



## Am I my brother's keeper?

### Snapshot

The Brexit vote's message is that supranational approaches are unwelcome. The New Zealand Government has released three reports which take the view that, for tax and anti-money laundering, a global approach is best.

- The [independent review of New Zealand's foreign trusts](#) proposes significantly expanded disclosure and reporting requirements.
- The [taxation framework for inbound investment](#) (a draft overview) outlines the case for considering the effect on other countries when establishing New Zealand's tax policy settings.
- A [Cabinet Paper](#) covering New Zealand's response to Base Erosion and Profit Shifting (BEPS) confirms interest and hybrid proposals will be consulted on in the second half of the year.

The clear message is that New Zealand needs to remain a good global citizen and a team player. This is not an entirely altruistic position. It benefits New Zealand through reputation and ultimately the tax collected.

The triple release is a mix of the high-level, the detailed and the theoretical. The New Zealand foreign trust recommendations and even the inbound foreign investment tax framework and BEPS reports are likely to directly affect very few.

However, they are an attempt to position New Zealand and its regulatory system. They are all important documents for assessing New Zealand and its future trajectory in a world that responds collectively to perceived problems.

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## What are the reports about?

### Government inquiry into foreign trust disclosure rules

The Government appointed John Shewan to review the adequacy of New Zealand's foreign trust tax rules as a response to the Panama Papers.

His review concludes that New Zealand's disclosure regime is "light handed". The rules may be exploited by those prepared to run the risk that their deeds will not remain hidden. It is therefore possible that New Zealand foreign trusts have been used to hide misbehaviour.

The review considers there is little evidence that the Panama Papers have adversely affected New Zealand's global reputation. Internationally, New Zealand is seen as a responsible global citizen. This is confirmed in reviews by the OECD and others. It states however that the tone of reporting has adversely affected New Zealand's view of their own tax system.

The review's recommendations include:

- More detailed disclosure (e.g. about the settlors, beneficiaries, trustees and any persons effectively exercising control) on establishment of a New Zealand foreign trust;
- Annual returns including financial statements to be provided to Inland Revenue;
- A register of foreign trusts, which is searchable by Government agencies;
- An annual fee of \$500 to cover administration costs of the new regime;
- Early extension of New Zealand's Anti-Money Laundering (AML) laws to lawyers and accountants. AML due diligence and reporting requirements will apply when they establish/administer New Zealand foreign trusts; and
- Providing more and better guidance on how AML requirements apply to trusts.

The review has considered and discarded:

- Removing the income tax exemption for New Zealand foreign trusts. It considers the current rules are principled and acceptable globally. However, if a trust does not comply with the new rules, New Zealand tax would apply;
- Registration of providers of trustee services as the benefits of additional regulation do not outweigh the costs; and
- The application of Automatic Exchange of Information (AEOI) rules, from 1 July 2017 to close the perceived gaps, because that will provide insufficient disclosure in New Zealand.

The disclosure rules are likely to change, but the Government has yet to formally accept Mr Shewan's recommendations. Officials are working through the detail. The Government's response will be given shortly.

### New Zealand's taxation framework for inbound investment

The strong advice to Government, for its consideration of the OECD's BEPS recommendations, has been to bear in mind New Zealand's national interest. The recommendations should not be blindly accepted at the cost of making our tax system less competitive.

The Officials' Issues Paper outlines New Zealand's framework for taxing inbound foreign investment, how those rules have developed, and whether the current policy settings are still appropriate in a post-BEPS world.

**A more company-like disclosure and register regime is justified as New Zealand foreign trusts can be misused for tax avoidance and investment of illegal funds**

**A more extensive regime is required to address AML concerns.**

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Broadly, it concludes that the current taxation of foreign investment through the company and non-resident withholding tax rules, buttressed by the thin capitalisation and transfer pricing rules, is appropriate. This is consistent with the (explicit or implied) conclusions of previous reviews and changes made to New Zealand's anti-avoidance regimes.

The Issues Paper argues though that:

- Designing a tax system for foreign investors who do not pay tax, or who can reduce their New Zealand tax, is detrimental to New Zealand. This is because substituting low taxed investors for tax paying investors reduces New Zealand's national welfare and does not necessarily lower the overall cost of capital to New Zealand or increase investment. However, this assumes that foreign capital needed by New Zealand will be provided by those who do pay foreign tax or who are prepared to pay New Zealand tax. In other words, it relies on there being insufficient tax competition or incentives to send foreign capital elsewhere.
- Relatedly, implementing rules that protect other countries' tax systems is helpful to New Zealand because it reduces the incentive to shift profits generally.

The Issues Paper is to be used for targeted consultation with the private sector on the BEPS trade-offs. It has been released more widely to help with understanding Officials' thinking. It will be finalised and released with consultation documents on New Zealand's response to BEPS.

#### [BEPS update on the New Zealand work programme](#)

The detail of New Zealand's BEPS implementation is covered in a Cabinet Paper. This is effectively a stocktake of measures to date and those to come.

It broadly confirms a number of actions already signalled. What might be described as mechanical items, such as New Zealand's implementation of AEOI and country-by-country reporting, are confirmed with a firmer timeline.

Of the more substantive issues:

- Consultation on measures to address hybrid mismatches and interest deductibility will follow the consultation on the inbound tax policy settings. The Cabinet Paper and the draft inbound investment tax framework document strongly suggest that New Zealand's measures will be consistent with the OECD's recommendations. The tax results for hybrid arrangements and financing are likely to change.
- The OECD recommendations on tax treaty changes (including changes to the transfer pricing guidelines) will be implemented either by New Zealand signing the multilateral instrument for BEPS tax treaty measures by 31 December 2016, or by relevant legislation.

An Officials report on diverted profits taxes and multi-national tax avoidance is being prepared. These taxes have been implemented by the UK and Australia in advance of global implementation of the OECD's recommendations.

#### **Why should you care?**

The triple release is a mix of the high-level, the detailed and the theoretical. The New Zealand foreign trust recommendations and even the inbound foreign investment tax framework and BEPS reports are likely to directly affect very few businesses operating in New Zealand.

**Reducing tax on foreign investment does not improve national welfare or lower the cost of capital.**

**Are there sufficient foreign investors indifferent to paying tax in New Zealand?**

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However, they are an attempt to position New Zealand for its tax and regulatory and enforcement systems. They are important documents for assessing New Zealand and its future trajectory in a global world. They impact all.

## Our view

### New Zealand foreign trusts

For the New Zealand reader, the message is the disclosure rules can be improved but New Zealand's global reputation has not been harmed. For our foreign audience, the message is that non-disclosure and insufficient due diligence due to gaps in existing regulation will no longer be able to be relied upon.

In our view, the report provides an objective assessment of New Zealand's current regime and its deficiencies. We agree that changes are required to the disclosure regime for New Zealand foreign trusts. This will help ensure that New Zealand's reputation as a good global citizen is maintained.

However, there are three matters which require further consideration.

In our view, requiring registration of all foreign trusts with Inland Revenue will extend beyond trusts established in New Zealand (i.e. those with a NZ trustee service provider) for the benefit of non-residents. A foreign trust is currently defined as any trust which has never had a New Zealand resident settlor. The review's recommendations potentially can be read as applying to all such trusts. We expect this to be modified to make the rules workable.

The second is the overlap of the new disclosure requirements with the AEOI rules. Any foreign trust which is a "financial institution" for AEOI purposes will have reporting obligations under both AEOI and the proposed foreign trust disclosure rules. This appears an unnecessary duplication but may not be easily resolved.

The review provided an opportunity to clarify the status of New Zealand foreign trusts for double tax agreement purposes. This opportunity has not been taken.

### Taxing foreign inbound investment and BEPS stocktake

The OECD's BEPS recommendations have a head of steam as New Zealand looks to join the global train. This is not surprising. There is a strong view by Officials and Government that New Zealand needs to be a good global tax citizen.

Both the anticipated hybrid and interest BEPS measures and the settings for taxing foreign inbound investment have the potential to affect access to capital for New Zealand Inc. The Cabinet Paper BEPS stocktake and framework document are detailed and require a considered response and critique.

However, we make four initial comments:

- The BEPS stocktake includes historical changes to New Zealand's tax base. Some pre-date the BEPS project (the "acting together" thin capitalisation changes, for example) or were stated not to be BEPS measures (the changes to NRWT and AIL in the May 2016 Tax Bill). These appear to be "positioning" to support the argument that New Zealand is not soft on BEPS;
- The Cabinet Paper says the OECD recommendations do not deal with the tax problems with the "new economy". This is surprising given that the proposals to change tax treaty definitions are explicitly focused on addressing a number of those problems.

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- The inbound investment tax framework draft continues to assume that gearing to thin capitalisation limits will reduce New Zealand taxable income by an equivalent percentage. That is, gearing to 60% results in a 60% reduction in taxable profit. If that was ever true, it is less so in a low interest rate environment. The draft does say that this is a rough cut but, importantly (as with the BEPS project itself), the draft does not address a key issue. The non-deductibility of dividends means that income sourced from foreign capital is over-taxed. Deductible interest goes some way to redressing the balance.
- The possibility of a diverted profits tax needs to be considered carefully. These rules tend to be uncertain of application and give the tax authority significant powers. This leaves legal disputes as the only means to resolve disagreements. Australia has an Inspector-General of Taxation whose task is to consider how the ATO operates. There is no such safety valve for New Zealand taxpayers. An equivalent safety valve may be desirable.

In short, these reports should not be ignored.

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