in and of themselves, *reporting entities*. However, *a trust and company service provider*[110] (TCSP) is specifically included as a *reporting entity* under regulations to the AML/CFT Act.
- The level of due diligence required (described below) is determined under the AML/CFT Act, but must also have regard to the level of risk as assessed by the TCSP. Under the Act, reporting entities are required to apply *enhanced due diligence* if they establish a business relationship with a customer that is a trust.[111]
- The due diligence and account monitoring obligations are ongoing. Reporting entities are required to ensure that the information obtained when the business relationship was established remains current and reflects the level of risk involved.

Customer due diligence

10 Customer due diligence is at the heart of the AML rules. A Guideline on Beneficial Ownership, issued by the joint supervisors, provides a useful overview[112]-

> *A key task is to identify and verify your customers' beneficial ownership arrangements. It is crucial to know who the beneficial owner(s) are so that you can make appropriate decisions about the level of money laundering and terrorism financing risk associated with your customer. Some criminal enterprises deliberately try to hide the true owners of their business and its assets. Sometimes identifying and verifying who your customers' beneficial owner(s) are can be difficult to do. This could be because the ownership structure is complex but legitimate. However, you should remain alert to the possibility that it may be because there is an attempt to conceal the beneficial owner(s).*

11 The core elements of customer due diligence are identity determination and verification, and information on the nature of the business relationship.[113]

12 Under the *enhanced due diligence* requirements that apply to foreign trusts, the reporting entity (normally the TCSP) must also obtain information relating to the source of funds or wealth of the customer[114] and, according to the level of risk involved, take reasonable steps to verify that information.[115] Any additional information prescribed by the regulations must also be obtained.[116]

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110 Under s.17 of the AML/CFT (Definitions) Regulations 2011 a person who carries out as the only or principal part of their business activities acting as a formation agent of legal persons or arrangements, arranging for a person to act as a nominee director or nominee shareholder or trustee in relation to legal persons or arrangements, or providing a registered office, business address, correspondence address or administrative address for any legal person or arrangements (which will include a trust) is declared a *reporting entity* for AML purposes. Such persons are described as trust and company service providers.

111 s.22 AML/CFT Act.

112 See http://www.dia.govt.nz/pubforms.nsf/URL/AMLCFT_BeneficialOwnershipGuideline_December2012.pdf/$file/AMLCFT_BeneficialOwnershipGuideline_December2012.pdf Beneficial Ownership Guideline, p.2.

113 s.15–17AML/CFT Act.

114 s.23 AML/CFT Act.

115 s.24 AML/CFT Act.

116 s.15–17 AML/CFT Act.

13 It is important to note that AML/CFT reporting obligations in relation to foreign trusts are imposed on the TCSP rather than on the foreign trust itself. To comply with their AML obligations, TCSPs are required to obtain and verify a significant amount of information from foreign trust customers under the enhanced due diligence process.

Record keeping, systems and processes

14 TCSPs must maintain (for five years) records sufficient to enable transactions that are conducted through them to be reconstructed at any time. Identity and verification records are required to be kept for five years after the end of the business relationship. [117]

15 TCSPs are also required to implement and maintain comprehensive systems and processes[118]-

- An AML/CFT compliance programme must be implemented and maintained. This is to include internal procedures, policies and controls to detect and manage and mitigate the risk of money laundering and the financing of terrorism.
- An employee must be designated as an AML/CFT compliance officer. This person is required to report to a senior manager of the TCSP.
- Before conducting customer due diligence the TCSP must undertake a thorough risk assessment that assesses the risk of money laundering and financing of terrorism in the context of the TCSP's overall business having regard to size, number of customers, countries it is dealing with and other factors.
- A written risk assessment is required that identifies and describes risks and outlines how obligations in the AML/CFT Act and regulations will be satisfied.
- The risk assessment and AML/CFT programme is required to be audited every two years.

16 An annual report on the TCSP's risk assessment and AML/CFT programme is required to be provided annually to DIA.

Customer due diligence at different levels

17 The supervising agencies have issued a Guideline that confirms that a trust is considered to be a customer for purposes of the AML rules.[119] Although a trust does not have a separate legal personality the agencies conclude that, in the context of the AML rules, trusts are intentionally included as a customer.

18 Under the AML/CFT Act[120] customer due diligence is required at three levels:

- customer
- any beneficial owner of a customer
- any person acting on behalf of the customer.

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117 s.49–50 AML/CFT Act.

118 Subpart 4 AML/CFT Act, s.56–61.

119 See http://www.dia.govt.nz/pubforms.nsf/URL/AMLCFT_FactSheet_TrustLetter_Aug2013.pdf/$file/AMLCFT_FactSheet_TrustLetter_Aug2013.pdf: *Clarification of the position the AML/CFT supervisors are taking with respect of the AML/CFT interpretation of a trust as a customer.*

120 s.11 AML/CFT Act.

The customer

19 Determining who the customer is will sometimes not be straightforward in the case of foreign trusts. It is not unusual for an offshore advisor to be the first point of contact with a TCSP, and they may constitute a customer in the period before a trust is established. Similarly, the advisor's offshore client, who may be a settlor of the proposed trust, may be a customer. The trustee may also be a customer, as well as the trust itself once it is formed. The full range of customer due diligence is required for each customer.

Beneficial owners

20 The AML/CFT Act defines beneficial owner as the individual who-

a) has effective control of a customer or person on whose behalf a transaction is conducted, or

b) owns a prescribed threshold (more than 25%)[121] of the customer or person on whose behalf a transaction is conducted.[122]

21 This definition can be difficult to apply in a trust context.

22 The *fact sheet* on customer due diligence for trusts notes that the beneficial owners may include[123]-

- trustees, and
- any other individual who has effective control over the trust, specific trust property, or with the power to amend the trust's deeds, or remove or appoint trustees. This might include a protector or special trustee (if there are any), or one or more of the beneficiaries of the trust.

Persons acting on behalf of the trust

23 In relation to determining *persons acting on behalf of the trust* the *fact sheet* notes[124]-

> *Acting on behalf of the customer is when a person is authorised to carry out transactions or other activities on behalf of the customer. For trusts, this includes persons who have authority to act on behalf of the trust, for example trustees or other persons who are able to give instructions about the trust's assets.*

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121 Regulation 5, Anti-Money Laundering and Countering Financing of Terrorism (Definitions) Regulations 2011.

122 s.5 AML/CFT Act.

123 http://www.dia.govt.nz/pubforms.nsf/URL/AMLCFT_FactSheet_Trusts_29Apr2013.pdf/$file/AMLCFT_FactSheet_Trusts_29Apr2013.pdf.

124 Ibid, p.2.

Identification information

24 The fact sheet[125] outlines the identification information to be obtained as part of customer due diligence for each level of a trust.

On the trust

a) full name

b) address

c) for a trust that is not a discretionary trust, the name and date of birth of each beneficiary of the trust

d) source of funds or wealth of the trust

e) any additional information prescribed by the regulations

f) information on the nature and purpose of the business relationship with the trust.

On the beneficial owners of the trust

a) name

b) date of birth

c) address

d) any additional information prescribed by the regulations.

On the persons acting on behalf of the trust

a) full name

b) date of birth

c) relationship to the customer (being the trust)

d) company identifier or registration number (if applicable).

25 For an individual, customer identity requirements are generally able to be satisfied through a certified copy of a passport photo page and a utilities bill showing the person's address.

Information on beneficiaries

26 Under Regulation 6 of the AML/CFT (Requirements and Compliance) Regulations 2011 rules a reporting entity must obtain the name and date of birth of each beneficiary of the trust. However, there is a 'carve-out' from this requirement for discretionary trusts. For them the beneficiaries can be described by class (for example, children of the settlor). There is no requirement for names or other details. The rationale for this is that obtaining details of discretionary beneficiaries would present practical problems. In addition, the intelligence gains would be limited as in many cases discretionary beneficiaries (who may number in the hundreds) will not have received benefits from the trust (and may not do so in the future).

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125 Op.. cit.

Politically exposed persons

27 Where the customer or any beneficial owner is a *politically exposed person*,[126] in addition to the usual information required under enhanced due diligence the TCSP is required to-

a) obtain senior management approval for continuing the business relationship, and

b) obtain information about the source of wealth or funds of the customer or beneficial owner and take reasonable steps to verify the source.[127]

Obligation to report suspicious transactions

28 Aside from their obligations to conduct customer due diligence and comply with the associated reporting requirements, reporting entities are required under the AML/CFT Act to report suspicious transactions.[128] Where a transaction is conducted through a reporting entity, and there are reasonable grounds to suspect that the transaction may be relevant to the enforcement of legislation concerning money laundering, drugs, terrorism or crime, then it is required to be reported to the Commissioner of Police within three working days.

29 The Financial Intelligence Unit (FIU) within the New Zealand Police collates and analyses information relating to suspicious transactional activity. The FIU advised the Inquiry that they receive about 10,000 to 12,000 suspicious transaction reports (STRs) each year. Very few are received from TCSPs, or from accountants and lawyers.

30 The FIU noted that STRs received from TCSPs, and from lawyers and accountants, tend to involve clear cases of criminal (rather than just suspicious) activities. In contrast, other reporting entities such as banks appear to report suspicious activity based on a lower threshold of suspicion.

31 FIU maintains a good working relationship with IRD. In the last 12 months FIU disseminated about 360 STRs a month with IRD, but to date none have involved foreign trusts.

Lawyers, conveyancers, accountants and real estate agents

32 Although TCSPs are specifically included as reporting entities for purpose of the AML rules, some persons who provide TCSP services are excluded from the definition. The exclusion is for lawyers, conveyancers, accountants and real estate agents who provide such services in the ordinary course of their legal, accounting or real estate business.[129] This carve-out was a deliberate policy decision to allow more time for the rules to be developed**.** These sectors will be included in phase 2 of the AML reforms, which the Government has announced will be enacted in 2017.

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126 Defined in s.5 of the AML/CFT Act. The term covers an individual who has in the preceding 12 months held in any overseas country a prominent public function. It also includes any immediate family member or person who has a close commercial or other relationship with the individual.

127 s.26 AML/CFT Act.

128 s. 40/41 AML/CFT Act.

129 s.20 of the AML/CFT (Definitions) Regulations 2011.

33 At a practical level the exclusion means that lawyers and accountants are generally not subject to the requirements of the AML/CFT Act. They are, however, required by the Financial Transactions Reporting Act 1996 to report any suspicious activity they detect, but the provisions are less prescriptive than under the AML/CFT Act, and there is no supervision component.

Enforcement of AML rules

34 Foreign trusts are not treated differently from New Zealand trusts under the AML/CFT Act. DIA is responsible for supervising TCSPs who are engaged in establishing and administering foreign (and other) trusts, and the majority of their oversight is through contact with these reporting entities.

35 There is no registration requirement for TCSPs. DIA maintains a register of reporting entities (not a register of foreign trusts) which it compiles based on open-source research to identify potential reporting entities. The register, which is on the DIA website, records the name, identification number (if applicable), region and sector (sectors cover a range of industries including casinos, debt collection, payroll and TCSPs.)

36 Each TCSP is required to file an annual report with DIA. The report provides information on the TCSP's risk assessment, AML/CFT programme, customer identification and verification procedures and transaction monitoring processes. It also responds to questions on products and services offered, revenue split between different sources, number and type of customers, channels through which customers are obtained (face-to-face, non-face-to-face, domestic intermediary, overseas intermediary) percentage of customers accepted, details of remittances of money and the three countries the TCSP receives most transactions from. Note that this information is in relation to the TCSP, not the underlying entity such as a foreign trust.

37 In carrying out its supervisory, monitoring and enforcement responsibilities DIA takes a risk-based approach to supervising the sector. This takes into account a range of risk factors, including size.

38 A number of tools are used to supervise reporting entities, one of which is a desk-based review. When a review is undertaken the reporting entity such as a TCSP is required to provide its AML/CFT policy and procedure documents, control documents (evidence of internal reviews, external audit reports and a register of AML/CFT incidents) together with an overall risk assessment. DIA assesses the documents to see if they meet the requirements of the AML/CFT Act.

39 If concerns arise, a decision may be taken to undertake a more in-depth review, and in these circumstances DIA will write to the TCSP and request further documents and/or outline remedial actions that must be taken. The remediation plan would include a set of outcomes to be completed within a set time frame.

40 TCSPs are required to have an independent audit undertaken every two years to verify that their risk assessment identifies the AML/CFT threats faced by the business and is current, and that the AML/CFT programme is being implemented effectively. DIA will sometimes ask to review the independent audit report.

41 DIA advises that there are currently 833 reporting entities in the sectors that they are responsible for supervising, of which 109 are TCSPs. No specific information is held on the number of TCSPs involved in providing services to foreign trusts, but between five and 10 suppliers have quite a heavy involvement.

Scope of review and audit activity

42 DIA's approach to reviews and audits is outlined in Part 7 of the report.

43 DIA has a series of templates that are used as a basis for programme review reports. These are currently being reviewed and redesigned.

44 There have been six site visits to TCSPs since the AML regime commenced. None have focused specifically on foreign trust procedures or files. Instead, the focus of such visits has been on the systems and procedures of the TCSP.

Sanctions for non-compliance

45 If non-compliance with the AML/CFT Act is identified then the AML/CFT supervisor may issue a formal warning, obtain an enforceable undertaking or seek an order or injunction from the High Court or apply to the Court for a pecuniary penalty to be imposed.

46 Penalties vary depending on the nature of the offence. For example, failure to conduct customer due diligence carries a maximum penalty of $200,000 in the case of an individual and $2 million for a company. Failure to adequately monitor accounts and transactions, or to provide satisfactory evidence of a person's identity, carries a maximum penalty of $100,000 for an individual and $1 million for a company.[130]

47 The Inquiry was advised that since the AML/CFT Act came into force on 30 June 2013 there have been no formal warnings issued or enforceable undertakings obtained for TCSPs. Since 1 July 2015 DIA has issued four warnings (one public), three enforceable undertakings and 25 remediation plans. Two TCSPs have had remediation plans put in place and monitored.

130 s.90 AML/CFT Act.

Appendix 7: New Zealand's Tax Treaty Network

Source: Inland Revenue Department.

Overview

1 Under historic legal principles, and pursuant to the strict terms of New Zealand legislation, exchange of information by IRD with other tax administrations can only take place when authorised by a tax treaty. New Zealand is party to a range of tax treaties that authorise exchange of information. These treaties are prescriptive as to the circumstances under which exchanges of information are to take place.

2 These treaties are:

- bilateral double taxation agreements (DTAs)
- bilateral tax information exchange agreements (TIEAs)
- the joint OECD/Council of Europe Multilateral Convention on Mutual Administrative Assistance in Tax Matters, as amended by Protocol in 2010 (the 'Multilateral Convention')
- bilateral FATCA agreement with the United States.[131]

3 Historically, information exchange has been primarily limited to bilateral tax treaties. However, in 2012, New Zealand signed the Multilateral Convention. As a result of this, the network of jurisdictions New Zealand can exchange information with has widened significantly. As at 16 June, New Zealand has 90 treaty partners with whom information exchange agreements are in force.

4 The amount of financial information about taxpayers that New Zealand will exchange with those partners is expected to increase significantly once New Zealand has completed its legislative procedures to bring the G20/OECD standard for Automatic Exchange of Financial Account Information in Tax Matters (AEOI) into force, with information exchanges expected to begin in 2018. AEOI is discussed in detail in Appendix 5.

Exchange of information provisions in DTAs and TIEAs

DTAs

5 New Zealand has 40 DTAs in force, primarily with its key trading and investment partners. These DTAs have been agreed on a bilateral basis over a number of decades. New Zealand's DTAs generally follow the OECD Model Tax Convention on Income and on Capital (the OECD Model), including its information exchange provisions.

131 Strictly, the exchanges of information to which this agreement relate are carried out under New Zealand's DTA with the United States.

6 The OECD Model provides for information to be exchanged for tax purposes in the following circumstances:

- *on request* by one treaty partner
- *spontaneous* exchange (that is, allowing for information discovered on audit, for example, to be provided to a treaty partner)
- *automatic* exchange of information (currently this includes information relating to interest, dividends and royalties, and in relation to FATCA, information such as account balances).

7 *On request* exchange of information describes a situation where one treaty partner asks for particular information about a taxpayer's affairs from another treaty partner. Typically, the information requested relates to an examination, inquiry or investigation of a taxpayer's tax liability for specified tax years. The information must be foreseeably relevant to the requesting tax authority.

8 *Spontaneous* exchange of information is the provision of information to another treaty partner that is foreseeably relevant to that other party but which has not been specifically requested. Spontaneous exchange typically occurs where the tax authority of a treaty partner has acquired information generally through its own compliance activities (for example, as a result of an audit) which it supposes to be of interest to a treaty partner's tax authority.

9 *Automatic* exchange of information involves the systematic and periodic transmission of 'bulk' taxpayer information by the source country to the residence country concerning various categories of income (eg dividends, interest, royalties, salaries, pensions, etc) or, under FATCA, other information (such as Taxpayer Identification Numbers and account balances).

10 The information which is exchanged *automatically* is normally collected in the source country on a routine basis, generally through reporting of the payments by the payer (financial institution, employer, etc). Automatic exchange can also be used to transmit other types of useful information such as changes of residence, the purchase or disposition of immovable property, value added tax refunds, etc. As a result, the tax authority of a taxpayer's country of residence can check its tax records to verify that taxpayers have accurately reported their foreign source income. In addition, information concerning the acquisition of significant assets may be used to evaluate the net worth of an individual, to see if the reported income reasonably supports the transaction.

TIEAs

11 As a result of concerns around international financial centres, certain low tax jurisdictions were encouraged by the OECD's Global Forum to enter into TIEAs with other jurisdictions to ensure effective information exchange.

12 TIEAs are tax treaties which provide for exchange of information, generally similar to the exchange of information provisions relating to information on request to those in the OECD Model DTA. However, TIEAs are invariably limited to exchange on request.

13 New Zealand has TIEAs in force with 11 jurisdictions. However, TIEAs are now largely irrelevant given developments with the Multilateral Convention (which most of our TIEA partners have now joined, or will shortly join).

Exchange of information provisions in the Multilateral Convention

14 New Zealand is one of 96 parties to the Multilateral Convention (although it is as yet only in force for 75 jurisdictions, including New Zealand). The Convention was developed jointly by the OECD and the Council of Europe in 1988, but upgraded and opened for signature by all jurisdictions by Protocol in 2010.

15 Overall, the Multilateral Convention represents best practice by comparison to many DTAs and TIEAs. The Multilateral Convention provides for information to be exchanged upon request and spontaneously.

16 The Multilateral Convention also provides for information to be exchanged automatically where jurisdictions have agreed through their tax authorities' competent authorities. An example of this is the AEOI Multilateral Competent Authority Agreement (AEOI MCAA), which is an agreement between competent authorities for the automatic exchange of financial account information under the AEOI initiative (this initiative is detailed in Appendix 5). Currently, over 80 jurisdictions have signed the AEOI MCAA, including New Zealand.

17 An agreement between competent authorities to exchange information automatically may be bilateral or multilateral and must specify the category of information which will be exchanged. It must generally also specify technical exchange modalities such as the encryption standards to be used and the timing of exchanges.

18 Most of New Zealand's DTAs and TIEAs are with jurisdictions that are parties to the Multilateral Convention.

List of New Zealand's treaty partners (bilateral and multilateral)

19 As of 16 June 2016, New Zealand has treaty arrangements that allow for full information exchange (on request, spontaneous exchange and automatic exchange) with the following jurisdictions:[132]

	Jurisdiction	Type(s) of agreement
1	Albania	MAC
2	Anguilla	MAC, *TIEA(S, NiF)*
3	Argentina	MAC
4	Aruba	MAC
5	Australia	MAC, DTA
6	Austria	MAC, DTA
7	Azerbaijan	MAC
8	Belgium	MAC, DTA
9	Belize	MAC
10	Bermuda	MAC, *TIEA(S, NiF)*
11	British Virgin Islands	MAC, *TIEA(S, NiF)*

132 *MAC = Multilateral Convention*
MAC(S, NF) = Multilateral Convention signed but not in force
DTA = Double Tax Agreement
TIEA = Tax Information Exchange Agreement
TIEA(S, NiF) = Tax Information Exchange Agreement signed but not in force
FATCA = Double Tax Agreement (FATCA)

	Jurisdiction	Type(s) of agreement
12	Cameroon	MAC
13	Canada	MAC, DTA
14	Cayman Islands	MAC, TIEA
15	Chile	*MAC(S, NiF)*, DTA
16	China	MAC, DTA
17	Colombia	MAC
18	Costa Rica	MAC
19	Croatia	MAC
20	Curacao	MAC, TIEA
21	Cyprus	MAC
22	Czech Republic	MAC, DTA
23	Denmark	MAC, DTA
24	Estonia	MAC
25	Faroe Islands	MAC
26	Fiji	DTA
27	Finland	MAC, DTA
28	France	MAC, DTA
29	Georgia	MAC
30	Germany	MAC, DTA
31	Ghana	MAC
32	Gibraltar	MAC, TIEA
33	Greece	MAC
34	Greenland	MAC
35	Guernsey	MAC, TIEA
36	Hungary	MAC
37	Iceland	MAC
38	India	MAC, DTA
39	Indonesia	MAC, DTA
40	Ireland	MAC, DTA
41	Isle of Man	MAC, TIEA
42	Italy	MAC, DTA
43	Japan	MAC, DTA
44	Jersey	MAC, TIEA
45	Kazakhstan	MAC
46	Korea	MAC, DTA
47	Latvia	MAC
48	Lithuania	MAC
49	Luxembourg	MAC
50	Malaysia	DTA
51	Malta	MAC
52	Mauritius	MAC

	Jurisdiction	Type(s) of agreement
53	Mexico	MAC, DTA
54	Moldova	MAC
55	Montserrat	MAC
56	Netherlands	MAC, DTA
57	Nigeria	MAC
58	Norway	MAC, DTA
59	Papua New Guinea	DTA
60	Philippines	*MAC(S, NiF),* DTA
61	Poland	MAC, DTA
62	Portugal	MAC
63	Romania	MAC
64	Russian Federation	MAC, DTA
65	Samoa	DTA
66	San Marino	MAC, *TIEA(S, NiF)*
67	Saudi Arabia	MAC
68	Seychelles	MAC
69	Singapore	MAC, DTA
70	Sint Maarten	MAC, TIEA
71	Slovak Republic	MAC
72	Slovenia	MAC
73	South Africa	MAC, DTA
74	Spain	MAC, DTA
75	Sweden	MAC, DTA
76	Switzerland	*MAC(S, NiF),* DTA
77	Taiwan	DTA
78	Thailand	DTA
79	Tunisia	MAC
80	Turkey	*MAC(S, NiF),* DTA
81	Turks and Caicos Islands	MAC, *TIEA(S, NiF)*
82	Ukraine	MAC
83	United Arab Emirates	DTA
84	United Kingdom	MAC, DTA
85	United States	DTA, MAC, FATCA
86	Viet Nam	DTA

20 New Zealand presently has agreements that provide only for information to be exchanged *upon request* with the following jurisdictions:

	Jurisdiction	Type(s) of agreement
1	Cook Islands	TIEA
2	Hong Kong	DTA
3	Marshall Islands	TIEA
4	Niue*	*MAC(S, NiF)*, TIEA

**It should be noted that, while the TIEA with Niue provides only for exchange on request, Niue has signed the Multilateral Convention which provides for information to be exchanged spontaneously and automatically. The Cook Islands and the Marshall Islands have signalled their intentions to sign the Multilateral Convention.*

21 New Zealand has agreements that are not yet in force with the following jurisdictions:

	Jurisdiction	Type(s) of agreement
1	Andorra	*MAC(S, NiF)*
2	Bahamas	*TIEA(S, NiF)*
3	Barbados	*MAC(S, NiF)*
4	Brazil	*MAC(S, NiF)*
5	Bulgaria	*MAC(S, NiF)*
6	Dominica	*TIEA(S, NiF)*
7	El Salvador	*MAC(S, NiF)*
8	Gabon	*MAC(S, NiF)*
9	Guatemala	*MAC(S, NiF)*
10	Israel	*MAC(S, NiF)*
11	Jamaica	*MAC(S, NiF)*
12	Kenya	*MAC(S, NiF)*
13	Liechtenstein	*MAC(S, NiF)*
14	Monaco	*MAC(S, NiF)*
15	Morocco	*MAC(S, NiF)*
16	Saint Christopher and Nevis	*TIEA(S, NiF)*
17	Saint Vincent and the Grenadines	*TIEA(S, NF)*
18	Senegal	*MAC(S, NiF)*
19	Uganda	*MAC(S, NiF)*
20	Uruguay	*MAC(S, NiF)*
21	Vanuatu	*TIEA(S, NiF)*

Appendix 8: OECD'S Harmful Tax Practices Work

Source: Inland Revenue Department.

Summary

1 In May 1996, OECD and G7 Ministers called upon the OECD to 'develop measures to counter the distorting effects of harmful tax competition on investment and financing decisions and the consequences for national tax bases, and report back in 1998'. In response to the Ministers' request, the OECD's Committee on Fiscal Affairs launched its project on harmful tax competition (subsequently renamed as 'harmful tax practices').

2 The Forum on Harmful Tax Practices (FHTP) was created in 1998 as a sub-committee of the OECD's main tax committee, the Committee on Fiscal Affairs. This work initially focused on two areas – harmful preferential regimes of OECD member and non-member countries, and tax havens.

3 In 2000, jurisdictions meeting the FHTP's 'tax haven' criteria were identified and asked to make commitments to meet OECD standards, and to enter into tax information exchange agreements (TIEAs). The OECD subsequently published a blacklist of uncooperative jurisdictions in 2000.

4 In 2001, the work of the FHTP changed to focus mainly on the exchange of information ('EOI') and transparency[133] rather than on preferential regimes.

5 After the global financial crisis, in 2009 the G20 Leaders urged all jurisdictions to commit to EOI and transparency.

6 Following this, the OECD's work on Harmful Tax Practices was significantly restructured. A new OECD working party (Working Party 10) was formed to design policy for transparency and EOI. Further, the implementation of transparency and EOI work was transferred from the FHTP to the Global Forum on Transparency and Exchange of Information for Tax Purposes.

7 The FHTP continued, but its work solely focused on harmful preferential regimes of OECD countries.

8 A key output of work of the Working Party 10 and the Global Forum was the upgrading of the OECD Multilateral Convention in 2010, and opening the Convention to all countries. This very significantly moved forward the OECD's work on EOI. (Previously, EOI required countries to enter into bilateral tax treaties, which was a slow and costly process.)

9 More recently, as a result of the OECD's BEPS Action Plan (specifically in Action 5 *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance*), the OECD will require the FHTP to revamp the work on harmful tax practices. There is renewed priority and focus on requiring substantial activity (using the 'nexus' approach) for any preferential regime and on improving transparency, including spontaneous exchange on rulings related to preferential regimes.

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133 Transparency refers, in particular, to the availability of information and access to it by regulatory authorities. Exchange of information involves the regulatory authorities exchanging that information with jurisdictions to which it is relevant for tax purposes.

10 It should be noted that the term 'tax haven' as defined by the OECD is now of more historic significance, as all countries meeting the 1998 tax haven criteria have committed to EOI and transparency measures.

11 New Zealand has supported and continues to support OECD's work in this area. New Zealand officials are active contributors.

12 New Zealand's tax rules were assessed by the FHTP (in 2000 and 2012) and none were identified as preferential.

1998 OECD report on harmful tax competition

13 The OECD released a report in 1998 *Harmful Tax Competition: An Emerging Global Issue* (the '1998 report').[134] The 1998 Report set out factors which would-

a) identify whether a jurisdiction was a tax haven, and

b) identify 'preferential regimes' in OECD and non-OECD jurisdictions.

Preferential regimes

14 This work included setting out four key factors and eight other factors used to determine whether a preferential regime was within the scope of the FHTP.

15 The four key factors are-

a) The regime imposes no or low effective tax rates on income from geographically mobile financial and other service activities.

b) The regime is ring-fenced from the domestic economy.

c) The regime lacks transparency (for example, the details of the regime or its application are not apparent, or there is inadequate regulatory supervision or financial disclosure).

d) There is no effective exchange of information with respect to the regime.

16 The eight other factors are-

a) an artificial definition of the tax base

b) failure to adhere to international transfer pricing principles

c) foreign-source income exempt from residence country taxation

d) negotiable tax rate or tax base

e) existence of secrecy provisions

f) access to a wide network of tax treaties

g) the regime is promoted as a tax minimisation vehicle

h) the regime encourages operations or arrangements that are purely tax-driven and involve no substantial activities.

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134 The 1998 report was followed by four progress reports (in 2000, 2001, 2004 and 2006).

Tax havens

17 The 1998 Report also set out the four key factors used to define 'tax havens'-

a) *No or only nominal taxes*

No or only nominal taxation on the relevant income is the starting point to classify jurisdiction as a tax haven

b) *Lack of effective exchange of information*

Tax havens typically have in place laws or administrative practices under which businesses and individuals can benefit from strict secrecy rules and other protections against scrutiny by tax authorities thereby preventing the effective exchange of information on taxpayers benefiting from the low tax jurisdiction.

c) *Lack of transparency*

A lack of transparency in the operation of the legislative, legal or administrative provisions is another factor in identifying tax havens.

d) *No substantial activities*

The absence of a requirement that the activity be substantial is important since it would suggest that a jurisdiction may be attempting to attract investment or transactions that are purely tax driven.

22 Further work included the development of detailed application notes on the above factors. In 2004 these notes were consolidated and published as a 'Consolidated Application Note'.

23 As noted above, further work also included the development of a List of Uncooperative Jurisdictions comprised of jurisdictions meeting the tax haven criteria that chose not to eliminate their harmful tax practices. The OECD website notes that the fourth factor above – 'no substantial activities' – was not considered when determining whether a jurisdiction was cooperative. Thus, in order to avoid being listed as an uncooperative tax haven, jurisdictions which met the criteria were asked only to make commitments to implement the principles of transparency and EOI for tax purposes.[135]

24 That is, the key focus of the work related to improving transparency and EOI. This reflects the key modification made to the project in 2001.

Forum on Harmful Tax Practices and the Global Forum

25 The Forum on Harmful Tax Practices was created following the OECD's 1998 Report. As mentioned above, this work initially focused on two areas – tax havens and preferential regimes.

26 Given that jurisdictions classed as tax havens had no representation at the FHTP, the dialogue with those jurisdictions was increasingly carried out by the Global Forum on Taxation[136] (Global Forum).

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135 http://www.oecd.org/tax/transparency/frequentlyaskedquestions.htm#howistaxhavenidentified

136 Renamed the Global Forum on Transparency and Exchange of Information for Tax Purposes in September 2009.

27 The Global Forum is the continuation of a forum which was created in the early 2000s in the context of the OECD's work to address the risks to tax compliance posed by uncooperative jurisdictions. The original members of the Global Forum consisted of OECD countries and jurisdictions that had been identified as needing to implement the international standards on transparency and exchange of information for tax purposes. The Global Forum was restructured in September 2009 in response to the G20 call to strengthen implementation of these standards. (It is now an international organisation in its own right, albeit formed under the auspices of the OECD.)

28 The Global Forum now has 127 members on equal footing and is the main international body for ensuring the implementation of the internationally agreed standards of transparency and EOI in the tax area. Through an in-depth peer review process, the restructured Global Forum ensures that its members fully implement the standard of transparency and exchange of information they have committed to implement.

29 In 2009, the OECD also decided to restructure the bodies responsible for EOI by creating Working Party No. 10 on Exchange of Information and Tax Compliance to take over the responsibilities of Working Party No. 8 on Tax Avoidance and Evasion, as well as the policy role on EOI matters previously undertaken by the FHTP.

BEPS Action 5

30 Work on Harmful Tax Competition is a continuing focus, with this work included in the BEPS Action Plan – specifically in Action 5 *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance*. The FHTP is required to revamp the work on harmful tax practices – there is renewed priority and focus on requiring substantial activity for any preferential regime (using the 'nexus' approach[137]) and on improving transparency, including spontaneous exchange on rulings related to preferential regimes.

31 The FHTP delivered an initial progress report in 2014. This was incorporated into the Action 5 Final Report (2015).

New Zealand's relationship to this work

32 New Zealand is a member of the OECD and committed to the OECD work on harmful tax practices, and the OECD's more recent work on BEPS.

33 After it was established in 1998, the FHTP conducted its first round of reviews of OECD member countries to identify harmful preferential regimes. New Zealand was the only OECD country was confirmed as not having any. In 2011/12 the FHTP undertook a second round of reviews of member countries to identify harmful preferential regimes. After some discussion the FHTP confirmed New Zealand's tax rules were neither preferential nor harmful.[138]

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137 Chapter 4 "Revamp of the work on harmful tax practices: Substantial activity requirement" in OECD (2015), Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 – 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

138 At that time two sets of New Zealand tax rules were tentatively identified as concessionary by the FHTP (insurance rules and film rental rules). However, once IRD provided clarification of how those rules in fact worked, the FHTP confirmed those regimes were neither preferential nor harmful.

34 As noted above, prior to the introduction of the Multilateral Convention (which is now the pre-eminent legal instrument for EOI), jurisdictions meeting the FHTP's 'tax haven' criteria were identified by the OECD and asked to make commitments to meet OECD standards. This included entering into bilateral exchange of information tax treaties (either double tax agreements (DTAs) or tax information exchange agreements (TIEAs)). New Zealand and Australia jointly worked to encourage tax havens to enter into OECD-standard TIEAs with New Zealand and/or Australia.

35 New Zealand officials regularly attend and contribute to relevant international committees and working parties. For example, a New Zealand official was the Vice Chair of Working Party No. 8 on Tax Avoidance and Evasion, Exchange of Information (now replaced by other committees including Working Party No. 10 on Exchange of Information and Tax Compliance), and is now part of the Bureau of Working Party No. 10, which governs the overall strategy of/direction of Working Party No. 10. A New Zealand official is the Coordinator of the UN's Subcommittee on Base Erosion and Profit Shifting Issues for Developing Countries, Vice Chair of Working Party 1 (which deals with tax treaties) and chaired the Focus Group on Action 6 of the BEPS Action Plan (which commenced the work to address abuse of tax treaties).

Appendix 9: New Zealand's Involvement in OECD Bodies and Initiatives

Source: Inland Revenue Department.

	Forum/Group	NZ a member?	NZ actively involved?	Comments
1.	OECD	Yes	Yes	Thirty-four countries are members of the OECD. Taxation forms an important part of the work of the OECD. It is administered by the CTPA (Centre for Tax Policy and Administration), which consists of a number of committees, headed by the Committee of Fiscal Affairs (CFA), and supported by a Secretariat of approximately 400 people. NZ officials attend a number of OECD working parties and forums.
2.	CFA (Committee of Fiscal Affairs)	Yes	Yes	The CFA is part of the OECD. It is the leading global body for setting international standards for tax and oversees the creation and maintenance of publications such as the OECD Model Tax Convention, which forms the basis for more than 3,000 bilateral tax treaties, the Transfer Pricing Guidelines and regular publications such as Revenue Statistics and Taxing Wages, which assist governments in reforming their taxes. The CFA's current work programme is dominated by the BEPS Project and AEOI.
3.	Forum for Harmful Tax practices (FHTP)	Yes	No (NZ monitors progress)	The FHTP is a working party of the OECD's CFA. The FHTP implements measures and proposes further improvements to counter harmful tax practices, and to promote those measures to non-OECD economies.
4.	Working Party 10 on EOI & Tax Compliance	Yes	Yes	Working Parry 10 (WP10) is a working party of the OECD's CFA. A key focus of WP10 is to develop and improve exchange of information and mutual administrative assistance, with a view to improving tax compliance.
5.	Taskforce on Tax Crimes (TFTC)	Yes	Yes	The TFTC is a working party of the OECD's CFA. The TFTC looks at ways to improve cooperation between tax and law enforcement agencies including anti-corruption and anti-money laundering authorities to counter crime more effectively.
6.	Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum)	Yes	Yes	The Global Forum is a separate international organisation from the OECD. It is responsible for improving transparency and quality of information exchanged for tax purposes. One hundred and twenty-seven jurisdictions are members of the Global Forum.

	Forum/Group	NZ a member?	NZ actively involved?	Comments
7.	AEOI Group	Yes	No (NZ monitors progress)	The AEOI Group is a sub-group of the Global Forum. It was set up to establish peer review monitoring and to provide technical assistance to developing countries on implementing AEOI.
8	WGB (Working Group on Bribery)	Yes	Yes	The OECD Working Group on Bribery in International Business Transactions (WGB) is responsible for monitoring the implementation and enforcement of the OECD Anti-Bribery Convention. The Ministry of Justice usually attends WGB meetings, which take place in Paris four times a year. NZ is evaluated by other states periodically and also participates as one of the lead examiners for other states. For example, NZ will be one of the lead examiners for the evaluations of Hungary (2019) and Colombia (2024). NZ will be evaluated in 2020.
9	JITSIC (Joint International Taskforce on Shared Intelligence and Collaboration, formerly the Joint International Tax Shelter Information and Collaboration Network)	Yes	Yes	JITSIC is an initiative of the OECD's Forum on Tax Administration (the Forum on Tax Administration is a forum for tax commissioners from 46 OECD and non-OECD countries). JITSIC brings together 36 of the world's national tax administrations to facilitate the ongoing work of tax administrations in countering abusive tax schemes and tax avoidance structures.

Other comments

Forum/Group/Term	Comments
CRS	The CRS is the Common Reporting Standard – the standard set by the Global Forum for AEOI.
Restructured Global Forum	In 2009 the Global Forum on Taxation was renamed the Global Forum on Transparency and Exchange of Information for Tax Purposes and restructured as an organisation in its own right.
Working Party 8 on Tax Avoidance and Evasion	Restructured in 2009 – now incorporated within Working Party 10.
BEPS Action Plan 5	New Zealand has participated fully in the OECD's BEPS Project and in all related decisions including: ■ the adoption of the Declaration on Base Erosion and Profit Shifting at Ministerial level in May 2013 (the Declaration is a non-binding legal instrument) ■ approval of the BEPS Action Plan in June 2013 ■ the approval of the BEPS final package and its endorsement by the OECD Council of Ambassadors in October 2015. New Zealand is one of 94 countries that has committed to the comprehensive package of BEPS measures and to their implementation. The package contains a mix of treaty recommendations, proposals for domestic law reform, and operational requirements. Four of the measures are mandatory for countries that have made the commitment. Countries' implementation of commitments will be monitored. For NZ BEPS Action Plan 5 requires new minimum standards to be met in exchanges of cross-border rulings and unilateral advance pricing agreements.

Appendix 10: New Zealand's Involvement in Financial Action Task Force Bodies and Initiatives

Source: Ministry of Justice.

	Forum/Group	NZ a member?	NZ actively involved?	Comments
1.	FATF (Financial Action Task Force)	Yes	Yes	Thirty-five countries and two regional organisations are members of the FATF. The FATF is a standard-setting body to promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system. The FATF has developed a series of 40 recommendations that are recognised as the international standard for combating of money laundering and the financing of terrorism and proliferation of weapons of mass destruction. The FATF monitors the progress of its members in implementing the standards through mutual evaluations. NZ officials attend a number of FATF working groups.
2.	GNCG (Global Network Cooperation Group) (part of FATF)	Yes	No (NZ monitors progress)	GNCG includes representatives from all 'FATF-style regional bodies' (FSRBs) and considers issues of relevance across the global network.
3.	ICRG (International Cooperation Review Group) (part of FATF)	Yes	Yes	ICRG is the enforcement arm of the FATF. It considers countries across the global network with strategic deficiencies in their AML regimes and recommends which countries should be listed in the FATF public statements. NZ attends ICRG meetings and has worked with individual countries in the ICRG process (including Indonesia and Papua New Guinea).
4.	PDG (Policy Development Group) (part of FATF)	Yes	Yes	PDG is the policy-setting working group. It was recently tasked with the development of the most recent iteration of FATF recommendations in 2012 and issues guidance and best practice documents on the operation of recommendations in practice. NZ has recently been involved in the development of guidance regarding money transfer businesses and has input into the best practice guide for correspondent banking.

	Forum/Group	NZ a member?	NZ actively involved?	Comments
5.	ECG (Evaluations and Compliance Group) (part of FATF)	Yes	Yes	ECG develops the methodology for use in mutual evaluations and considers individual mutual evaluation reports before they are submitted to the FATF plenary for agreement. NZ participates in the discussion of individual mutual evaluations and has provided experts for four mutual evaluations[139] during the most recent round (as the round is currently underway, this number may increase).
6.	RTMG (Risks, Trends and Methods Group) (part of FATF)	Yes	No (NZ monitors progress)	RTMG has an operational focus and concentrates on typologies and trends for money laundering and terrorist financing. NZ has contributed to recent reports on terrorist financing, but does not routinely attend this meeting.
7.	APG (Asia Pacific Group on Money Laundering)	Yes	Yes	The APG is one of nine FSRBs. At 41 members, it is the largest FSRB in the world. NZ is a founding member of the APG and is currently serving as its co-chair (a two-year term from July 2014–July 2016). NZ is active in the APG, serving as co-chair of its Implementation Issues Working Group, providing technical assistance on key issues (including two regional workshops on targeted financial sanctions) and providing experts for five mutual evaluations[140] in the most recent round (as the round is currently underway, this number is likely to increase).

139 Singapore and the United States as an assessor; Canada and Malaysia as a reviewer.

140 Samoa, Vanuatu, Fiji, Bangladesh and Macao, China.

Appendix 11: New Zealand's Involvement in the Egmont Group of Financial Intelligence Units

Source: Financial Intelligence Unit, New Zealand Police.

	Forum/Group	NZ a member?	NZ actively involved?	Comments
1.	Egmont Group	Yes	Yes	One hundred and fifty-one countries are members of the Egmont Group of FIUs, including New Zealand which was a founding member. The Egmont Group's primary purpose is to facilitate information sharing which is achieved through provision of the Egmont Secure Web communications platform. The Egmont Secure Web is the NZP FIU's main conduit for information sharing with other FIUs. Operationally, the NZP FIU is an active participant in the international FIU information sharing network. The Egmont Group also provides a forum for several working groups to enhance coordination, run cooperative projects and offer technical training and assistance to members.
2.	Heads of FIUs (HoFIU)	Yes	No	The HoFIU is the main decision-making body of the Egmont Group. NZ participation has been limited in recent years as the HoFIU spent several years focusing on administrative issues, which were difficult for NZ to prioritise travel to. Since the Paris attacks, HoFIU has made a policy shift to focus more on emerging strategic matters of interest.
3.	Policy Working Group	Yes	No	The Policy Working Group (PWG) is the main mechanism by which the Egmont Group develops policy recommendations to make to the FATF. NZ has not participated in this group owing to the difficulty in attending meetings.

	Forum/Group	NZ a member?	NZ actively involved?	Comments
4.	Information Exchange Working Group	Yes	Yes	The Information Exchange Working Group (IEWG) focuses on information sharing projects and projects to increase FIU's technical capacity to share information (eg ICT arrangements). Other than day-to-day operational cooperation, the IEWG is the New Zealand FIU's major focus in Egmont- NZ currently serves as the co-chair of the working group (the current chair being Australia) NZ is a core member of the major information exchange project on ISIL funding the Head of the NZ FIU has executive oversite of two further IEWG information sharing projects (law enforcement cooperation with FIUs and business email compromise). IEWG is not currently running projects relevant to the Inquiry's scope, but if Egmont were to conduct work in this space it would be coordinated through this working group.
5.	Asia Pacific Regional Working Group	Yes	No	Egmont runs a regional coordination mechanism. The Asia-Pacific Group is not particularly active other than basic administration for upcoming plenaries. The FIU tends to focus its regional activity through the Asia Pacific Group on Money Laundering (the FSRB) as this allows it to provide assistance to a broader range of government agencies in the Pacific and South East Asia.

Appendix 12: Reputation Rankings

Reputation is an inherently subjective concept, and by its nature does not lend itself well to objective analysis. Further, a country's reputation can vary by criteria. For example, New Zealand may have an excellent reputation for rugby, but perhaps not in another area. Also, of course, reputation varies over time, with a popular anecdote being that a good reputation is hard to earn, but is easy to lose.

The closest indicators available of an objective measure of reputation are the various surveys of opinions on a country's reputation in areas such as government and business integrity and ethics. Below are New Zealand's rankings in some of the better-known reputation indices.

Transparency International's Corruption Perceptions Index (CPI)

The focus of the CPI is corruption of public officials and government entities. The Index ranks countries on a scale from 100 (very clean) to 0 (highly corrupt) based on external surveys and assessments from 13 reputable international organisations.[141]

Rank	2015 Country or territory	Score	2014 Change in score from previous year	Score	2013 Change in score from previous year	Score	2012 Change in score from previous year	Score
1	Denmark	91	▼1	92	▲1	91	▲1	90
2	Finland	90	▲1	89	–0	89	▼1	90
3	Sweden	89	▲2	87	▼2	89	▲1	88
4	New Zealand	88	▼3	91	–0	91	▲1	90
5	Netherlands	87	▲4	83	–0	83	▼1	84

New Zealand currently sits fourth out of 167 countries that are ranked. New Zealand has been in the top four over the past four years as shown above, although its ranking has fallen from first in 2012.

World Bank Ease of Doing Business

2016	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006	Country
1	1	1	1	1	1	1	1	1	1	1	Singapore
2	2	3	3	3	3	3	3	2	2	2	New Zealand
3	4	5	5	5	6	6	5	5	6	6	Denmark
4	5	7	8	8	16	19	23	22	19	20	South Korea
5	3	2	2	2	2	2	2	4	4	4	Hong Kong
6	8	10	7	7	4	5	6	6	5	5	United Kingdom
7	7	4	4	4	5	4	4	3	3	3	United States
8	11	14	13	14	14	18	17	14	14	16	Sweden
9	6	9	6	6	8	10	10	9	9	8	Norway
10	9	12	11	11	13	16	14	13	13	13	Finland

[141] http://www.transparency.org/cpi2015

New Zealand currently ranks second out of 189 countries in the World Bank's Ease of Doing Business rankings. Over the past 10 years it has consistently ranked either second or third in ease of doing business.[142]

Heritage Foundation Index of Economic Freedoms

	Country	Overall	Change
1	Hong Kong	88.6	-1.0
2	Singapore	87.8	-1.6
3	New Zealand	81.6	-0.5
4	Switzerland	81.0	0.5
5	Australia	80.3	-1.1
6	Canada	78.0	-1.1
7	Chile	77.7	-0.8
8	Ireland	77.3	0.7
9	Estonia	77.2	0.4
10	United Kingdom	76.4	0.6

New Zealand currently ranks third in the Heritage Foundation Index of Economic Freedom.[143] It has ranked in the top five each of the past four years. In the commentary for New Zealand under Rule of Law, the Foundation states-

> *New Zealand ranked second out of 175 countries surveyed in Transparency International's 2014 Corruption Perceptions Index. The country is renowned for its efforts to penalize bribery and ensure a transparent, competitive, and corruption-free government procurement system. The judicial system is independent and functions well. Private property rights are strongly protected, and contracts are notably secure.*

The Good Country Index

The Good Country Index uses a number of criteria to determine how much a country contributes to global humanity versus how much it takes away, relative to its size.[144] New Zealand currently sits 10th in the index out of the 125 countries that are ranked. The rankings are-

1 Sweden
2 Denmark
3 Netherlands
4 United Kingdom
5 Germany
6 Finland
7 Canada
8 France
9 Austria
10 New Zealand

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142 http://www.doingbusiness.org/rankings
143 http://www.heritage.org/index/
144 http://goodcountry.org/

Milken Institute – Global Opportunity Index

The Global Opportunity Index ranks countries as attractiveness as a destination for foreign direct investment based on a number of criteria, including quality of regulations and rule of law. Rule of law includes criteria such as contract and investor protection, and quality of regulations including regulations for transparency and protection against corruption. New Zealand ranks fourth overall out of the 136 countries that are evaluated[145]-

1 Singapore
2 Hong Kong
3 Finland
4 New Zealand
5 Sweden
6 Canada
7 Norway
8 United Kingdom
9 Ireland
10 Malaysia

New Zealand ranks first in the sub-category of rule of law and sixth in the subcategory of quality of regulation.

The World Economic Forum's Index on Global Competitiveness

New Zealand ranks 16th in the World Economic Index rankings on Global Competitiveness.[146] However, it ranks third in the sub-category of Ethics and Corruption (with Singapore and Finland being the two countries that rank higher).

Transparency International – Government Defence Anti-Corruption Index

Transparency international has rated the New Zealand Defence Force (NZDF) as the most transparent and the least corrupt in the Asian region. It was the only country to receive an 'A' rating in the region.[147] Transparency International gathers the evidence for the Index and the project is funded by UK defence.[148]

145 http://www.globalopportunityindex.org/opportunity.taf?page=rankings
146 http://reports.weforum.org/global-competitiveness-report-2015-2016/competitiveness-rankings/
147 http://www.transparency.org.nz/docs/2015/Defence-Index-Gives-New-Zealand-A-Crimes-Bill-Passed.pdf
148 http://government.defenceindex.org/#intro

Appendix 13: List of Submitters

Amicorp New Zealand Limited

Jeremy Bowen

Simon Boyce

BusinessNZ

Cavanaugh, Denise

Chartered Accountants Australia and New Zealand

Covisory Trust Services Limited

CPA Australia Limited

Ernst & Young Limited

KPMG

Michael Littlewood

New Zealand Council of Trade Unions

New Zealand Law Society

New Zealand Trustee Companies Association

Olivershaw Limited

PricewaterhouseCoopers

Deborah Russell

Society of Trust and Estate Practitioners

Southwest Trustees Limited

TGT Legal

Transparency International New Zealand Inc.

Trustee Corporations Association of New Zealand Inc.

Williams, Dale A and Clarke, John S

Total 23

Glossary

AEOI	Automatic Exchange of Information, a Global Forum-led initiative for countries to share financial account information of non-residents.
AML	Anti-Money Laundering; Anti-Money Laundering and Countering Financing of Terrorism Act 2009; http://www.legislation.govt.nz/act/public/2009/0035/latest/DLM2140720.html?src=qs
AML/CFT	Anti-Money Laundering/Countering Financing of Terrorism; Anti-Money Laundering and Countering Financing of Terrorism Act 2009; http://www.legislation.govt.nz/act/public/2009/0035/latest/DLM2140720.html?src=qs
Beneficiary	A person entitled to benefit under a **trust**.
CFA	Committee on Fiscal Affairs, the committee of the **OECD** that analyses issues and sets standards relating to tax policy and tax administration.
CRS	Common Report Standard, the standard set by the Global Forum for countries to implement **AEOI**.
DIA	Department of Internal Affairs.
FATCA	Foreign Account Tax Compliance Act, a United States law that has led to the US and other countries sharing financial account information of non-residents.
FHTP	Forum on Harmful Tax Practices, an **OECD** working party under the **CFA**.
FIU	Financial Intelligence Unit, a part of the New Zealand Police.
Foreign Trust	Foreign Trust is defined in the Income Tax Act 2007. It is generally a trust which, for all times in its existence, has not had a settlor who is resident in New Zealand for tax purposes.
Global Forum	Global Forum on Transparency and Exchange of Information for Tax Purposes, responsible for setting the **CRS** for **AEOI**.
ICIJ	International Consortium of Investigative Journalists.
IRD	Inland Revenue Department.
ITA	Income Tax Act 2007; http://www.legislation.govt.nz/act/public/2007/0097/latest/DLM1512301.html?src=qs
JITSIC	Joint International Taskforce on Shared Intelligence and Collaboration, formerly the Joint International Tax Shelter Information and Collaboration Network.

LTC	Look Through Company is defined in the Income Tax Act 2007. It is generally a closely-held company which is not subject to New Zealand tax. Instead, the shareholders are subject to New Zealand tax as if they earned their share of the company's income directly.
Multilateral Convention	An agreement among 94 countries (74 currently in force), including New Zealand, to share tax information.
NFE	Non-Financial Entity, an entity which is not an **RFI**.
OECD	Organisation for Economic Cooperation and Development.
Qualifying Resident Foreign Trustee	Qualifying Resident Foreign Trustee is defined in the Tax Administration Act 1994.
Resident Foreign Trustee	Resident Foreign Trustee is defined in the Tax Administration Act 1994. It is generally a **trustee** of a **foreign trust** who is resident in New Zealand for tax purposes.
RFI	Reporting Financial Institution, an entity required to report financial information of non-residents under **CRS** and **AEOI**.
Settlor	A person who makes a gift of property to a **trustee** to hold in **trust**.
STR	Suspicious Transaction Report, as defined in the Anti-Money Laundering and Countering Financing of Terrorism Act 2009.
TAA	Tax Administration Act 1994; http://www.legislation.govt.nz/act/public/1994/0166/latest/DLM348343.html?src=qs
TCSP	Trust and Company Service Provider.
TFTC	Taskforce on Tax Crimes, an **OECD** working party under the **CFA**.
Trust	An arrangement where a **settlor** gifts property to a **trustee** to manage and hold in accordance with the **trust deed** for the interests of the **beneficiaries**.
Trust Deed	A document which sets out the terms of a **trust**.
Trustee	A person who holds property in **trust** for the purposes of the **trust**.