Tax Tips Alert | 1 November 2021

Show Me The Money: Inland Revenue's new information-gathering powers

Inland Revenue is flexing the Commissioner's new information-gathering powers by requiring detailed financial information from high-wealth individuals and domestic trusts.

Whilst the new reporting requirements for domestic trusts is currently undergoing consultation, both new powers were passed under urgency and without any consultation, scrutiny or Select Committee review that is usually expected for tax legislation under the Generic Tax Policy Process (GTPP). There will be instances where legislation will need to be passed under urgency and minimal consultation can be justified (for example, the increase in personal tax rate to 39% which NZ Labour Party campaigned for at the 2020 election). However, these information gathering powers are not such instances, in particular given their intrusive nature. The recent increased willingness to pass tax legislation without due consultation is a cause for concern as it fundamentally undermines GTPP – an approach that has delivered a wide sense of confidence in the tax system for several decades.

Inland Revenue's research project into high-wealth individuals

In 2019, the Tax Working Group recommended that the Government collect better data on its taxation system, including gaining a better understanding of the profile of capital income, wealth and its owners in New Zealand. In response to this, Inland Revenue (IR) have recently launched the High-Wealth Individuals Research Project to understand the effective tax rates relative to economic measures of income of high-wealth individuals (HWIs). IR has selected and notified around 400 HWIs, estimated to have a net worth of above $20m, to participate in the project. IR have specifically referred to using the power granted by last year's insertion (under urgency) of section 17GB to the Tax Administration Act 1994, compelling those individuals to comply with the subsequent information request.

In this initial notification, IR have signalled that further information requests will follow in three phases, including requests for:

- details of household members, including a "lead person", their partner and any dependent children (November 2021);
- entities, significant assets and business undertakings (such as trusts and companies) that the taxpayer and their partner had interests in (January 2022); and
- financial information required to estimate measures of the income derived by the individuals since the 2016 financial year, including financial information of the entities of which the individuals have an interest in (May 2022).

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IR have stated that the project will "help to create a comprehensive picture of the tax system and ensure future policy development is built on more robust evidence", with a final report to be published in June 2023 – coinciding with the 2023 General Election.

As mentioned above, IR seeks to compel HWIs to provide this information under its newly-bestowed (and seemingly very broad) power to collect information "for a purpose relating to the development of policy for the improvement or reform of the tax system".

To help alleviate taxpayer concerns, IR have confirmed that:

- it will preserve the privacy and confidentiality of all information collected in accordance with the principles in the Privacy Act 2020 (a privacy impact assessment is currently being prepared);
- the information collected will not be shared with IR staff who work in compliance and investigation areas, and will not be used to reassess a HWI's taxable income;
- the information will be destroyed once the final report is published in 2023; and
- the final report will contain aggregated data that will not identify the HWIs.

The intent is that the analysis in IR's report will help inform future tax policy advice. IR's report will not contain any recommendations in relation to future tax changes (for example, the introduction of wealth or capital gains taxes), however it is possible that the report will be used as the basis for campaign policies announced ahead of the 2023 General Election.

New reporting requirements for domestic trusts

With the re-introduction of the 39% personal tax rate, the Government enacted legislation which requires the trustees of most New Zealand domestic trusts to disclose detailed information to Inland Revenue. The rationale is that increased disclosure and transparency in relation to the use of New Zealand domestic trusts will help IR monitor whether trusts are being used to circumvent the 39% personal tax rate, while also gaining better insight into how trust structures are used generally.

The new disclosure rules for New Zealand domestic trusts took effect from 1 April 2021 and have been modelled off the regime introduced for New Zealand "foreign trusts" in 2017, following the Panama papers leak, although there are some key differences between the two regimes.

IR is now consulting on how the New Zealand domestic trust disclosure rules will operate in practice, including the requirements in relation to financial statements. Certain New Zealand domestic trusts will be exempt from the disclosure requirements, including non-active trusts, bare trusts, Māori authorities and charitable trusts.

At a high level, the new rules require trustees of New Zealand trusts (unless excluded) to file an "annual return" comprising:

- a statement of profit or loss and a statement of financial position;
- the amount and nature of each settlement made on the trust in the income year;
- the details of settlors and appointers;
- the amount of every distribution made by the trust (both income and capital distributions), and the details of beneficiaries who receive distributions; and
- any other information required by the Commissioner.

Non-monetary settlements and distributions must also be disclosed, although trustees have the option to disclose the value of non-monetary items as nil.

Comment

Although the basis for both the research project and the new trust disclosure rules is understandable, and the wealth data will be useful for policy development, we question whether such strong information-gathering powers should have been introduced under urgency and without any consultation, scrutiny or Select Committee review that is usually expected for tax legislation in New Zealand under the GTPP.

We agree that in some instances tax legislation should be passed under urgency, such as when its introduction closes a tax loophole or an increase to tax rates that has an electoral mandate, however we consider that the introduction of the powers discussed in this article is not one of those instances. Both powers comprise broad discretion to request information that has historically been private and places a significant compliance burden on the individuals and trustees affected.

The increased enactment of tax legislation under urgency significantly undermines GTPP which has been the envy of many other tax jurisdictions as it has harnessed a collaborative relationship between the private sector and policy makers over almost 30 years. We are concerned about this growing trend and the impact it has on the delicate balance between policy makers and the private sector, and the collaboration that happens currently. In our view, this collaboration helps to encourage voluntary compliance and input from the private sector in developing new tax legislation to ensure it meets policy intent.

On the subject of privacy, there remain questions as to what IR can and cannot do with information gathered as part of the HWI project. Although IR notes that it will preserve the privacy and confidentiality of all information collected, it acknowledges that there may be instances, such as when a foreign tax authority makes an information request under a double tax treaty, where it will be compelled to share this newly-acquired information. This is an example of an issue that could have been addressed through consultation prior to legislation being enacted.

Aside from disclosures made to IR, New Zealand domestic trusts still offer a degree of privacy relative to New Zealand companies and other entities given New Zealand does not currently have a public register of trusts. However, the introduction of the New Zealand domestic trust disclosure rules is part of a broader trend of increased transparency in relation to New Zealand trusts, with the Trusts Act 2019 containing many examples of increased accountability and access to information for beneficiaries.

A number of commentators have questioned whether these new disclosure rules foreshadow the introduction of a 39% tax rate for trusts (to align with the highest personal tax rate). Given IR now has enhanced data and analytics capability following the roll out of its new START computer system, a 39% trust tax rate is a real possibility if there is evidence which suggests widespread use of trusts to circumvent the 39% personal tax rate.

The increased transparency of a trust's affairs means good financial housekeeping is likely to be a key duty of trustees going forward. Trustees should be comfortable that their trust records (including disclosing intra-group debt and transfers of value that are deemed to be settlements under tax law) comply with the new rules. PwC's integrated service offering can assist with experts across the tax, accounting and legal advisory spectrum. If you would like our assistance, please get in touch with us.

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