eJournal of Tax Research

Volume 15, Number 2 December 2017
(Special Edition: Tax and Corruption Symposium)

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sourced income of non-residents. The issue exists in relation to New Zealand's disclosures, or historical absence thereof, which limit the capacity for most countries' tax authorities to have knowledge of the presence of the foreign trust. This supports the view that, while New Zealand is not facilitating tax evasion in its own country, it is effectively facilitating tax evasion in other jurisdictions. New Zealand's involvement in the international 'Panama Papers' scandal resulted in significant regulatory change in New Zealand, with a rapid inquiry led by one of New Zealand's most well-known tax commentators, with all recommendations subsequently agreed to by the government.

The tax treatment of facilitation payments and of foreign trusts in both cases posed threats to New Zealand's global reputation as a country with low levels of corruption. However, different responses resulted when each of the activities was brought into the public domain. Thus, the focus of this study is on the process of achieving change in the area of tax and corruption.

This article is structured as follows. Section 2 provides a brief background on corruption and the benefits gained when countries are perceived as having low levels of corruption. This section also outlines the relevant provisions of two international conventions that are targeted towards reducing corruption. A brief outline of historical institutionalism, the theoretical framework used for analytical purposes, is provided in section 3. Section 4 describes the New Zealand case study, including how New Zealand is perceived from a corruption perspective, and the two tax activities that are the primary focus of this study: the tax treatment of facilitation payments; and the treatment of foreign trusts. Section 5 outlines New Zealand's responses to possible threats to its reputation as a country with low levels of corruption. Section 6 outlines the lessons that may be learned from New Zealand's recent experience, with an analysis informed by an historical institutionalism lens. The study concludes in section 7.

2. BACKGROUND

There are many advantages gained by a country with a reputation as an honest location

for addressing corruption in international business transactions. Article 1 of the Convention requires countries to take measures 'as may be necessary' to establish a criminal offence under that country's law for any person

> intentionally to offer, promise or give any undue pecuniary or other advantage, whether directly or through intermediaries, to a foreign public official, for that official or for a third party, in order that the official act or refrain from acting in relation to the performance of official duties, in order to obtain or retain business or other improper advantage in the conduct of international business.[17]

The OECD Convention establishes legally binding standards that create an offence where foreign public officials are bribed in international business transactions. While the OECD cannot enforce the adoption of specific legislation in nation states, it does monitor and report on progress subsequent to countries ratifying the Convention. Since its introduction there have been three phases of monitoring nation states against the Convention.

The OECD view on tax deductibility of 'bribes' has changed since the introduction of the Convention. In early publications the OECD recommended that 'those Parties that do not disallow the deductibility of bribes to foreign public officials re-examine such treatment with the intention of denying this deductibility'.[18] The Recommendation of the Council on Tax Measures for Further Combating Bribery of Foreign Public Officials in International Business Transactions, published in 2009, has now moved to recommend that 'member countries and other Parties to the OECD Anti-Bribery Convention explicitly disallow the tax deductibility of bribes to foreign public officials, for all tax purposes in an effective manner'.[19] Moreover, OECD guidance on facilitation payments recommends that member countries

> undertake to periodically review their policies and approach on small facilitation payments in order to effectively combat the phenomenon; [and] encourage companies to prohibit or discourage the use of small facilitation payments in internal company controls, ethics and compliance programmes or measures, recognising that such payments are generally illegal in the countries where they are made, and must in all cases be accurately accounted for in such companies' books and financial records.[20]

The OECD Convention continues to state that it urges 'all countries to raise awareness of their public officials on their domestic bribery and solicitation laws with a view to stopping the solicitation and acceptance of small facilitation payments'.[21] Thus, the signal from the OECD is that facilitation payments are not acceptable in the ordinary course of doing business.

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[17] Ibid art 1, para 1.

[18] OECD Working Group on Bribery in International Business Transactions, 'Review of the OECD Instruments on Combating Bribery of Foreign Public Officials in International Business Transactions Ten Years after Adoption' (Consultation Paper, January 2008).

[19] OECD, *Recommendation of the Council on Tax Measures for Further Combating Bribery of Foreign Public Officials in International Business Transactions*, (2009)64, 25 May 2009.

[20] OECD, *Recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions*, above n 7, para VI.

[21] Ibid para VII.

A further relevant Convention, the UN Convention against Corruption ('*UN Convention*'), was introduced by the UN in 2003. The aim of the UN Convention is

> to promote and strengthen measures to prevent and combat corruption more efficiently and effectively; to promote, facilitate and support international cooperation and technical assistance in the prevention of and fight against corruption, including in asset recovery; to promote integrity, accountability and proper management of public affairs and public property.[22]

The UN Convention has since been signed by 140 countries.[23] In a similar way to the OECD Convention, the UN Convention requires State Parties to adopt legislative and other measures to establish criminal liability for offering bribes to foreign public officials.[24] Like the OECD Convention, the UN Convention also covers the issue of tax deductibility of expenses that constitute bribes and facilitation payments. In relation to bribes the UN Convention states that 'each State Party shall disallow the tax deductibility of expenses that constitute bribes … and, where appropriate, other expenses incurred in furtherance of corrupt conduct'.[25] In relation to facilitation payments, the UN position is noted in other policy documents:

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actual policy choices made.[29] Moreover, HI originally arose from a desire to explain variation, which is the objective of this study.[30] HI highlights a number of influencing factors within the political domain that contribute towards the different actions adopted in each of the scenarios discussed in this study.

HI is pluralist in its methodological approach, which allows for the multiple competing perspectives to be drawn out. HI supports macro-level analysis and seeks to focus on the interactions between multiple institutions and processes. The focus of HI on 'relations between politics, state and society'[31] draws out the politically nuanced scenarios discussed herein. It is a feature of HI that it focuses on a small number of cases that have some commonality,[32] which is relevant for the current study. HI can also assist with emphasising the historical impact of policies and institutions on future policy development[33] which is also relevant to this research.

HI has a number of components that assist with analysis of the two activities investigated in this study. Those that are particularly relevant are:

1. *Path dependency*, which is the idea that extant policy has a continuing or constraining influence over policy into the future.[34] At least in part, path dependency relates to the political risk associated with introducing new policy. HI provides for policy to evolve, with the caveat that a high level of political pressure is required to do so.[35] Reference back to the 'historical' component of HI is needed to track how ideas become embedded in practice. HI suggests that the concept of increasing returns links to path dependency, as policy directions become more difficult to change when they have moved steadily in one direction over time. This then requires a 'critical juncture' to achieve change.

2. *Critical junctures* are defined by Collier and Collier as major transitions in institutional life that shape politics and policy formation into the future; frequently 'the critical juncture is intertwined with other processes of change'.[36] The Panama Papers discovery may be considered as a critical juncture: it was a large event that resulted in meaningful societal impact. Moreover, the event resulted in significant policy change.

3. *Punctuated equilibria*, within the context of HI, involve the expectation that a policy will continue in a state of equilibrium, as determined by decisions made at its origin, or past point of punctuation. However, equilibria are not

[29] Sven Steinmo, 'Historical Institutionalism and Experimental Methods' in Orfeo Fioretos, Tulia G Falleti and Adam Sheingate (eds), *The Oxford Handbook of Historical Institutionalism* (Oxford University Press, 2016) 107.
[30] Ibid.
[31] Ellen M Immergut, 'The Theoretical Core of the New Institutionalism' (1998) 26(1) *Politics & Society* 5, 17.
[32] Kathleen Thelen, 'Historical Institutionalism in Comparative Politics' (1999) 2 *Annual Review of Political Science* 369.
[33] Jacob Torfing, 'Path-Dependent Danish Welfare Reforms: The Contribution of the New Institutionalisms to Understanding Evolutionary Change' (2001) 24(4) *Scandinavian Political Studies* 277.
[34] B Guy Peters, *Institutional Theory in Political Science* (Pinter, 1999) 63.
[35] Ibid 65.
[36] Ruth Collier and David Collier, *Shaping the Political Arena: Critical Junctures, the Labor Movement, and Regime Dynamics in Latin America* (Princeton University Press, 1991) 27.

permanent and are capable of change.[37] Punctuated equilibria highlight that new policies evolve during periods of crisis, with stasis visible during other periods.

4. *Power* is highlighted by HI in emphasising the uneven distribution of power among interest groups. The 'institutional' component of HI shows how institutions allocate power to some interests in the decision-making process. Studies have shown how policies may facilitate the organisation of interests through emphasising the legitimacy of particular claims.[38]

5. *Ideas* are inevitably multiple and competing in tax policy. However, interests and ideas can interact, generating incentives that support certain behaviours and making 'the expression of political views more or less viable for certain groups', thereby impacting on the power held within certain institutions.[39] Perhaps the most important argument is the institutionalisation of certain behaviours, which constrains the potential for new ideas to be conveyed.[40] However, ideas can also help to communicate both the need for change and the form that this change should take. Ideas may also help in communicating the need for change and how this change can be structured. Blyth asserts that 'change can reconstitute those interests by providing alternative narratives through which uncertain situations can be understood'.[41] One example of a dominating idea in the New Zealand context is the 'broad-base, low-rate' approach that is generally adopted in relation to tax policy.

Historical institutionalism is used in this study to highlight the influences on the policy approaches adopted in the two case studies examined in this research. Specifically, the HI approach is used as a framework in section 6 to analyse the path dependency arrangements, punctuated equilibria, power and ideas that are visible in the two case studies discussed in sections 4 and 5.

4. Case study: New Zealand

New Zealand is typically perceived to be a country with low levels of corruption. This is supported by high rankings on many of the well-known surveys on corruption. Perhaps the most well-known measure of corruption is the Transparency International Corruption Perception Index (CPI). This is a global survey that measures the perceived level of public sector corruption across multiple countries. Corruption is measured on a scale from 0 to 100, where 0 is highly corrupt and 100 is not corrupt. Measures for New Zealand over the past five CPI rankings are outlined in Table 1. New Zealand is typically highly ranked by this measure and, while it fell from top position in 2014 and 2015, it returned to be equal first (with Denmark and Finland) in 2016.

[37] Peters, above n 34, 68
[38] Immergut, above n 31, 22.
[39] Peter A Hall, 'The Movement from Keynesianism to Monetarism: Institutional Analysis and British Economic Policy in the 1970s' in Sven Steinmo, Kathleen Thelen and Frank Longstreth (eds), *Structuring Politics: Historical Institutionalism in Comparative Analysis* (Cambridge University Press, 1992) 90, 91.
[40] Ibid.
[41] Mark Blyth, *Great Transformations: Economic Ideas and Institutional Change in the Twentieth Century* (Cambridge University Press, 2002) 38.

Table 1: Corruption Perception Index Rankings and Scores: 2011-2015[42]

	2012	2013	2014	2015	2016
CPI (ranking)	1= (from 176 countries)	1= (from 177 countries)	2 (from 175 countries)	4 (from 168 countries)	1= (from 176 countries)
CPI (score)	90/100	91 / 100	91 / 100	88/100	90/100

It is worth observing that the Transparency International ranking is a perceptions-based index focused on the public sector, rather than an index measuring actual behaviours across a range

A case study method is adopted in this study. The case study method is appropriate when the researcher has no control over the events being examined. Moreover, case studies typically examine phenomenon occurring within a real-life context.[50] The cases selected in this study are chosen as they reflect the underlying problem of potential damage to New Zealand's reputation as an honest jurisdiction in which to do business. Historical and current documents form the primary data source for the analysis, which is guided theoretically by historical institutionalism.

Notwithstanding the sometimes inconsistent results in rankings outlined above and the two case studies discussed in this article, New Zealand should not, as a general rule, be considered a corrupt country. The two case studies that are the topic of this research are selected due to their nature as outliers in a country that is typically considered as incorrupt. The following sub-sections outline these two tax case studies, both of which have attracted national and international criticism: the tax treatment of facilitation payments; and the tax treatment of foreign trusts.

4.1 Tax treatment of facilitation payments and bribes

Under s DB 45(1) of the *Income Tax Act 2007* (NZ) ('*Income Tax Act*'), bribes are not an allowable deduction. However, this is not extended to all bribes; instead, it is bribes given or offered within circumstances specified in ss 101, 102(2), 103(2), 104(2), 105(2), 105C or 105D(1) of the *Crimes Act 1961* (NZ) ('*Crimes Act*'). Moreover, s DB 45(1) does not apply in circumstances specified in s 105C(3) of the *Crimes Act*.

Before examining the specific sections of the *Crimes Act* two observations are necessary. The first is that s DB 45 overrides the General Permission of the *Income Tax Act*. The General Permission is s DA 1, which provides the general rule for deductibility of expenditures or losses, ie, that expenditures or losses must have a nexus with the derivation of income in order to meet the general test for deductibility. The second is the definition of a bribe, which is provided in s 99 of the *Crimes Act* as 'any money, valuable consideration, office, or employment, or any benefit, whether

serious concerns about the lack of enforcement of the foreign bribery offence. Since becoming a Party to the Convention in 2001, New Zealand has not prosecuted any foreign bribery cases. Only four foreign bribery allegations have surfaced. New Zealand opened its first investigations into two of these allegations in July 2013.[53]

foreign trust if it makes any distribution after a settlor becomes a New Zealand resident, or if a New Zealand resident makes a settlement on the trust.[59]

The relevant legislation is ss CW 54 and HC 26(1) of the *Income Tax Act*. Under ss CW 54 and HC 26(1), where foreign-sourced amounts are derived by a trustee who is resident in New Zealand, these amounts are exempt income if no settlor of the trust is a New Zealand resident in the income year. This exemption applies only to trustees, that is, if beneficiaries are New Zealand resident, then income received by beneficiaries is taxed. Where income is sourced in New Zealand it is also taxed as income in the hands of the trustee. Thus, the New Zealand approach to taxing offshore trusts is driven by the principle that non-residents are not taxed on non-New Zealand sourced income. However, it is also possible that this income may be free from tax in the foreign settlor's jurisdiction as a result of New Zealand's approach to taxing foreign trusts.[60]

New Zealand's foreign trust rules were introduced in 1988, together with other international tax reforms. The rules depart from typical international practice of taxing on the basis of the residence of the trustee.[61] It is acknowledged that the difference between the generally accepted international approach and the approach adopted in New Zealand creates an arbitrage opportunity. The rule is designed to protect the New Zealand tax base by restricting the ability of New Zealand residents to place assets in a trust that is managed offshore with non-resident trustees in order to avoid New Zealand income tax on the income of the trust.[62]

New Zealand's approach is premised on the idea that while trustees have legal ownership of the assets, the settlor has the economic power, as the settlor establishes the trust, transfers assets to the trust, appoints the trustees, determines who the beneficiaries are and specifies the terms of the trust deed.[63] It has been suggested that one of the objectives of New Zealand's approach to the tax treatment of trusts is to assist New Zealand in developing an international financial services industry.[64] However, the primary objective was to protect against the use of non-resident trusts by New Zealanders to protect income from New Zealand income tax.

Inland Revenue do not report separately the value of fees collected from foreign trusts; instead they report this in an amount that includes employment income for third party employees and principals for foreign trust provider entities. This is estimated at approximately NZD 24 million per annum.[65] Also disclosed is the tax collected on fee income, goods and services tax, and pay-as-you-earn paid on behalf of third party

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3. options for enhancements to New Zealand's foreign trust disclosure rules.[89]

Not all responses addressed all components of the terms of reference. Nine of the 19 responses to the first point above responded that they believed the current policy settings were fit for purpose, with one submitter choosing not to make their own response and instead concurring with another submitter in this respect. A further submitter did not comment on the extant rules, and instead noted the potential benefits to New Zealand from the presence of foreign trusts.

The other responders adopted a range of positions that reflected dissatisfaction with the current policy settings. These ranged from suggesting the current scheme is 'fundamentally flawed'[90] to suggesting that the current New Zealand tax law facilitates tax evasion in the trusts home country[91] or that loopholes were created as a result of New Zealand's tax law.[92] Multiple submissions observed that it was not New Zealand potentially losing tax revenue from the current tax policy settings relating to foreign trusts.

In relation to disclosure, most submitters were in agreement that there was a need for greater disclosure. Most submitters felt that the current rules were inadequate (10) or that the introduction of Automatic Exchange of Information would act to resolve current disclosure issues. Only one submitter to this question expressed the view that adequate controls and processes were in place.

The third issue relates to anti-money laundering and countering foreign terrorism. The majority of submitters did not expressly comment on this particular issue, with those that did generally agreeing that the rules were adequate or that there was insufficient evidence of failure of the current scheme. Only two respondents suggested that the current rules were inadequate.[93]

An additional issue that arose frequently in submitters' responses was the need to protect New Zealand's reputation as a jurisdiction with low levels of corruption and good regulation. Some suggested that New Zealand's reputation had been damaged as a result of the treatment of foreign trusts, while others were more concerned that the future of New Zealand's reputation was not damaged by an inadequate response to the Panama Papers.

5. THE NEW ZEALAND RESPONSE

5.1 Tax treatment of facilitation payments

In November 2014, the New Zealand government introduced the Organised Crime and Anti-corruption Legislation Bill with the expressed aim of strengthening the law to combat organised crime and corruption.[94] The Bill was passed into law in November 2015, by way of 15 amendment Acts. The changes were intended to introduce an all-of-government response to addressing various components of organised crime. Components addressed include attending to gaps in the current anti-corruption framework, increasing penalties for bribery and corruption and multiple amendments to offences such as human trafficking, identity related offences and money laundering offences.[95]

The legislative changes allowed New Zealand to ratify the UN Convention, and enable implementation of the *Agreement between the Government of the United States of America and the Government of New Zealand on Enhancing Cooperation in Preventing and Combating Crime*.[96] It further extends New Zealand's compliance with a range of other international conventions.

The Bill also resulted in changes to the *Income Tax Act* in relation to the acceptance of a bribe by a foreign public official. However, the legislative changes did not result in any changes likely to result in different behaviours or different interpretations of the legislation, with the issues outlined in the previous section still remaining.

There were 23 (written and oral) submissions to the Law and Order Select Committee on the Organised Crime and Anti-corruption Legislation Bill, most of which were concerned with issues such as the timing of implementation and information sharing provisions. Of the 20 written submissions to the Select Committee on the Bill, two submissions directly commented on facilitation payments. They also made reference to New Zealand's reputation as follows:

> At stake is New Zealand's reputation as one of the least corrupt countries in the world. By taking a strong stance on facilitation payments, and providing clarity to all New Zealand organisations trading and operating abroad, the government will also send a clear and important message to the international community that honest transactions are expected when working with New Zealand Inc. and New Zealand companies;[97]

and

> A facilitation payment is still a bribe no matter how low the amount and such payments inculcate a culture of corruption. Given New Zealand's leadership in the field of ethics and integrity, and also its deserved global

[94] Explanatory Note, Organised Crime and Anti-corruption Legislation Bill 2014 (NZ) <http://www.parliament.nz>.

[95] Ministry of Justice (NZ), 'Organised Crime and Anti-Corruption Legislation Bill – Initial Briefing' (5 February 2015) <https://www.parliament.nz/resource/en-NZ/51SCLO_ADV_00DBHOH_BILL56502_1_A420384/57a531cdb1c2734fed0ec6b756e7b11ee5067f72>.

[96] *Agreement between the Government of the United States of America and the Government of New Zealand on Enhancing Cooperation in Preventing and Combating Crime*, signed on 22 March 2013 (not yet in force), < http://www.treaties.mfat.govt.nz/search/details/p/54/590>.

[97] Transparency International, Submission to the Law and Order Select Committee on the Organised Crime and Anti

5. expansion of scope and application of anti-money laundering rules (3);
6. suspicious transaction reporting (2); and
7. information sharing (1).

The Government's response[103] was to agree with all the recommendations, although the 'wa

whether New Zealand was acting as a tax haven. Notwithstanding this comment, addressing the disclosure rules effectively would be likely to end any accusation that New Zealand was facilitating tax evasion in other jurisdictions.

The role of New Zealand as a 'good global citizen' arose in many submissions to the Shewan Inquiry.[112] One view was that 'it is certainly not up to, or even possible, for New Zealand to attempt through its tax laws to compensate for what we may see as deficiencies of the tax policies of other countries'.[113] However, the issue was less about deficiencies of tax policy in other countries and more about insufficient disclosure to allow other countries to enforce their tax laws. This was represented in other submissions, for example that 'it is not New Zealand's role to be the prime enforcer of other countries' tax systems … However, New Zealand should be in a position to provide reasonable assistance to other countries with the enforcement of their laws when requested…'.[114] Thus, there is a conflict between New Zealand's laws and how these will impact in other jurisdictions. The incompatibility between New Zealand taxing on the basis of residence of the settlor, while much of the rest of the world taxes on the basis of the residence of the trustees, was not disputed. The issue was whether this was a concern that New Zealand should be addressing. In general, the view was that New Zealand's tax treatment was aligned with overall principles of taxation and 'tax differences (and mismatches) should not normally be a specific concern to be addressed'.[115]

The KPMG submission to the Shewan report notes the global trend for countries to provide support for each other in preventing behaviours such as tax evasion and illegal money flows.[116] The greater focus on the international impact of New Zealand's

decision-making and action in relation to the foreign trusts issue. This is despite the fact that any negative financial impact for New Zealand is likely to result from the tax deductibility of facilitation payments, rather than the tax treatment of foreign trusts.

The limitations associated with this study are acknowledged. There is limited ability to generalise from a case study. Moreover, a case study approach using New Zealand, which is a country with low levels of corruption, may have limited application to other countries where corruption is embedded within the culture of that location. The study also only examines two examples where New Zealand has been tainted with corruption. Future research could examine other tax examples or extend into other regulatory and disclosure regimes within New Zealand.

The study leads to the suggestion that concern for New Zealand's reputation is likely to be the catalyst for future changes, rather than a desire to be a good global tax citizen. While these two factors may be connected, submissions to the Shewan Inquiry showed little concern for other jurisdictions' tax revenue collection, but greater disquiet relating to the potential impact on New Zealand's reputation in the event that no action was taken.