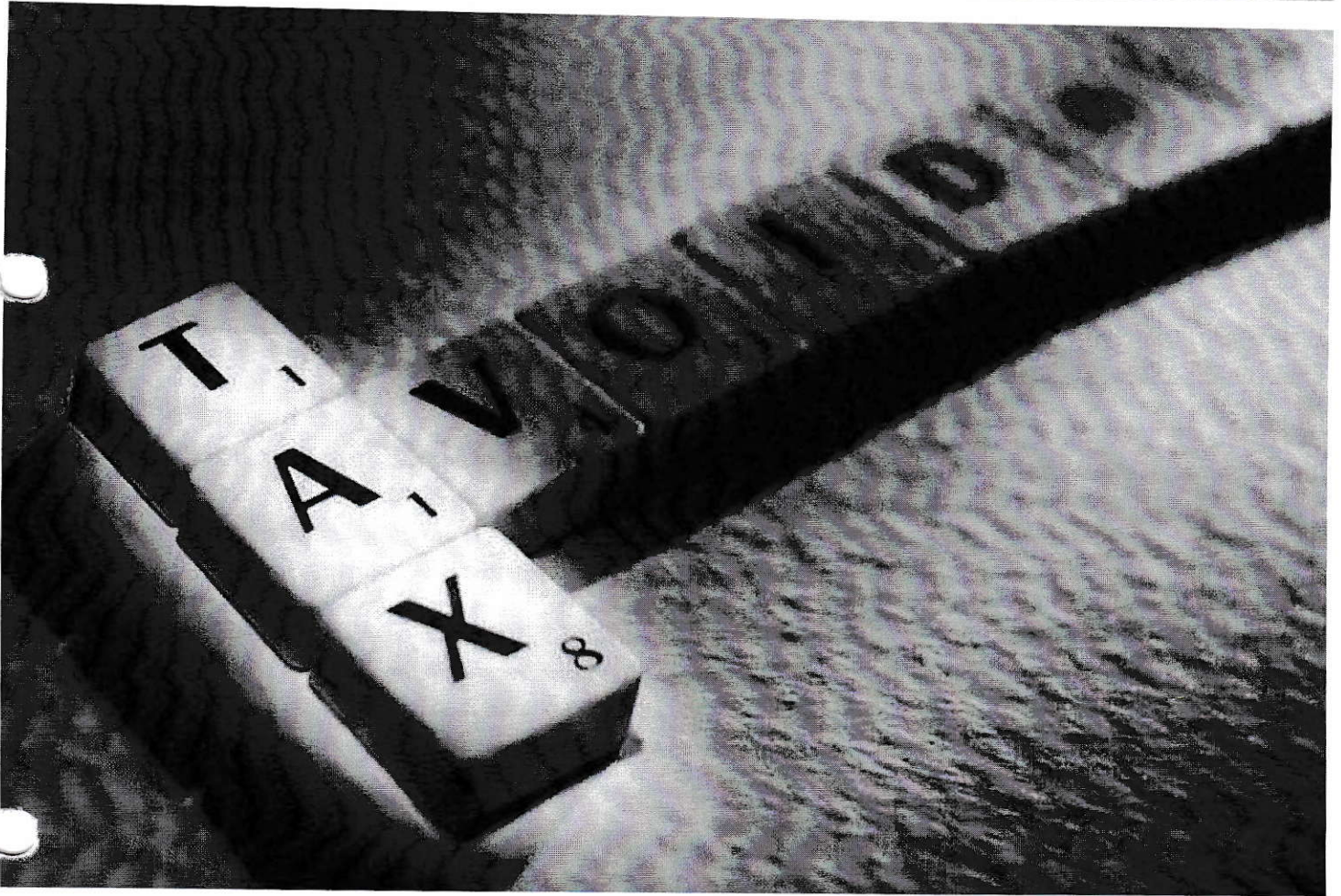




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## Explainer: Is New Zealand a tax haven?



The Panama Papers have ignited a debate about whether New Zealand is a tax haven.

*By Dr Deborah Russell.*

Ever since the Panama Papers shone the spotlight on foreign trusts set up in New Zealand, there has been a debate about whether we are a tax haven. In this article tax specialist Dr Deborah Russell answers all your questions about New Zealand trust law, why we've been accused of being a tax haven, and how to fix the problem.

### What is a 'foreign trust'?

No one ever set out to create a tax haven in New Zealand. Our tax system is largely robust, transparent and fair. There's just this one weird trick that enables a small part of our tax laws to be exploited as a tax haven. It's the laws surrounding foreign trusts.

To be clear, there is no such thing as a "foreign trust" in trust law. There are just trusts. The term "foreign trust" only comes into play when it comes to tax.



New Zealand is interested in taxing trusts because it is interested in taxing income. If a New Zealand resident (technically, a New Zealand tax resident) earns income anywhere in the world, or income is sourced from New Zealand, then we claim the right to tax that income. This is consistent with other countries: like New Zealand, other jurisdictions claim the right to tax income earned by anyone who is tax resident within their country, or any income that is earned from their country, even if it is earned by a non-resident.

The upshot is that if income is earned overseas by a non-resident, then New Zealand is simply not interested in taxing it.

## How does NZ trust law create a loophole?

So how does that apply to trusts? Under New Zealand tax law, trusts are divided into three groups: complying trusts, non-complying trusts, and foreign trusts. We tax each of them based on where the settlor of the trust lives. The settlor is the person or entity that puts property into the trust. This rule was introduced back in 1988, and the objective was to stop New Zealanders from squirreling assets away in trusts overseas. Even if the assets and beneficiaries and trustees are overseas, if the settlor is based here, we tax the trust.

The technical rules for designating an entity as a foreign trust are complicated, and, like our other trusts, they're based on when property was settled in the trust, when income was earned, and when distributions are made. In theory, and in practice, it is possible for a trust to change status, based on those rules. It could be a foreign trust one year, and become a complying trust the next.

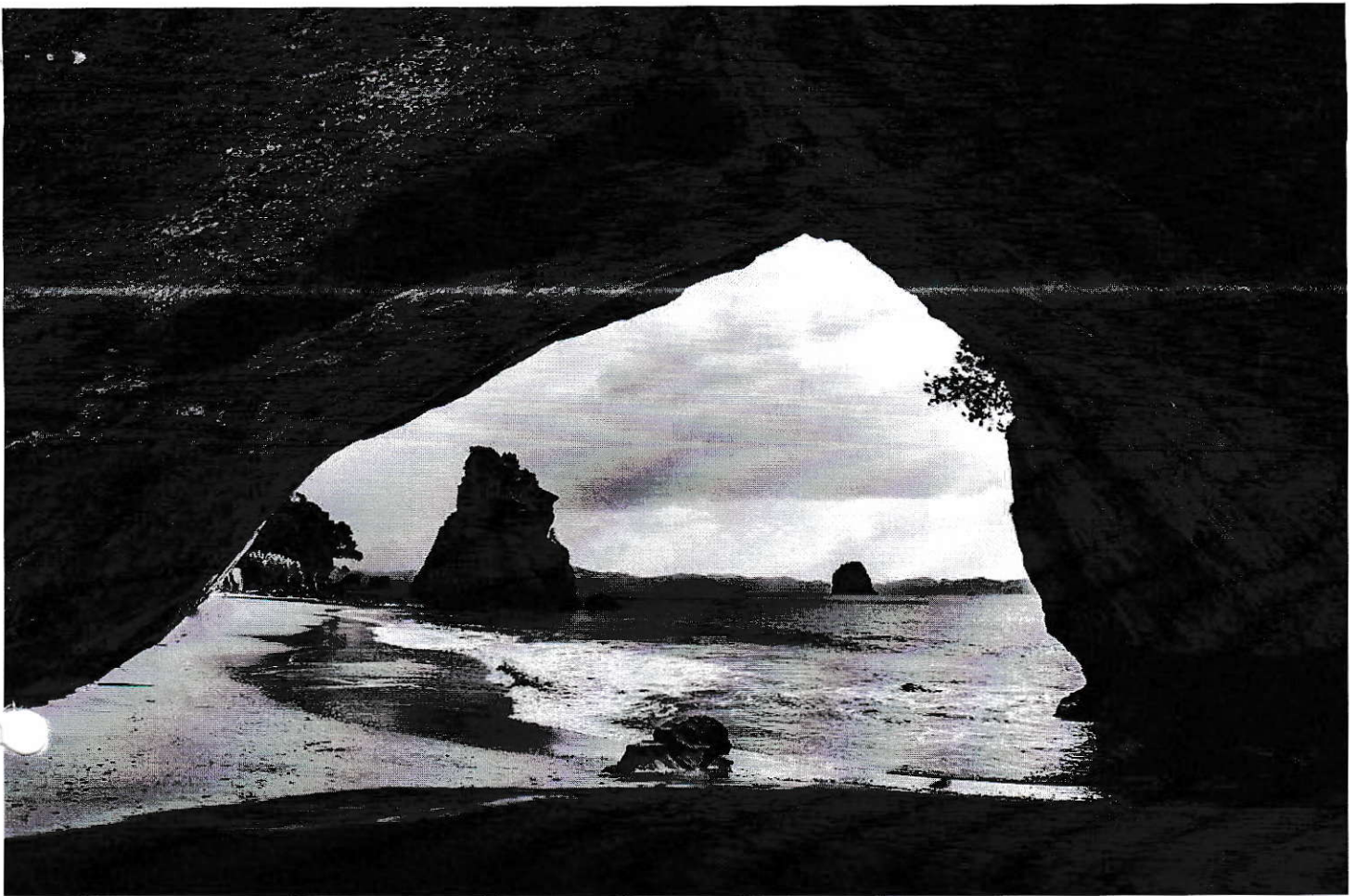
However, in practice, foreign trusts tend to remain foreign trusts. Their settlors are overseas, their beneficiaries are overseas, the assets that are in the trust are overseas. And because all the income is earned by non-residents, and it is earned outside New Zealand, we're not interested in taxing them. That's why foreign trusts don't pay any tax here.

The real problem is our mismatch with other countries. Most other countries tax trusts based on where the trustee lives. From the other country's point of view, even if the settlor and the beneficiaries and all the assets are based in their own country, but the trustee is based overseas, then the trust itself is not taxed. There may be rules for taxing income sourced in that country, and so on, but as a rule of thumb, the trust itself escapes tax, because the trustee is elsewhere.

That's the loophole. New Zealand taxes trusts based on settlors, so foreign trusts with only a trustee based in New Zealand don't get taxed here. Other countries tax trusts based on where the trustee lives, so if the trustee is based in New Zealand, then there's no tax in the other country. The result is that if they are set up right, then New Zealand's foreign trusts can escape tax everywhere. That's the "high quality jurisdiction for trusts with a benign tax system in certain circumstances" that we provide.

But we never set out to provide to create this effect. All we ever tried to do was make sure that we had a consistent set of rules for trusts and other taxpayers in New Zealand. We didn't set out to create a tax haven, we didn't try to set up a foreign trustee industry, we weren't trying to help people to evade their tax.





We may not look like a typical tax haven but, in practice, our tax system does allow people to avoid tax.

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## Should there be foreign trusts at all?

Having “foreign trusts” as part of our tax rules is probably necessary. We need to have some way of differentiating between trusts that we have an entitlement to tax, and trusts that we think we shouldn’t be taxing.

For example, think of a trust that has been set up in say, the United Kingdom, but then the trustee moves to New Zealand. Even though the trustee is now here, we shouldn’t be taxing that trust, based on our principles for which income we think is entitled to tax. So we call it a “foreign trust” to make it clear that it won’t be taxed here.

## Is New Zealand a tax haven?

Are the foreign trust rules a tax haven? That probably depends on what you think a tax haven is. If you think that a tax haven is a country that explicitly sets out to create a benign tax system and enable people to hide assets and minimise taxation, then no, we’re not a tax haven. On the other hand, if you think that intent doesn’t matter, and what really counts is the way the tax system and secrecy rules operate in practice to allow people to avoid and evade tax, then we are a tax haven.

For those that doubt that we are a tax haven, what other explanation is there for New Zealand firms marketing New Zealand as a great place to pay no tax and be confidential about it?

## What is the solution?

Foreign trusts depend on secrecy. Although trustees here are required to keep records, they are not required to proactively file information with Inland Revenue. The only information that Inland Revenue collects each year is the name of the trust and the name of the trustee. In theory, we will collect information for other countries on request, but we don’t go on fishing expeditions, and other countries have to know enough in the first place in order to ask for the information.

There's one exception to this general secrecy around foreign trusts. Inland Revenue collects information about whether there is an Australian resident settlor and who those settlors are, and it discloses this information to the Australian Taxation Office. That means that the ATO has enough information to pursue people who ought to be paying tax in Australia.

The Australian example provides the solution to the tax haven issue. Disclosure. We have no interest in taxing foreign trusts, but other countries do. However they can't tax entities and assets they don't know about. As a minimum, we should be doing exactly what we do for Australia: collecting names of settlors and beneficiaries, and proactively disclosing them to authorities elsewhere. That would shut our foreign trusts tax haven down immediately.

***Dr Deborah Russell is a senior lecturer in taxation at Massey University. She was the Labour candidate for Rangitikei in 2014.***

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