UPDATE
OVERSEAS TAXATION

New UK reporting obligations and how they may affect New Zealand

BY **HENRY BRANDTS-GIESEN AND NICK BERESFORD**

New Zealand has long been a favoured destination for British expats, with recent estimates suggesting there are more than 300,000 British citizens living here. Some reports have predicted a further surge in interest as a result of Brexit. Furthermore, many New Zealanders migrate in the other direction but maintain financial connections to New Zealand. In our increasingly globalised world most New Zealand lawyers and accountants will have clients with some connection with the UK.

Many British expats assume their UK tax obligations end the moment they step off the plane in New Zealand. However, in contrast to New Zealand, the UK has a highly complex personal tax regime and has a broad capital gains tax as well as inheritance taxes which apply to both individuals and trusts. UK tax liabilities can often arise in unexpected ways even after an individual has ceased to be resident in the UK for tax purposes. Furthermore, very few New Zealand lawyers and accountants seem to be aware that UK tax obligations may have extraterritorial effect.

The EU's directive and new HMRC reporting obligations

On 26 June 2017 the EU's 4th Anti-Money Laundering Directive (4AMLD) was implemented into UK law by the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (the Regulations).

The Regulations update the UK's existing Anti-Money Laundering regime. In doing so, they introduce new beneficial ownership reporting requirements for trusts which are subject to UK taxation. The reporting aspects of the Regulations have extraterritorial effect as they purport to apply regardless of where the settlor, trustee and beneficiaries are resident for tax purposes.

Affected trustees are required to report a wide range of information to Her Majesty's Revenue and Customs (HMRC). Due to the complexity of the UK tax system, reporting obligations may arise in unexpected ways. There are civil and criminal penalties for non-compliance, and so it is important for New Zealand-based trustees, lawyers and accountants to have an understanding of the circumstances in which UK taxation (and therefore a reporting obligation) arises.

Non-UK trusts and the scope of UK taxation

Trustees of non-UK trusts face an exceedingly difficult task complying with the complexity of UK tax legislation.

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Even before the Regulations were enacted, British expatriates had potential tax liabilities to HMRC. This is because the UK taxes certain transfers of assets to trusts and levies periodic inheritance tax charges on non-UK trusts if the trust holds UK situs assets or the settlor is domiciled in the UK under the common law definition of domicile. In this respect, the UK differs from many other jurisdictions which levy inheritance or estate taxes on the basis of situs of property and/or tax residence.

As a result, non-UK resident but UK domiciled settlors and non-UK trustees can (often unwittingly) be subject to inheritance tax if they own UK situated assets, or if the settlor has retained a UK domicile. UK inheritance tax legislation provides that a UK resident and UK domiciled individual retains a 'deemed' UK domicile for three years following their date of departure from the UK, even if such departure is permanent. Any trusts established during this three year period can be subject to ongoing UK inheritance tax charges.

In addition, some forms of UK source income (including dividends from UK companies) can be taxable to non-resident trustees if the trust has one or more UK resident beneficiaries.

For example, the authors are aware of many situations where new migrants to New Zealand from the UK have purchased a New Zealand home through a trust that they set up shortly after arrival in New Zealand and almost certainly whilst they were still domiciled in the UK for inheritance tax purposes. The Regulations, together with the exchange of financial information facilitated by the Common Reporting Standard, now mean that it is possible that these transactions could come to the attention of HMRC, with potentially very adverse consequences for clients and advisors.

Which trusts must report?

A trust will have a reporting obligation to HMRC in every tax year in which the trustee is liable to pay any of the following taxes in the UK: income tax, capital gains tax, inheritance tax (IHT), stamp duty reserve tax (SDRT), and stamp duty land tax (SDLT).

The following relatively common scenarios will give rise to a reporting obligation:

- Holding UK situated assets in excess of the IHT tax-free threshold (or 'nil-rate band') of £325,000 on the 10-yearly anniversary date of the trust's settlement,
- Distributing UK situated assets to a beneficiary (regardless of the beneficiary's country of residence),
- Purchasing UK situated investments (such as shares in a UK listed company) that give rise to an SDRT liability for the trustee,
- The receipt of UK source interest or dividend income by the trustee where the settlor is non-UK resident, but there are one or more UK resident beneficiaries.

Other perhaps less common scenarios (at least for the type of structures encountered by New Zealand-based trustees) but which will also give rise to a reporting obligation include:

- The receipt of rental income from UK residential property directly owned by the trustee,
- The sale of UK residential property held directly by the trustee, and
- The purchase of UK residential or commercial property that results in the payment of SDLT by the trustee.

What must be reported?

The trustee of a trust with a reporting obligation must provide HMRC with a wide range of information through a newly created online portal, including:

- Name, date of establishment, country of residence and country of administration of the trust, and details of the trustee;
- Name, tax number, address, passport number, and date of birth of the settlor, all current beneficiaries, and all "controlling persons" (including protectors and any other person with the ability to influence the trustee's decisions);
- Description of the class of "potential" beneficiaries (this includes any wishes as to future beneficiaries by the settlor in a Letter of Wishes or other document);
- Details of the trust's worldwide assets including current market values (rather than historic or book values); and
- Details of the trust's legal, financial and tax advisors.

The register containing the information reported to HMRC will be available on request to a limited number of UK law enforcement bodies, including the Financial Conduct Authority, the National Crime Agency, the Serious Fraud Office and the police.

This is narrower than Article 14 of 4AMLD, which suggested the registers maintained by EU member states should be accessible to "persons who are able to demonstrate a legitimate interest" in the information on the register. This raised concerns that the register may be made accessible to investigative journalists or non-governmental organisations. Whether the UK's narrower interpretation will be open to court challenge by parties claiming a legitimate interest will remain to be seen.

What are the deadlines for reporting?

Trustees must report to HMRC by 31 January 2018 (for trusts which are already registered with HMRC for UK tax purposes), or, for trusts which are not already registered with HMRC, by 31 January following the end of the tax year in which the trust was liable to pay UK taxes.

Example 1 – UK situated assets

The Kiwiana Trust is a trust settled by a British citizen following permanent relocation to New Zealand in 2010. A New Zealand law firm's trust company acts as the sole trustee and the class of beneficiaries includes the settlor, the settlor's spouse and their adult children, all of whom are New Zealand resident. The Kiwiana Trust owns a home in Auckland valued at $NZ1.5 million and a portfolio of blue chip UK listed equities valued at £500,000.

In this example, a reporting obligation arises for the trustee if further UK equities are purchased (as SDRT will apply), if the equities are still held at the time of the trust's 10-yearly anniversary in 2020 (as a periodic IHT charge would apply) or if the equities are distributed to a beneficiary (as an IHT 'exit charge' would apply).

Example 2 – Beneficiary moves to the UK

One of the Kiwiana Trust's adult children decides to move to the UK to undertake university study. As the trust now has a UK resident beneficiary, the dividends received from the portfolio of UK equities will become taxable to the trustee at the UK's trust income tax rate of 45%. A reporting obligation arises for the trustee in each year dividends are received for as long as the beneficiary remains UK resident.

Example 3 – UK domicile retained

The Hobbit Trust is settled by a British citizen in December 2007, two months after the settlor relocated to New Zealand. The trust purchased a residence used by the settlor in Wellington for $NZ800,000.

At the time the trust was established, the settlor had not formed the intention to remain in New Zealand permanently and in any case the trust was settled within the three-year period following their departure from the UK. Therefore, the settlor was still British domiciled. As the trust was formed by a British domiciled individual, the trust is subject to the UK's inheritance tax regime on its worldwide assets. In this example, the Hobbit Trust will have a periodic inheritance tax charge in December 2017 and will therefore need to report by 31 January 2019 in respect of the 2017/18 UK tax year.

The settlor may also face separate UK tax liabilities as a result of the settlement of assets on the trust.

Conclusion

The EU's 4th Anti-Money Laundering Directive and the associated UK Regulations can be viewed in the context of an ever-increasing push towards global tax transparency and similar measures are being enacted in other EU member states and indeed globally. As with most tax transparency measures there are implications for personal privacy, duties of confidentiality and legal professional privilege.

Many clients will feel uneasy providing HMRC with information greatly exceeding what may be exchanged under the Common Reporting Standard, and certainly exceeding that which is necessary for HMRC to be satisfied that the trustee is meeting its UK tax obligations. In this regard the Regulations are not dissimilar to the recently imposed New Zealand foreign trust disclosure regime.

As yet, the UK Government has not shown an appetite to introduce a public register of trusts, although this has been floated by sections of the UK and EU bureaucracy. Thankfully, there is also no such suggestion in New Zealand, but it is not inconceivable. Notably, France introduced its own public trust register in 2016 only for this to be declared unconstitutional by the French Constitutional Court on privacy grounds.

The Regulations add another layer of complexity for New Zealand-based trustees, lawyers and accountants who act for clients with UK connections. It is important to understand, at a basic level, the types of scenarios that may give rise to UK taxation. As the Regulations are now law in the UK, trustees should be reviewing their client base to identify trusts which may be at risk of incurring UK tax liabilities and seeking UK advice where appropriate. ■

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UPDATE
PROPERTY LAW

More on the new Land Transfer Act

BY **THOMAS GIBBONS**

MY LAST UPDATE (A NEW LAND TRANSFER ACT, *LAWTALK* 909, August) considered three key issues arising from the Land Transfer Act 2017: the new terminology of "record of title" (RT), the new "manifest injustice" test as an important exception to immediate indefeasibility, and covenants in gross (and the continued role of encumbrances).

This article briefly considers some further issues arising from the new legislation.

Purpose

The purposes and intent of the Torrens system has been debated since, and even before, its inception. It's a good system, and the reasons why it is good are expressly restated.

The Land Transfer Act 2017 (LTA) aims to:

- Continue and maintain the Torrens system in New Zealand;
- Retain the fundamental principles of that system – security of ownership of estates and interests in land, facilitating land dealings, providing compensation, and providing a register of ownership;
- Reflect the electronic nature of the land transfer register and associated dealings;
- By these means, maintain the integrity of title to estates and interests in land.

These purposes are stated in s 3, while s 10 restates the purpose of the register:

- To provide a public record of land subject to the LTA 2017;
- To provide a mechanism for creating title to estates and interests that (subject to the legislation) cannot be set aside;
- To facilitate transfers and dealings with estates and interests in land;
- To facilitate giving effect to the purposes in s 3; and
- To enable compliance.

That is, to achieve the economic aims of our society, we want a public record of land ownership, we want a strong system of "title by registration", and we want it to be easy to deal with land.