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## NEW DISCLOSURE AND RECORDKEEPING RULES FOR FOREIGN TRUSTS

*Sections HH 4(3BB) and HH 4(3BC) of the Income Tax Act 2004, sections 3(1), 22(2)(fb) and (m), 22(2C), 22(7)(d), 59B, 61(1B), 81(4)(mb), 143(1B), 143(IC), 147(2B) and 147B of the Tax Administration Act 1994*

*This letter is provided in accordance with information of New Zealand Inland Revenue Department and valid on September 2010.*

New disclosure and record-keeping rules have been introduced for foreign trusts in 2006-2008. A New Zealand-resident trustee of a foreign trust (referred to as a "resident foreign trustee") is required to disclose certain information to Inland Revenue and keep financial and other records relating to each foreign trust for New Zealand tax purposes. They are also obliged to provide these records to Inland Revenue, if requested.

Failure to comply with these requirements may result in a resident foreign trustee being subject to sanctions, such as prosecution for knowingly failing to disclose or keep the required information. In certain circumstances, the resident foreign trustee may be taxed in New Zealand on the foreign trust's worldwide income.

All section references in this item are to the Tax Administration Act 1994, unless otherwise stated.

### Background

The new rules will enable New Zealand to meet its exchange of information obligations with its double tax rules will also ensure that New Zealand is better placed to meet its informational obligations as a member of the international community and organisations such as the Organisation for Economic Co-operation and Development (OECD).

Previously, a foreign trust that received a foreign-sourced amount of income was not required to provide information to Inland Revenue or keep records for New Zealand tax purposes about that income. A foreign trust is a trust that is not a unit trust and on each date on which a distribution is made from it, no settlor of it has been resident in New Zealand since the later of 17 December 1987 or the date that the first settlement was made under the terms of the trust.

Information relating to the foreign income of foreign trusts could be requested by foreign tax authorities under the exchange of information provisions in New Zealand's DTAs. As these trusts

were not required to provide information to Inland Revenue, there was a risk that New Zealand was unable to provide foreign tax authorities with the information requested.

While the size of the problem is not readily definable, failure to provide information would have affected New Zealand's relationship with its DTA partners. Australian authorities, in particular, were concerned that foreign trusts were being established in New Zealand to avoid Australian tax.

The OECD has recently developed minimum standards to improve greater transparency and exchange of information between foreign tax authorities and to encourage international cooperation on tax matters. To comply with these standards, New Zealand must be in a position to exchange information on the foreign income of foreign trusts that are administered by New Zealand resident trustees.

### **Key features**

The new rules for resident foreign trustees are contained in the Tax Administration Act 1994 and in new sections HH 4(3BB) and HH 4(3BC) of the Income Tax Act 2004.

- New section 59B requires that resident foreign trustees must disclose specified information relating to the foreign trust to Inland Revenue, including the name or other identifying particulars of the foreign trust; the name and contact details of the resident foreign trustees and 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 individuals who belong to the approved organisation must be disclosed. If a resident foreign trustee has been appointed to make the required disclosure and keep records, the name of that trustee and the names of the appointing trustees; any changes in this information. New sections 22(2)(fb) and (m), 22(2C) and 22(7)(d) require resident foreign trustees to maintain certain financial and other records in New Zealand for at least seven years after the end of the income year to which they relate. These records should enable the financial position of the foreign trust to be determined.
- The records required to be maintained must be provided to Inland Revenue, if requested. Such requests may be made periodically in respect of foreign trusts that have an Australian-resident settlor, and on a case-by-case basis if a valid request for information is received from another country with which New Zealand has a DTA.
- New sections 143(1B), 143 (1C) and current section 143A enable sanctions to apply to resident foreign trustees that knowingly fail to comply with the disclosure and record-keeping requirements.
- New sections 147(2B) and 147B enable sanctions to apply to the directors or other individuals holding positions of influence over the affairs of a corporate trustee if the trustee has knowingly failed to comply with the new rules.
- New sections HH 4(3BB) and HH 4(3BC) of the Income Tax Act 2004 provide that in certain circumstances, resident foreign trustees may be taxed in New Zealand on the worldwide income of the foreign trust, until such time as the requested information is provided.

The new rules apply to resident foreign trustees only. A "resident foreign trustee" is a person who:

- either alone or jointly with another person, acts as trustee of a foreign trust; and
- is resident in New Zealand within the meaning of section OE 1 or section OE 2 of the Income Tax Act 2004.

A resident foreign trustee can be an individual or a corporate body. A trustee of a foreign trust that is registered as a charitable entity under the Charities Act 2005 is specifically excluded from the definition of "resident foreign trustee".

New section 59B requires all resident foreign trustees to provide specific information to Inland Revenue. However, if there is more than one resident foreign trustee, the resident foreign trustees may appoint one of themselves as an agent for the purpose of making the required disclosure.

### **Application date**

The new rules relating to resident foreign trustees apply from 1 October 2006.

### **Information to be disclosed**

The specific information includes:

- the name or other identifying particulars (such as the date of settlement) about the foreign trust;
- the name and contact particulars of the resident foreign trustees;
- whether a settlor is resident in Australia;
- if a resident foreign trustee has been appointed by another resident foreign trustee as an agent to make disclosure and keep records required by the new rules, the name of that trustee and the names of the appointing trustees; and
- any changes in the particulars referred to above.

The collection of this information will assist Inland Revenue to identify the appropriate trustee(s) when information about a foreign trust is requested by one of New Zealand's DTA partners.

Inland Revenue will provide the Australian Taxation Office with information relating to foreign trusts that have a resident foreign trustee and an Australian resident settlor on a regular basis. The requirement to inform Inland Revenue if a settlor of a foreign trust is an Australian resident is intended to ensure that Inland Revenue is in a position to request and provide this information. Australia is the only country to which New Zealand is proposing to provide information on that basis.

### **Timing of disclosure**

The specific information must be provided as follows:

- Resident foreign trustees appointed on or after 1 October 2006 will be required to provide the specific information to Inland Revenue 30 days after the later of the date of the person's appointment as a trustee or the date of the person's arrival in New Zealand.

- Resident foreign trustees appointed before 1 October 2006 will be required to provide the specified information to Inland Revenue 60 days after the later of 1 October 2006 or the date of the person's arrival in New Zealand.

Therefore, in each case a disclosure will not be required until after the resident foreign trustee has arrived in New Zealand.

### **Keeping of financial and other records**

New sections 22(2)(fb) and (m) impose an obligation on resident foreign trustees to maintain certain financial and other records in New Zealand for at least seven years after the end of the income year to which they relate.

If there is more than one resident foreign trustee the resident foreign trustees may appoint one of themselves as an agent for the purpose of keeping the records required by the new rules.

### **Meaning of "records"**

The definition of "records" in section 22(7) has been amended to require 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 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 takes place; and
- 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 describes the accounting system used in each income year in the administration of the trust.

### **Differential record-keeping requirements**

The records outlined above are required to be kept by all resident foreign trustees of foreign trusts that are in business.

Foreign trusts that are not in business are excluded from the requirement to keep information relating to their accounting information system. However, the records relating to the assets and liabilities of the foreign trust and the details of all sums of money received and expended by the trustee relating to the trust are required to be kept and retained. This more limited record-keeping is intended to reduce compliance costs for these trusts while ensuring that they maintain sufficient records to enable the financial position of the trust to be determined with reasonable accuracy.

### **Keeping of records offshore**

Section 22(2) provides that a person who is required to keep records may apply to Inland Revenue for permission to keep records offshore, or in a language other than English. If a resident foreign trustee does not personally hold information relating to a foreign trust's offshore interests, the

trustee may apply to Inland Revenue under this provision and the department may exercise its discretion to allow records to be kept offshore. If records are kept offshore, a trustee will be expected to provide records to Inland Revenue within a reasonable timeframe, if requested.

#### **Keeping of records when no resident foreign trustee**

If a resident foreign trustee leaves New Zealand and no resident foreign trustees remain in New Zealand, the departing trustee can either seek Inland Revenue's approval to keep and retain the records of the foreign trust outside New Zealand, or maintain the records of the foreign trust in New Zealand. It is the responsibility of the departing trustee to ensure that the records are readily available and can be provided at minimal cost to Inland Revenue, if requested.

#### **Sanctions for non-compliance**

##### **Knowledge offence in section 143A**

The main sanction for non-compliance with the new rules is the knowledge offence in section 143A. 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 new rules but was not aware of these rules, sanctions will not apply. As a matter of practice, if Inland Revenue is aware of the name and contact particulars of a resident foreign trustee, it will notify the trustee of his or her tax responsibilities as a trustee of a foreign trust, seek the required information disclosure and outline the recordkeeping requirements. Whether the trustee is aware of his or her tax responsibilities will be a question of fact to be determined on a case-by-case basis, although it can be reasonably assumed that "professional trustees" and those trustees in the business of providing trustee services will be aware of the new requirements.

If a resident foreign trustee has failed to comply with the new 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 section 143A and, if convicted, will be subject to a monetary fine and/or imprisonment.

##### **Sanctions for directors and managers of corporate trustees (new sections 147(2B) and 147B)**

If a corporate trustee has committed an offence under section 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 new section 147B. This will occur if the section 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.

New section 147(2B) clarifies that the section 147B offence is not intended to apply to non-managerial employees of corporate trustees such as clerical staff.

##### **Application of new sections HH 4(3BB) and HH 4(3BC) of the Income Tax Act 2004**

In some cases, if a foreign trustee has been convicted of an offence under section 143A and has not provided the requested information, the world-wide income of the foreign trust will be subject to tax in New Zealand.

The possibility of conviction under section 143A should provide sufficient deterrent for qualifying resident foreign trustees to meet their obligations under the new rules. A successful conviction may lead to disciplinary action being taken by the professional body of which the trustee is a member.

### **Non-application of section 143**

The criminal penalty for failure to disclose information or keep records as required by law in section 143 will not apply to resident foreign trustees if they did not know of the new requirements described above, and/or another resident foreign trustee had been appointed to meet those requirements. It is recognised that had this penalty applied it would have created unfair results, especially for non-professional trustees of family trusts or estates and those trustees who are not in the business of providing trustee services.

New section 143(1B) clarifies that a resident foreign trustee cannot commit an offence under section 143(1)(a) for not keeping books and documents required to be kept under section 22. This will occur if the trustee proves that he or she did not know of the requirements of section 22 and/or that another resident foreign trustee had been appointed as agent of the resident foreign trustees for the purposes of section 22 and Inland Revenue had been notified of the appointment.

New section 143(1C) clarifies that a resident foreign trustee cannot commit an offence under section 143(1)(b) for not disclosing information required to be disclosed under section 59B. This will occur if the trustee proves that he or she did not know of the requirements under section 59B and/or that another resident foreign trustee had been appointed as agent of the resident foreign trustees for the purposes of section 59B and Inland Revenue had been notified of the appointment. Two-year moratorium in applying the new rules in certain cases

New section 59B(3) provides that the disclosure required under new section 59B(1) and (2) and the application of section 22(2)(fb) and (m) is delayed for a period of two years (calculated from the date on which the trustee becomes a New Zealand resident). This delay applies to individuals who have been appointed a trustee of a foreign trust before becoming a New Zealand resident and the trustee:

- becomes a New Zealand resident on or after 1 October 2006; and
- is not in the business of providing trustee services; and
- has not been resident in New Zealand on any day in the period five years that ends immediately before the trustee becomes a New Zealand resident.

A trustee who is still resident in New Zealand at the end of the two-year period will be required to disclose the required information to Inland Revenue and start keeping records for New Zealand tax purposes. There is no ability to extend the two-year moratorium.

### **Requests for information about trusts from other countries**

When a resident foreign trustee indicates that a settlor of a foreign trust is an Australian resident, Inland Revenue will periodically request additional information about the trust (such as financial records, details of distributions to beneficiaries and the identity of the settlor) and provide this information to the Australian Taxation Office.

Information will be provided to other DTA signatory countries on a case-by-case request basis, when Inland Revenue considers that there are valid grounds for requesting the information. Inland Revenue will not entertain general "fishing expeditions" from tax treaty partners for information on foreign trusts, or satisfy requests for information from countries that do not have a DTA or a tax information exchange agreement with New Zealand.

When a valid request for information is received, Inland Revenue will request additional information from the appropriate resident foreign trustee.

Inland Revenue is permitted to require information to be provided under section 17. That section imposes an obligation on persons to provide information that Inland Revenue considers necessary for any purpose relating to the administration or enforcement of the Inland Revenue Acts, or any other lawful function of the Commissioner.

Any information provided by a trustee will be subject to the existing tax confidentiality laws. Section 81 prevents Inland Revenue from providing information to a foreign jurisdiction except as permitted by section 88 such as under a DTA.

#### **Related amendment**

New section 61(1B) provides an exemption from the disclosure requirement in section 61 if the resident foreign trustee has complied with the disclosure requirement in new section 59B.