

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

Background

In broad terms, the Common Reporting Standard (CRS) requires that reporting New Zealand financial institutions:

- carry out due diligence to review their financial accounts to identify accounts held (and/or, in certain circumstances, controlled¹) by foreign tax residents
- collect certain prescribed identity and financial account information about such persons, and
- report this information² to Inland Revenue for exchange with the jurisdiction of tax residence of the account holder (or controlling person).

Inland Revenue has received a number of queries about applying the CRS to corporate trustees operating within a professional group (largely law and accounting firms) to provide trustee and managerial services to trusts who are clients of those professional firms. The queries have focused on the circumstances when corporate trustees (and the trusts they provide services to) will be financial institutions for CRS purposes.

There are four types of financial institutions for CRS purposes:

- investment entity
- depository institution
- custodial institution, and
- specified insurance company.

This guidance will focus on the investment entity type of financial institution, which is the type most likely to be relevant to corporate trustees and trusts.

The scheme of the CRS³ (and the CRS commentary) is clear that corporate trustees and trusts can (depending on the circumstances) be investment entity financial institutions. However, this guidance focuses on the circumstances when this is the case.

Definition of "investment entity" for CRS purposes

An entity will be an investment entity for CRS purposes if either of the following applies:

- The entity primarily conducts as a business (with at least half of its income – 50% or more over the specified period⁴) for or on behalf of customers one or more of a number of specified investment activities. These specified investment activities include "investing, administering or managing financial assets or money on behalf of other persons",⁵ or

¹ This will apply if the account holder is a type of entity known as a passive non-financial entity under Section VIII(D)(8) of the CRS.

² This will be the case if the person is tax resident in a Reportable Jurisdiction or the financial institution otherwise chooses to adopt what is known as the wider approach to reporting (in which case they would report all relevant foreign tax residents they identify).

³ See, for example, sections VIII(B)(1)(e) and VIII(C)(4) of the CRS.

⁴ The "specified period" is the period covering the preceding 3 reporting periods (ended 31 March).

⁵ Such as trading in money market instruments (cheques, bills, certificates of deposit, derivatives etc), foreign exchange, exchange, interest rate and index instruments, transferable securities, commodity futures trading, individual and collective portfolio management, or otherwise investing, administering or managing financial assets or money on behalf of other persons. Refer to the definition of "Investment Entity" a) in the CRS for Automatic Exchange of Financial Account Information in Tax Matters (AEOI) in the CRS at Section VIII(A)(6).

- The entity:
 - derives its income "primarily" (at least half of its income – 50% or more over the specified period⁶) from investing, reinvesting or trading in financial assets, and
 - is managed by another financial institution (other than a managed investment entity).⁷

The definition of investment entity also refers to the Financial Action Task Force Recommendations (FATF recommendations), which underpin New Zealand's Anti-Money Laundering regime, and is based on looking at the nature of the activities that the entity performs (ie an activity based focus), as opposed to a narrow focus of what entity within a group of entities may receive the payment for such activities.

For example, under the FATF recommendations:

- An entity performing individual portfolio management/custodial services for customers would still be a financial institution under the FATF recommendations even if another entity within the group received the remuneration for those services for matters of administrative convenience, and
- An entity performing collective portfolio management services for customers would still be a financial institution under the FATF recommendations even if another entity within the group received the remuneration for those services for matters of administrative convenience.

Therefore, it is a principle underpinning the definition of investment entity – which needs to be read in accordance with the FATF recommendations – that an entity that would otherwise be a financial institution because of the activities/services that it carries out would not cease to be a financial institution simply if another group entity receives the fees for those services for matters of **administrative convenience**.

We also note that New Zealand introduced the CRS (and the related CRS commentary) into New Zealand law with the purpose of participating in a globally consistent approach to the application of CRS due diligence, reporting, and exchange of information requirements. Similarly, the CRS commentary itself emphasises the importance of jurisdictions interpreting fundamental parts of the CRS consistently, so that there is a consistent and 'level playing field' amongst Participating Jurisdictions.

For example, page 16 of the CRS booklet (which includes the CRS and the CRS commentary) states that:

"For each section of the Model CAA and the CRS, **there is a detailed Commentary that is intended to illustrate or interpret its provisions**. The Commentaries are contained in Part III of the Report. **Given that implementation will be based on domestic law, it is important to ensure consistency in application across jurisdictions to avoid creating unnecessary costs and complexity for financial institutions in particular those with operations in more than one jurisdiction**. For certain limited situations alternatives are provided for in the Commentaries (Emphasis added)."

Similarly, page 176 of the CRS commentary states (albeit in relation to a different technical issue) that in adopting domestic guidance:

"care should be taken to address any inconsistencies that may arise in a cross border context...so that the **guidance** does not frustrate the purposes of the Common Reporting Standard (Emphasis added)."

The global approach taken by jurisdictions implementing the CRS (known as Participating Jurisdictions) has been to read the reference to "primarily as a business" in the definition of

⁶ The "specified period" is the period covering the preceding 3 reporting periods (ended 31 March).

⁷ Refer to definition of "Investment Entity" (b) in the CRS at Section VIII(A)(6).

investment entity (and a conceptually similar reference in the definition of custodial institution) contextually as covering an entity that performs the specified investment activities that are remunerated, irrespective of what entity within the group receives the payment for such services. This is consistent with the FATF recommendations. We have set out a summary of this global approach in the appendix to this guidance.

This global approach - focusing on the nature of the activities that the entity performs and the remuneration that is attributable to those activities in determining whether the entity is a financial institution - is further supported by numerous parts of the CRS commentary,⁸ which point to the nature of such activities as determining whether or not an entity is a financial institution, and, indeed, the type of financial institution that the entity is (i.e. the difference between an investment entity and a specified insurance company is based on the **different types of activities that the entity carries out**).

The examples set out below outline Inland Revenue's view of the circumstances when corporate trustees (and the trusts they act for) will be investment entity financial institutions for CRS purposes. These examples:

- align with the global approach to interpreting the language in the definition of investment entity (and a similar conceptual approach to the definition of custodial institution), and
- are consistent with the background context and purpose underpinning the introduction of the CRS in New Zealand.

Section 185O and Schedule 2 of the Tax Administration Act 1994 (TAA) have also been amended to clarify the application of the CRS to a financial institution that is an *Investment Entity* or *Custodial Institution* for CRS purposes. These amendments are in line with the above guidance.

Examples

The following examples provide guidance about the circumstances when corporate trustees within professional groups (and the trusts that they act for) will come within the CRS definition of financial institution. These examples are also subject to review by the OECD, so are potentially subject to change.

The nature of a payment in this context (for example, whether it constitutes 'trustee fees' and what those fees relate to) will depend on what the payment is "for". This will require a consideration of the particular facts and will not be based simply on the label that is used to describe the payment.

There is also a CRS anti-avoidance provision set out in section 185R of the Tax Administration Act 1994 that could potentially apply to deem a corporate trustee (and the trusts they act for) to be financial institutions if an arrangement is entered into for a person to avoid being a financial institution.

If a corporate trustee or trust is a financial institution, they will generally⁹ have CRS due diligence and (if they have any reportable accounts) reporting obligations. If such entities are not financial institutions, but hold accounts with financial institutions they will have obligations to assist such other institutions with their CRS due diligence.

⁸ For example, page 160 (paragraph 11), page 161 (paragraphs 13 and 14), page 162 (paragraphs 15-16 and 20), and page 165 (paragraphs 20 and 29).

⁹ However, a financial institution trust is able to engage a reporting financial institution trustee to carry out CRS due diligence and reporting on its behalf. The trust – in this context – is then known as a "trustee documented trust", which is a type of Non-Reporting financial institution. It is important to note, though, that if the trustee does not comply with such obligations (i.e. due diligence and reporting obligations), these obligations will then revert to the trust.

Further information about these obligations is set out in the following Inland Revenue guidance:

- **IR CRS Guidance (IR1048)**
- **IR CRS Family Trust Guidance (IR1053)**
- **IR CRS Registration and Reporting User Guide**
- **<http://www.ird.govt.nz/international/exchange/crs/crs-registration-reporting/>**

Example 1

A trust is set up on the advice of a professional firm (for example a law firm or an accounting firm) to their client. That firm's corporate trustee acts as the trustee of the trust.

A trust's income is 100% attributable to investing, reinvesting or trading in financial assets (such as shares and bonds) over the specified period.¹⁰

The corporate trustee acts for the trust (as a business) without itself directly charging any fees. However, its related entity (the firm) charges trustee fees for the corporate trustee's services of investing, administering or managing the trust's assets (i.e. investing, administering or managing financial assets). The firm receives the trustee fees for matters of administrative convenience.

The trustee fees are 100% attributable to investing, administering or managing the trust's financial assets.

Is the corporate trustee a financial institution?

Yes. The trustee fees are primarily attributable (i.e. 50% or more – 100% in this case) to the trustee's services of investing, administering or managing the trust's financial assets and money. Therefore, the trustee is an investment entity financial institution. This is the case even though the firm receives the trustee fees (not the trustee) for matters of administrative convenience.

Is the trust a financial institution?

Yes. The trust is managed by a financial institution (the corporate trustee). The trust's gross income is also primarily attributable (50% or more – 100% in this case) to investing, reinvesting or trading in financial assets (such as shares and bonds) over the specified period. Therefore, the trust is an investment entity financial institution.

Example 2

The facts are the same as example 1, except that there is no charge for the corporate trustee's services (i.e. no trustee fees).

Is the corporate trustee a financial institution?

No. There are no trustee fees (i.e. the corporate trustee is not remunerated). Therefore, the corporate trustee can't be a financial institution.

Is the trust a financial institution?

No. This is because the trust is not managed by a financial institution (i.e. the corporate trustee is not a financial institution). [Please note, however, that the trust would still be a financial institution if it was managed by some other financial institution].

¹⁰ The "specified period" is the period covering the preceding 3 reporting periods (ended 31 March).

Example 3

A trust is set up on the advice of a professional firm (for example a law firm or an accounting firm) to their client. That firm's corporate trustee acts as the trustee of the trust.

A trust's income is 50% attributable to investing, reinvesting or trading in financial assets (such as shares and bonds) over the specified period.¹¹ The other 50% of the trust's income is attributable to rental from an investment property (a non-financial asset) over the specified period.

The corporate trustee acts for the trust (as a business) without itself directly charging any fees. However, its related entity (the firm) charges trustee fees for the corporate trustee's services of investing, administering or managing the trust's assets (i.e. investing, administering or managing financial assets) and administering/managing the investment property. The firm receives the trustee fees for matters of administrative convenience.

The trustee fees are 50% attributable to investing, administering or managing the trust's financial assets. The other 50% of the trustee fees are attributable to investing, administering, or managing the investment property (a non-financial asset).

Is the corporate trustee a financial institution?

Yes. The trustee fees are primarily attributable (50%) to the trustee's services of investing, administering or managing the trust's financial assets and money. Therefore, the trustee is an investment entity financial institution. This is the case even though the firm receives the trustee fees (not the trustee) for matters of administrative convenience.

Is the trust a financial institution?

Yes. The trust is managed by a financial institution (the corporate trustee). The gross income of the trust is also primarily attributable (50%) to investing, reinvesting or trading in financial assets such as shares and bonds) over the specified period. Therefore, the trust is an investment entity financial institution.

Example 4

A trust is set up on the advice of a professional firm (for example a law firm or an accounting firm) to their client. That firm's corporate trustee acts as the trustee of the trust.

A trust's income is 50% attributable to investing, reinvesting or trading in financial assets (such as shares and bonds) over the specified period.¹² The other 50% of the trust's income is attributable to rental from an investment property (a non-financial asset) over the specified period.

The trust was set up on the advice of a professional firm (for example a law firm or an accounting firm) to their client and that firm's own corporate trustee is the trustee of the trust.

The corporate trustee engages a financial institution provider of discretionary investment management services (a DIMS provider) to manage the trust's financial assets (the shares and bonds).

The corporate trustee manages and administers the trust's investment property and carries out general trust administration.

The corporate trustee acts for the trust (as a business) without itself directly charging any fees. However, its related entity (the firm) charges trustee fees for the corporate trustee's services of managing and administering the trust's investment property and carrying out general trust administration. The firm receives the trustee fees for matters of administrative convenience.

The trustee fees are 90% attributable to managing and administering the trust's investment property (a non-financial asset) and providing general trust administration. 10% of the trustee fees are attributable to managing and administering money (including receipt of rental/paying rates and insurance etc) as an incidental part of providing these services.

¹¹ The "specified period" is the period covering the preceding 3 reporting periods (ended 31 March).

¹² The "specified period" is the period covering the preceding 3 reporting periods (ended 31 March).

The DIMS provider is also remunerated (by the trust) for its services of managing the trust's financial assets.

Is the corporate trustee a financial institution?

No. The trustee fees are primarily attributable (90% in this case) to managing and administering the trust's investment property (a non-financial asset) and providing general trust administration.

Therefore, the corporate trustee is not a financial institution.

Is the trust a financial institution?

Yes. The trust is managed by a financial institution (the DIMS provider). The gross income of the trust is also primarily attributable (i.e. 50% or more – 50% in this case) to investing, reinvesting or trading in financial assets (such as shares and bonds) over the specified period. Therefore, the trust is an investment entity financial institution.

Example 5

A corporate trustee is a trustee of a trust whose only asset is a family home.

The trust was set up on the advice of a professional firm (for example a law firm or an accounting firm) to their client and that firm's own corporate trustee is the trustee of the trust.

The trust does not derive any income.

The corporate trustee acts for the trust (as a business) without itself directly charging any fees. However, its related entity (the firm) charges trustee fees for the corporate trustee's services of general trust administration and activities related to the family home (a non-financial asset).

The firm receives the trustee fees for matters of administrative convenience.

Is the corporate trustee a financial institution?

No. The trustee fees are not primarily attributable (50% or more) to specified financial services (such as managing, investing, or administering financial assets or money). Instead, the trustee fees are for general trust administration and activities related to the family home (a non-financial asset).

Therefore, the corporate trustee is not an investment entity financial institution.

Is the trust a financial institution?

No. The trust does not derive any income. Therefore, it cannot be a financial institution.

Disclaimer

The information in this guidance is a high level summary, with some exceptions, to help you understand your obligations under the CRS laws in New Zealand. It does not constitute a ruling or binding legal advice.

This guidance is also subject to review by the OECD, so may be subject to change.

For more information about tax residence and automatic exchange of information, go to:

- **NZ** <http://www.ird.govt.nz/international/exchange/crs/crs-index.html>
- **OECD** www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/
<http://www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/tax-residency/>

Appendix – Global Approach

U.K. CRS Guidance

Example of Investment Entity:

Paragraph IEIM400780 of U.K. CRS guidance

"Family trust with a corporate trustee – The ABC family trust's gross income is primarily attributable to investing, reinvesting or trading in financial assets. The trust was set up on the advice of a law firm and that firm's own corporate trustee is the trustee of the trust. The corporate trustee acts for the law firm's clients without itself charging any fees to the clients. Even though the corporate trustee does not charge, it is a Financial Institution by virtue of being an Investment Entity. Its Related Entity (the law firm) is charging the clients for the corporate trustee's services of managing assets, the corporate trustee therefore primarily conducts as a business, for or on behalf of a customer, the prescribed activities. This in turn means that the ABC family trust is also an Investment Entity."

Example of Custodial Institution:

Paragraph IEIM400650 of U.K. CRS guidance

"There may be circumstances where an entity holds financial assets for a customer where the **income attributable to** holding the financial assets or providing related financial services either belongs or is otherwise paid to a connected party such as another company in the same group of companies. This may be because the entity holds assets for a customer of a connected party, or simply that any consideration is paid to a connected party, either as an identifiable payment or as one element of a consolidated payment. In that case the attributable income should be taken account of when applying the 20% test (Emphasis added)."

Hong Kong CRS Guidance

Example of Investment Entity:

Paragraph 44(g) of Hong Kong CRS guidance:

"Family trust with a corporate trustee – The gross income of Family Trust-ABC is primarily attributable to investing, reinvesting or trading in financial assets. The trust was set up on the advice of a law firm and that firm's own corporate trustee is the trustee of the trust. The corporate trustee acts for the law firm's clients without itself charging any fees to the clients. Even though the corporate trustee does not charge, it is a financial institution by virtue of being an investment entity. Its related entity (the law firm) is charging the clients for the corporate trustee's services of managing assets, the corporate trustee therefore primarily conducts as a business, for or on behalf of a customer, the prescribed activities. This in turn means that the Family Trust-ABC is also an investment entity."

Example of Custodial Institution:

Paragraph 14 of the Hong Kong CRS guidance:

"14. There may be circumstances where an entity holds financial assets for a customer where the **income attributable to** holding the financial assets or providing related financial services either belongs or is otherwise paid to a connected party such as another company in the same group of companies. This may be because the entity holds assets for a customer of a connected party, or simply that any consideration is paid to a connected party, either as an identifiable payment or as one element of a consolidated payment. In that case the attributable income should be taken account of when applying the 20% test (Emphasis added)."

Canada CRS Guidance

Example of Custodial Institution:

Paragraph 3.12 of Canadian CRS guidance:

"3.12 There can be circumstances where an entity holds financial assets for a customer where the **income attributable to** holding the financial assets or providing related financial services belongs to (or is otherwise paid to) a related entity. For example, the entity could hold assets for a customer of a related entity, or consideration is paid to a related entity, either as an identifiable payment or as one element of a consolidated payment. In such a case, the income should be taken into account when applying the 20% test (Emphasis added)."

Guernsey CRS Guidance

Example of Investment Entity:

Paragraph 4.3.2 of Guernsey CRS guidance:

"Family trust with a corporate trustee – The ABC family trust's gross income is primarily attributable to investing, reinvesting or trading in Financial Assets. The trust was set up on the advice of a law firm and that firm's own corporate trustee is the trustee of the trust. The corporate trustee acts for the law firm's clients without itself charging any fees to the clients. Even though the corporate trustee does not charge, it is a Financial Institution as its related entity (the law firm) is charging the clients for these services, it therefore primarily conducts as a business for or on behalf of a customer the prescribed activities. This in turn means that the ABC family trust is also an Investment Entity."

Seychelles CRS Guidance

Paragraph 4.2.1.3 of Seychelles CRS Guidance:

"Family Trust with a Corporate Trustee – The ABC family trust's gross income is primarily attributable to investing, reinvesting or trading in Financial Assets. The trust was set up on the advice of a law firm and that firm's own corporate trustee is the trustee of the trust. The corporate trustee acts for the law firm's clients without itself charging any fees to the clients. Even though the corporate trustee does not charge, it is a Financial Institution as its related entity (the law firm) is charging the clients for these services, it therefore primarily conducts as a business for or on behalf of a customer the prescribed activities. This in turn means that the ABC family trust is also an Investment Entity."

Cyprus CRS Guidance

Page 24 of Cyprus CRS Guidance:

"Family Trust with a Corporate Trustee – The ABC family trust's gross income is primarily attributable to investing, reinvesting or trading in Financial Assets. The trust was set up on the advice of a law firm and that firm's own corporate trustee is the trustee of the trust. The corporate trustee acts for the law firm's clients without itself charging any fees to the clients. Even though the corporate trustee does not charge, it is a Financial Institution as its related entity (the law firm) is charging the clients for these services, it therefore primarily conducts as a business for or on behalf of a customer the prescribed activities. This in turn means that the ABC family trust is also an Investment Entity."

Mauritius CRS Guidance

Page 24 of Mauritius CRS Guidance:

"Family Trust with a Corporate Trustee – The ABC family trust's gross income is primarily attributable to investing, reinvesting or trading in Financial Assets. The trust was set up on the advice of a law firm and that firm's own corporate trustee is the trustee of the trust. The corporate trustee acts for the law firm's clients without itself charging any fees to the clients. Even though the corporate trustee does not charge, it is an FI as its related entity (the law firm) is charging the clients for these services, it therefore primarily conducts as a business for or on behalf of a customer the prescribed activities. This in turn means that the ABC family trust is also an Investment Entity."