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Inland Revenue Notification: The application of the Common Reporting Standard to corporate trustees within a professional group (and to the trusts that such companies provide services to)

Introduction

1. The New Zealand Law Society (Law Society) welcomes the opportunity to comment on Inland Revenue Notification: *The application of the Common Reporting Standard to corporate trustees within a professional group (and to the trusts that such companies provide services to)* (Notification).
2. For the reasons set out below, the Law Society disagrees with the preliminary view expressed in the Notification.

Comments

3. The Notification states on page 2 that the definition of 'Investment Entity' includes an attribution test, which considers the nexus between such income and who performs such specified investment activities. Section VIII of The New Zealand CRS Applied Standard sets out the definition of 'Investment Entity' at clause A(6).¹ Clause A(6) provides:

The term 'Investment Entity' means any Entity:

- a) *That primarily conducts as a business one or more of the following activities or operations for or on behalf of a customer:*
 - (i) *Trading in money market instruments (cheques, bills, certificates of deposit, derivatives, etc.); foreign exchange; exchange, interest rate and index instrument; transferable securities; or commodity futures trading;*
 - (ii) *Individual and collective portfolio management; or*
 - (iii) *Otherwise investing, administering, or managing Financial Assets or money on behalf of other persons; or*

¹ <https://www.ird.govt.nz/resources/d/9/d99f167c-2f4b-4b87-bef3-ac56d08d8ee0/nz-crs-applied-std.pdf>

b) *the gross income of which is primarily attributable to investing, reinvesting, or trading in Financial Assets, if the Entity is managed by another Entity that is a Depository Institution, a Custodial Institution, a Specified Insurance Company, or an Investment Entity described in subparagraph A(6)(a).*

4. Clause A(6) goes on to provide as follows:

An Entity is treated as primarily conducting as a business one or more of the activities described in subparagraph A(6)(a), or an Entity's gross income is primarily attributable to investing, reinvesting, or trading in Financial Assets for purposes of subparagraph A(6)(b), if the Entity's gross income attributable to the relevant activities equals or exceeds 50% of the Entity's gross income during the shorter of:

- (i) the three-year period ending on 31 December of the year preceding the year in which the determination is made; or*
- (ii) the period during which the Entity has been in existence. The term 'Investment Entity' does not include an Entity that is an Active NFE because it meets any of the criteria in subparagraphs D(9)(d) through (g).*

This paragraph shall be interpreted in a manner consistent with similar language set forth in the definition of 'financial institution' in the Financial Action Task Force Recommendations.

5. The Notification expresses the preliminary view that the definition of 'Investment Entity' includes an attribution test. We have not been able to identify the source of that test, as it does not appear to be in the Common Standard on Reporting and Due Diligence For Financial Account Information (CRS), the Tax Administration Act 1994 or the Financial Action Task Force Recommendations.² Clause 6(b) refers to income being primarily attributable to certain activities of an entity, but it does not attribute income between entities. Further, that attribution appears only in clause 6(b). There appears to be no attribution test in clause 6(a) which is the category of Investment Entity on which the Notification seeks to rely to categorise corporate trustees of professional firms as being financial institutions.

6. There are a number of attribution tests in the Income Tax Act 2007 in relation to other regimes, most relevantly the attribution rule for income from personal services contained in section GB 27. This rule requires an amount paid to an entity to be attributed to the individual who has actually performed the services for which the consideration is paid. However, there is not an attribution rule in the Income Tax Act 2007 which is applicable to the CRS regime.

7. The two key elements of the attribution rule in section GB 27 are that:

- i) Attribution should only be performed if the services for which consideration is paid are actually performed by the individual to whom the income is to be attributed; and

² <http://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatf-recommendations.html>

- ii) Attribution should only be performed if the consideration which was paid is actually paid in respect of the services performed by the individual, and not for another good or service provided to the payer.
8. In contrast to the two principles outlined above, the preliminary view in the Notification is as follows:

Even though the corporate trustee does not charge, it is a financial institution by virtue of being an investment entity. Its related entity (the firm) is charging the clients for the corporate trustee's services of managing the trust's assets.

The fees are attributable to prescribed activities (services) performed by the corporate trustee for or on behalf of the customer (the trust).

We disagree that a corporate trustee is an investment entity, simply because a related entity (the firm) is charging clients. There needs to be a nexus between the services and the fees charged. The preliminary view appears to propose an attribution of fees to the corporate trustee whether or not the fees in question relate to services performed by the corporate trustee, and whether or not the corporate trustee actually performed those services. This approach does not appear to have a basis in the text of the CRS, or in related domestic legislation, or with reference to an analogous provision in the Income Tax Act 2007.

9. We note that under Section 142H of the TAA there are penalties for failure to meet a requirement under Part 11B (i.e. under The New Zealand CRS Applied Standard). Accordingly, the issue of whether a corporate trustee is a Financial Institution or a Non-Financial Entity is of critical importance to professional firms and others.
10. The Notification cites various examples from other jurisdictions where a corporate trustee acts for various clients of the professional firm in providing trustee services. A common practice in New Zealand is for a private trust company to undertake the trusteeship of a single trust only, and the single purpose may be set out in the company's constitution. It is difficult to conceive of such a single purpose company having a customer, and certainly not customers.
11. If a single purpose corporate trustee, or for that matter a corporate trustee which acts as the trustee of more than one trust, is to be treated as being in business with an imputed income, it is not clear whether such corporate trustee would need to prepare accounts and file a tax return.
12. The Notification refers to 'Related Entity' which is a term used in the New Zealand CRS Applied Standard relating to due diligence and reporting obligations, not financial institution identification.
13. The proposed attribution of business income to a corporate trustee, and particularly to a single trust corporate trustee is, in our view, not supported by the provisions of the CRS or the Financial Action Task Force Recommendations. Application of the proposal in the Notification would distort the ordinary meanings of words where no justification for such distortion exists. There is no need for such distortion, as no circumvention of the CRS is involved in the conventional treatment of a corporate trustee and a trust, having regard to clearly expressed definitions.

14. The Law Society understands that in many cases, no charge is made for the services provided by the corporate trustee, rather charges are sometimes made by professional firms for the provision of partners to director roles or charges are made for specific services provided by the law firm such as the filing of an annual return for the trustee company and other legal advice provided to the trust. The circumstances of each corporate trustee should be analysed carefully and a view taken in the particular case of whether a corporate trustee is a financial institution or a non-financial entity, having regard to the legal definitions of these terms.
15. Many family trusts have an 'in business' investment advisor involved in managing the trust's financial investments, which means that the trust itself would be a financial institution. In such a case the trustee or trustees of the trust would need to ensure that the trust met its financial institution obligations. Where the trust is not managed by an 'in business' investment advisor, the trust would, if it had financial assets, need a bank account. In such a case, the bank (as the maintainer of the trust's account) is the appropriate financial institution to gather any information required in respect of the trust, such as controlling persons for a passive NFE trust. Therefore, adequate CRS disclosure will be made without distorting the language of the CRS to impose an unjustified burden on a corporate trustee which clearly does not meet the definition of 'Investment Entity'.

Further information

16. This submission has been prepared with the assistance of the New Zealand Law Society's Tax Law Committee. If you wish to discuss this further, please contact the committee's convenor, Neil Russ, via the committee secretary, Jo Holland (jo.holland@lawsociety.org.nz / 04 463 2967).

Yours faithfully



Kathryn Beck
President