

23 March 2021

Policy and Regulatory Stewardship
Inland Revenue Department
New Zealand

By email: policy.webmaster@ird.govt.nz

Dear Sir or Madam,

Foreign trust remedials consultation

CPA Australia represents the diverse interests of more than 168,000 members, including over 2,600 members in New Zealand, working in over a 100 countries and regions supported by 19 offices around the world. We make this submission on behalf of our members and in the broader public interest.

The Inland Revenue's (IRD) consultation document on **Foreign Trust Remedials (the Consultation Document)** seeks submissions on the ten proposed remedial changes to the foreign trust disclosure rules, which were enacted in the **Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017**.

The clarifications are welcomed but we express reservations in relation to Issue 1: The definition of "foreign trust" is not aligned with the requirements for the foreign-sourced income exemption in sections CW 54 and HC 26 of the Income Tax Act 2007 (ITA).

The proposed changes will require that a significant number of trusts, currently treated as New Zealand complying trusts regardless of the residence of the settlor, to be registered as a New Zealand foreign trust. This proposed change will create a significant compliance burden. There is also a risk that ordinary New Zealand family trusts default into non-complying trusts if they do not register as a New Zealand foreign trust. We would prefer that the new definition describes a foreign disclosing trust as a trust which is applying the foreign-sourced income exemption instead.

Our responses to selected items in the summary of initial conclusions presented in the Consultation Document are contained in the Attachment.

If you have any queries about this submission, contact Rick Jones, Country Head, New Zealand on +64 21 190 1039 or rick.jones@cpaustralia.com.au or Elinor Kasapidis, Senior Manager Tax Policy on +61 3 9606 9666 or elinor.kasapidis@cpaustralia.com.au.

Yours sincerely,



Dr Gary Pflugrath
Executive General Manager,
Policy and Advocacy



Mr Rick Jones
Country Head,
New Zealand

Consultation questions

Issue 1: The definition of “foreign trust” is not aligned with the requirements for the foreign-sourced income exemption in sections CW 54 and HC 26 of the *Income Tax Act 2007 (ITA)*

Proposed change

IRD’s preferred remedial change is to:

- *Revert to the previous definition of “foreign trust” in section HC 11 of the ITA under which a trust can be a foreign trust in relation to a particular distribution.*
- *Enact a new defined term “foreign disclosing trust” for the purposes of sections HC 26(1)(c) and (d) and the disclosure regime in the TAA. The new definition would set out which trusts must comply with the TAA’s registration and disclosure requirements and should include any trust qualifying for the foreign-sourced income exemption.*

These remedial changes would only apply prospectively.

In determining the tax treatment of distributions made by trustees to beneficiaries, the *ITA* classifies trusts into three main categories:

1. Complying,
2. Foreign, and
3. Non-complying.

A trust is a foreign trust if no settlor is a resident of New Zealand at any time in the period that starts on the later of 17 December 1987 and the date on which a settlement was first made on the trust, and ends when any settlor becomes resident.

A foreign trust that does not have a settlor resident in New Zealand at any point in the income year is able to use the foreign income exemption in sections CW54 and HC26 of the *ITA*.

For a trust to be a complying trust there is a requirement that the trustee satisfies all tax obligations for the trust for every year.

A trust settled by a New Zealand tax resident will be a complying trust unless the trust does not satisfy the income tax obligations of the trustees for every year.

The proposed change, which will apply prospectively, suggests a new defined term of “foreign disclosing trust” for the purpose of sections HC26(1)(c) and (d) and clarifies that all trusts which qualify for the foreign sourced income exemption have to register as a foreign trust.

Trusts which have made an election to be a complying trust, regardless of the residence of the settlor, technically qualify for the foreign-sourced income exemption; therefore, these trusts would be required to register as a foreign trust under the proposed change.

Not registering such trusts as a foreign trust would mean they have not applied the foreign-sourced income exemption, but they would default into a non-complying trust with the effect that any distribution of a capital gain is taxed at a penalty tax rate.

As it currently stands, the proposed changes will require that a significant amount of trusts, currently treated as New Zealand complying trusts regardless of the residence of the settlor, to register as a New Zealand foreign trust. This proposed change will then create a significant compliance burden. Also, there is a risk that ordinary New Zealand family trusts default into non-complying trusts if they do not register as a New Zealand foreign trust.

We recommend that the new definition defines a foreign disclosing trust as a trust which is **applying** the foreign-sourced income exemption instead.

Issue 2: A power to deregister trusts does not explicitly exist

Proposed change

We propose to set out explicitly the circumstances where a foreign trust may be deregistered, and the effect of such deregistration.

Requirements for deregistration

The Commissioner should have the explicit power to deregister a foreign trust where she is satisfied the trust:

- *is no longer a foreign trust*
- *no longer has a New Zealand resident trustee, or*
- *should not have been registered in the first place, as the requirements for registration were not made out.*

The IRD may also wish to consider adding two additional categories for deregistering a foreign trust:

- The foreign trust has been terminated, i.e. when the foreign trust has distributed all of its assets to its beneficiaries, and
- The foreign trust is no longer a New Zealand foreign trust because it now has a settlor who is a New Zealand tax resident

Issue 3: The term “in the business of providing trustee services” is not defined and may be confusing

Proposed change

We propose to replace references to trustees “in the business of providing trustee services” with “professional trustees”.

We agree with the proposed change.

Issue 6: Testamentary trusts do not have trust deeds and cannot qualify for the foreign-sourced income exemption in section CW 54

Proposed change

We propose to allow testamentary trusts to obtain the foreign-sourced income exemption by allowing a will establishing a trust to be treated as a trust deed for the purposes of section HC 26.

We propose to make this change retrospective to 21 February 2017, when the new disclosure requirements came into effect.

We agree with the proposed change.

Issue 8: The Commissioner has no discretion to allow the foreign-sourced income exemption where the foreign trust was not registered at the relevant time

Proposed change

We are considering two ways in which this issue may be fixed. Where the trustee has made reasonable efforts to be registered in time and the other conditions for the exemption are met, either:

- *give the Commissioner a discretion to allow the foreign-sourced income exemption, or*
- *allow the Commissioner to backdate a registration.*

We agree that the Commissioner’s discretion should be used to allow a backdated registration to not to apply the exemption. Such a trust would need to comply with the registration under the Commissioner’s discretion to be able to apply the foreign-sourced income exemption.

Issue 10: References to a minor beneficiary’s age should instead refer to their date of birth

Proposed changes

We propose to replace the references to age in sections 59B(3)(d) and 59D(2)(e) with references to date of birth.

We agree with the proposed change.