Kokay, Nick

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Sent: Friday, 15 October 2021 1:17 pm
To: Kokay, Nick
Cc: Hill, Andrew; Rona.Lemalu@dia.govt.nz
Subject: Re: Review of New Zealand's AML/CFT Act
Attachments: Submission on AMLCFT Act.docx

Kia ora Nick

Submission attached.

Regards

Ngā mihi

Michael

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You can see some of my research on SSRN at:
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SUBMISSION TO THE MINISTRY OF JUSTICE REVIEW OF THE AML/CFT ACT

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INTRODUCTION

1. I am a Professor of Law at the University of Auckland Law School. My principal field of expertise is tax law and tax policy, including international tax, tax planning and tax avoidance. I have published extensively in these areas both in New Zealand and in other countries. I am a fulltime academic but I have also from time to time provided advice to business interests and to the governments of several countries. I make this submission in my personal capacity.
2. My published work relevant to this inquiry includes: Michael Littlewood, "Using New Zealand Trusts to Escape Other Countries' Taxes" (2017) 31 Trust Law International 113-136; Michael Littlewood, "Foreign Trusts, the Panama Papers and the Shewan Report" [2017] New Zealand Law Review 59-90. My work on foreign trusts has also been the subject of several public and private lectures, numerous media statements and several mentions in Parliament.
3. The law relating to money laundering has been greatly improved in recent years, in particular by the enactment and amendment of the AML/CFT Act 2009 and by the beefing up of the disclosure requirements applying to foreign trusts in 2017.
4. There is still however a problem in the law relating to foreign trusts, as evidenced most recently by the so-called Pandora Papers. This is that the law providing for an exemption from tax of foreign trusts established in New Zealand encourages people in other countries to use such trusts for illicit purposes, including money laundering.

THE REVIEW'S TERMS OF REFERENCE

5. This problem might be outside the terms of reference of the current review (since it seems to be confined to the AML/CFT Act). But if the Minister ignores this issue, the Government will fail to achieve its stated objectives of:

    (a) Deterring money laundering; and

    (b) Maintaining and enhancing New Zealand's international reputation; and

    (c) Contributing to public confidence in the financial system.

6. The Review's "guiding principles" include:

    (a) Creating "a financial environment which is hostile to serious and organised crime and national security threats by maintaining and enhancing our ability to detect and deter money laundering"; and

    (b) Facilitating "international collaboration"; and

    (c) Adopting "international best practice".

7. The current tax exemption available to foreign trusts, far from being "hostile" to money laundering, positively encourages it. Far from facilitating international collaboration, the exemption enables persons not resident in New Zealand to escape the AML laws of other countries. The exemption is not "international best practice"; nor do other countries, other than some tax havens, offer such exemptions.

THE PROBLEM

8. The problem, more specifically, is that as the law stands a New Zealand-resident trustee of a foreign trust doesn't have to pay New Zealand tax, so long as:

    (a) the settlor (the person who established the trust) is not resident in New Zealand; and

    (b) the trust's income-generating assets are situated outside New Zealand; and

    (c) none of the beneficiaries is resident in New Zealand.

9. This exemption is provided for by sections CW 54 and HC 26(1) of the Income Tax Act 2007.

10. The exemption is arguably consistent with the basic scope of the New Zealand tax system, which is based on the twin pillars of residence and source. That is, you generally have to pay New Zealand tax if, and only if, either:

    (a) you're resident in New Zealand, or

    (b) you derive income from a source in New Zealand.

11. The current tax treatment of foreign trusts can therefore be justified on the basis that:

    (a) the income belongs to the beneficiaries,

    (b) the beneficiaries are not resident in New Zealand, and

    (c) the income is derived from outside New Zealand.

12. On the other hand, exempting the New Zealand-resident trustees of foreign trusts from tax leaves open the possibility that non-residents might use trusts set up in New Zealand for various dubious or illegal purposes, including money laundering. To what extent, if at all, this has happened since the disclosure rules were tightened up in 2017 is unclear. It appears from media commentary on the Pandora Papers, however, that it is still happening to some extent.

THE SOLUTION

13. It might be a good idea, therefore, to withdraw the exemption, so that the New Zealand-resident trustees of foreign trusts would be liable for tax in the same way as tax is generally imposed on people and companies resident in New Zealand. Taxing foreign trusts would generate little if any revenue, because they would probably all leave. Nor would it stop people resident in other countries from using other tax havens to launder money. But it would eliminate, or, at least, substantially eliminate, their ability to use New Zealand trusts for that purpose.
14. New Zealand's reputation internationally is generally good, but allowing non-residents to set up trusts here without paying tax is likely to damage it, and has probably done so already. The reputational damage might be a price worth paying if the economic activity generated by setting up and administering such trusts were substantial, but it seems unlikely that that is so.
15. At the very least, it would be desirable for the Government to extend the review so as to bring sections CW 54 and HC 26(1) of the Income Tax Act 2007 expressly within its scope. It is possible that those who act as the trustees of foreign trusts and those who advise them might be able to show that the exemption is in the national interest, but it seems unlikely.

QUESTIONS

16. I would be happy to elaborate on this submission and to answer questions about them.

Michael Littlewood

4 March 2022