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New Zealand trusts for international wealth structuring

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Abstract

This article provides an introduction to trusts in New Zealand, examines the components of a trust, the different types of trusts available, taxation issues and practical uses for New Zealand foreign trusts.

New Zealand is not an 'offshore' jurisdiction. However, New Zealand has grown in prominence as an international wealth structuring jurisdiction over recent years largely due to its tax neutrality as regards 'foreign' trusts and, more recently, limited partnerships. This article will focus on the New Zealand 'foreign' trust.

> *New Zealand has grown in prominence as an international wealth structuring jurisdiction over recent years largely due to its tax neutrality.*

New Zealand is under Organization for Economic Co-operation and Development (OECD) and Financial Action Task Force (FATF) member jurisdiction and is therefore distinct from some other jurisdictions offering tax neutrality as regards trusts established by or for the benefit of people who do not live in the same country as the trustee.

Furthermore, the New Zealand 'foreign' trusts regime is based predominantly on a deliberate and long-standing tax 'philosophy' rather than a contrived legislative framework intended to create a new industry for the economy. The Inland Revenue Department focuses on the source of income and residency of the settlor and person(s) who will ultimately benefit from that income.

The fundamentals of New Zealand trust law have been in place and have gradually evolved since New Zealand was first colonized by Great Britain in 1840. New Zealand has an extensive network of international tax treaties. There are certain disclosure requirements as regards 'foreign' trusts but these are limited and only affect residents of Australia and New Zealand.

Polynesian and European heritage

New Zealand is a former British colony and has a strong Polynesian, European and Anglo-Saxon heritage reflected in English and Maori being the two official languages spoken and governmental and judicial systems based on a Westminster model. New Zealand is a self-governing member of the Commonwealth.

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At least in some circumstances, a trustee in close geographic proximity to the UK and Europe can be disadvantageous—particularly as the trend continues for courts, revenue authorities and public policy for a to extend their jurisdictional reach far beyond traditional borders. Of course, New Zealand is by no means immune to these measures but, at least for now, enjoys relative independence.

For quite legitimate reasons, settlors and beneficiaries may desire their assets to be held further afield than the traditional Crown Dependencies and Carribean jurisdictions. There is no denying that New Zealand is literally at the other end of the world in both time and distance. However, it is generally agreed that the development of the internet, email, scanned resolutions, BlackBerry, Skype and other communications technology—together with good old-fashioned organizational skills—mean that this time difference can be well managed. Inevitably for the poor Kiwi trustee, this does mean that the odd late night phone call or email is inevitable!

In practice, discretionary investment management is nearly always delegated to an investment manager resident in a more favourable time zone. There are also other ways and means of managing the trustee/beneficiary relationship including the use of delegated authorities, administration agreements, managed trust company structures and, as revealed in the following paragraphs, use of the provisions contained in the Trustee Act 1956 which allow for different types of trustee, each with unique roles.

An emerging market outlook

New Zealand is reasonably well situated to the major and emerging markets of Asia and Australia. Admittedly, due to the disclosure requirements there are likely to be very few, if any, New Zealand 'foreign' trusts established by Australian resident settlors.

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Currently, New Zealand seems particularly attractive for settlors from Mexico, Brazil and Italy, for whom direct use of traditional 'offshore' financial centres has been proscribed.

Furthermore, there is a strong Asian and Southern African cultural influence and synergy within New Zealand society due to high levels of foreign direct investment in, and immigration to, New Zealand in recent decades.

Introduction to trusts in New Zealand

The paragraphs that follow are applicable to all trusts governed by New Zealand law. Apart from their tax treatment, New Zealand 'foreign' trusts do not differ from their domestic counterparts. They are all subject to the same principles of law and equity.

A trust in New Zealand is more or less akin to its counterparts in the UK and many of the 'offshore' jurisdictions. In that respect, some of the following paragraphs may, for some readers, be very basic and unenlightening.

Suffice to say a trust in New Zealand is a legally binding arrangement whereby a person (the 'settlor') transfers assets to another person (the 'trustee') who becomes the registered owner of the trust assets for the benefit of other persons named in a trust deed (the 'beneficiaries'). Unless named as a beneficiary or otherwise permitted by the trust deed, a trustee is prohibited from benefiting from trust assets.

The manner in which the settlor requires the assets to be managed and, ultimately, distributed will normally be contained in the trust deed. It is fair to say that the standard of trust administration in New Zealand can be uneven. However, generally the judiciary is well familiar with trust principles (there are estimated at being several hundred thousand 'domestic' trusts in New Zealand). However, an area in which the jurisdiction could almost certainly improve its credentials would be through the establishment of a specialized equity division of the bench.

There are high standards of prudence imposed on trustees under New Zealand law.

In very general terms the duties of a trustee under New Zealand law include:

(i) acquaintance with the trust and its affairs;
(ii) compliance with the terms of the trust;
(iii) taking possession of trust property and preserving it;
(iv) if necessary, bringing and defending legal proceedings to protect trust property;
(v) fidelity to the trust;
(vi) proper administration of the trust;
(vii) diligence and prudence;
(viii) unless so authorized by the trust deed, not making voluntary gifts or payments from the trust;
(ix) acting personally;
(x) acting unanimously where there is more than one trustee, unless otherwise authorized by the trust deed;
(xi) acting impartially between beneficiaries;
(xii) acting honestly and not benefiting one beneficiary over another except to the extent that the trust deed confers that discretion on the trustee;
(xiii) paying the income and capital of the trust property to the persons who are entitled to them respectively;
(xiv) giving information regarding the trust to the beneficiaries;
(xv) keeping accurate accounts of the trust property;
(xvi) selling and converting trust property as may be required under the terms of the trust deed or by law but with a power to postpone sale in certain circumstances; and
(xvii) promptly investing trust money.

As in most Commonwealth jurisdictions, a higher level of skill is expected from a professional trustee (as provided by Sections 13B and 13C of the Trustee Act 1956). In relation to investments, the law is conduct-orientated, not result-orientated. *Jones v AMP Perpetual Trustee Company New Zealand Ltd* [1994] 1 New ZealandLR 690 held that the trustee will not be held accountable for whether or not he or she lost money, but whether or not the loss resulted from improper conduct. That case followed the famous English decision in *Bartlett v Barclays Bank Trust Co Ltd (No 1)* [1980] 1 All ER 139 which expressed the oft-quoted opinion that:

> a higher duty of care is plainly due from someone like a trust corporation which carries on a specialised business of trust management. A trust corporation holds itself out in its advertising literature as being above ordinary mortals ... a professional corporate trustee is liable for breach of trust if loss is caused to the trust fund because it neglects to exercise the special care and skill which it professes to have.

A settlor may also decide to express to the trustee his wishes as to the management and distribution of the trust assets in a manner which is less prescriptive. A letter of wishes is usually used for this purpose. Such a letter is not legally binding but will generally be considered by the trustee to be of influential effect as it carries out its functions.

Non-charitable trusts can postpone vesting in interest for up to 80 years. This is the maximum period permitted by the Perpetuities Act 1964 which provides that the trust deed can fix a perpetuity period of 80 years or less for the duration of the trust. Under the Perpetuities Act 1964, the rule against accumulations can apply to monetary requirements to accumulate but not to discretions to accumulate where expressly conferred on trustees. If no perpetuity period is expressly stipulated in the trust deed, then the common law perpetuity period of a life or lives in being plus 21 years will apply to fix the maximum duration of the Trust.

Creation of a trust in New Zealand

No particular form is required to create a trust in New Zealand except where land or equitable interests are being made subject to a trust, in which case the trust must be recorded in writing.

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It is usual for a trust to be created by the execution of a formal written deed. Trusts created in writing may be either by a settlement on trust signed by both the settlor and the trustee, or by a declaration of trust signed by the trustee alone. Following execution of the trust deed a trust will come into existence upon settlement of the initial property, which may be added to later.

The components of a trust in New Zealand

Again, the main protagonists within an New Zealand trust relationship are well familiar to international practitioners.

Settlor

Once a trust is created, the settlor will no longer be the legal owner of the trust assets. The settlor may be a beneficiary and he may also act as a co-trustee or protector.

It is common, especially in a domestic context, for a settlor to also be a trustee or at least reserve the power to appoint and remove trustees.

In an international context, settlors often retain a degree of control over the trust, such as the power to approve distributions, the power to appoint and remove trustees and the power to revoke the trust by acting as protector, reserving specific powers or retaining powers of veto.

Settlor reserved powers and protector powers commonly include the powers to revoke, vary or amend the terms of a trust, to distribute income or capital, to appoint or remove any trustee or beneficiary, and to change the governing law of the trust.

Whether the settlor should retain powers of the nature described is often determined by tax advice in the jurisdiction in which he is resident.

Trustee

Legal title to the trust assets is registered in the trustee under the terms and conditions set out in the trust deed and is transferred to the trustee by whatever means is appropriate to the type of property in question (i.e. share transfer, real property conveyance, cash transfer, etc.). Once title passes the trustee is responsible for the management of the trust. A trustee must exercise his powers solely for the benefit of the beneficiaries and the trust assets do not form any part of the trustee's own estate or property available to any creditors of the trustee.

Beneficiaries

The beneficiaries are the persons entitled to benefit from the assets held on trust by the trustee. The settlor may (but does not have to) be one of the beneficiaries. An express power for the addition of further persons to the class of beneficiaries is usually included in the trust deed. The beneficiaries may enjoy equal or unequal benefits, as specified in the trust deed, or, in the case of a discretionary trust, as the trustee may determine. It is also possible to include in the trust deed a power to exclude certain people from benefiting under the trust.

Trust fund

Unless the trust deed provides otherwise, there are no restrictions on the type of assets which may be held in an New Zealand trust and further assets may be added from time to time. It is normal to establish a trust with a nominal initial amount and subsequently to add further assets such as real property, shares or other forms of investment. Generally, a trustee will have all the powers of a natural person acting as beneficial owner of the trust assets.

Protector

Although not specifically provided for by the Trustee Act 1956, New Zealand trust law recognizes and permits the use of a protector to counterbalance the wide discretionary powers conferred on a trustee. Sometimes the settlor will fulfil this role or appoint a trusted friend or professional advisor to act as a protector of the trust. In such cases, the consent of the protector will generally be required before the trustee may exercise certain important powers under the trust deed.

It is likely that future legislation will eventually provide greater guidance and certainty to the courts and trustees in relation to the recognition, roles and responsibilities of protectors. Such legislative progression would generally be well received by practitioners, and particularly those specializing in international wealth structuring.

Custodian and advisory trustees

Sections 49 and 50 of the Trustee Act 1956 provide a point of difference from many other jurisdictions in that they permit family advisors, settlors and beneficiaries to influence the exercise of powers by the trustees through the use of a mechanism which separates powers between (i) custodian trustees, (ii) managing trustees and (iii) advisory trustees.

These might be referred to as 'remote control' provisions and, it is believed, were brought into New Zealand trust law to facilitate early settlement by British migrants to New Zealand who were reluctant to hand over absolute control of their New Zealand situs assets to colonial trustees.

Interestingly, these provisions can now be used for a similar purpose by international wealth planners in relation to assets that are not usually situated in New Zealand. They can be invaluable tools to cut across time zones and appease settlors unwilling to cede complete control to trustees in a (now) former colony.

For example, all things being equal, an New Zealand resident custodian trustee (perhaps a private or managed trust company) could hold registered title to an investment portfolio comprising equities and bonds listed on major international exchanges.

The client relationship management and day-to-day administration of the trust could be exercised by a managing trustee company based in Jersey. That managing trustee could delegate discretionary investment management over the investment portfolio to an investment firm in Singapore.

Meanwhile, a trusted family advisor resident in the jurisdiction in which the settlor resides, say Italy, could hold office as advisory trustee. Interestingly, section 49 of the Trustee Act 1956 provides that where any advice is tendered or given by the advisory trustee, the managing trustee may follow the same and act thereon but, if it does do so, shall not be liable for anything done or omitted by reason of following that advice or direction.

Binding directions in relation to the assets held by the New Zealand resident custodian trustee would, from time to time, be given to it by the Jersey resident managing trustee. All transactions would be implemented by the New Zealand resident custodian trustee on an 'execution only' basis. However, the New Zealand resident custodian trustee would retain power to apply to the court for directions and retain certain core fiduciary duties. The New Zealand resident custodian trustee would not be liable for acting on properly given directions.

Crucially, as far as the outside world is concerned the 'owner' of the investment portfolio is the New Zealand resident custodian trustee. This may provide a solution for the Jersey managing trust company which worked hard to develop the relationship with the Italy resident settlor only to be constrained by Italian tax policy.

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Provided there are no New Zealand resident settlors and there is no New Zealand source income, then the trust could still be regarded as an New Zealand 'foreign' trust and retain its tax neutrality in New Zealand.

This is a relatively unique and attractive feature of New Zealand trust law, the potential of which has not yet been fully realized by international wealth planners. It would also be fair to say that, generally, New Zealand practitioners have also not seen far beyond their own borders at the roles they could potentially play in such structures.

Types of trusts in New Zealand

The two most common types of trust established in New Zealand are:

(i) Discretionary trust

The discretionary trust generally provides maximum flexibility and is the most widely used and, often, the most effective solution for both settlor and beneficiaries. The trustee is given wide discretionary powers as to when, how much and to which beneficiaries the income and capital of the trust should be distributed. Such a trust is useful where at the time of creation of the trust the future needs of beneficiaries cannot accurately be determined and are likely to change over time. The beneficiaries are not regarded as having any direct legal rights over any particular portion of the trust fund but only a right to be considered when the trustee exercises his discretion.

(ii) Fixed interest in possession trust

Under a fixed interest trust, a named beneficiary will normally be granted a vested interest in the income of the trust fund for a defined period. For example, the trust deed may specify that the trustee is required to distribute all of the income of the trust fund to a particular individual during that person's lifetime and subsequently to distribute the capital of the trust fund in fixed proportions to named beneficiaries (such as the settlor's children).

(iii) Other types of trusts

Accumulation and maintenance trusts

An accumulation and maintenance trust is one where no beneficiary has a fixed entitlement to the benefits accruing to the trust for a certain period, during which time income is accumulated and becomes part of the capital. The beneficiaries may therefore benefit from the accumulation of capital. The trust deed may give the trustee a discretionary power to make distributions amongst the beneficiaries up to a specific age for their education, maintenance and benefit and to provide thereafter for a designated share of the trust fund to be distributed to each of them on attaining a specified age. An accumulation and maintenance trust may be particularly appropriate where the settlor wishes to benefit a group of children, for example, grandchildren wishing to study at university.

Charitable trusts

Generally, in order for a trust to be valid there must be identifiable beneficiaries who can enforce the duties against the trustees. An exception to this general rule has permitted trusts to be established in favour of charitable purposes. Charitable trusts are often used to further the objectives of philanthropists and not for profit organizations.

Except in the most limited of circumstances, New Zealand trust law does not permit non-charitable purpose trusts. It seems unlikely that trusts of the nature provided for by the STAR and VISTA regimes in the Cayman Islands and British Virgin Islands, respectively, will ever be provided for under New Zealand law.

Revocable trusts

Generally, it is not common for New Zealand trusts to be revocable. For tax and other reasons, it is usually desirable for a trust to be constituted as an irrevocable settlement. In certain circumstances, the settlor may require the additional comfort of retaining the power to revoke the trust and enforce the return of the trust fund. Careful consideration should be given to the possible consequences of a revocable trust so as not to negate some of the hoped for benefits of creating the trust. Nevertheless, as a matter of New Zealand law, there is nothing to prevent a trust being settled which can then be revoked by the settlor.

Taxation of trusts in New Zealand

Section HC 11 of the Income Tax Act 2007 provides that a trust is a 'foreign' trust in relation to a distribution if no settlor is resident in New Zealand at any time in the period that:

(i) starts on the later of 17 December 1987 and the date on which a settlement was first made on the trust; and
(ii) ends on the date of distribution.

Section HC 27 of the Income Tax Act 2007 extends the definition of 'settlor' so that it includes any person who at any time transfers value to or for the benefit or on the terms of the trust or who provides financial assistance to the trust.

However, of crucial importance for international wealth structuring purposes, the Income Tax Act 2007 further provides that where the settlor is resident outside New Zealand the trust will be exempt from assessment in respect of New Zealand tax on income and capital gains arising outside of New Zealand.

Accordingly, the trustee of a 'foreign' trust may make distributions out of the trust fund of a trust established in New Zealand without any withholding or deduction for New Zealand income or capital gains tax. New Zealand levies neither inheritance nor wealth taxes.

Interestingly, the fact that a beneficiary might be or become resident in New Zealand does not compromise the tax neutrality of the trust itself. It just means that the beneficiary pays tax on distribution at the applicable marginal rate of tax.

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Finally, it should be mentioned that a non-resident of New Zealand, who is not domiciled here, will incur neither gift duty, nor goods and services tax (VAT), liability on the transfer, to the trust, of any assets save land situated in New Zealand. Stamp duty was abolished in 1999.

Successive New Zealand governments have reviewed and endorsed this long-standing tax treatment of 'foreign' trusts and have emphasized that there is no intention to restrict what is generally agreed to be a rational and fair regime—which just happens to also be commercially attractive to international wealth planners.

As previously discussed, there are minimal reporting requirements to the Inland Revenue Department (but it should be noted that there are important record-keeping requirements incumbent on New Zealand trustees). When the regime was last reviewed in 2006, the then Labour government stated that the Inland Revenue Department will not entertain general 'fishing expeditions' from tax treaty partners for information on 'foreign' trusts. Any information so provided is subject to existing tax confidentiality laws.

New Zealand has an extensive network of 35 double taxation agreements in force with its main trading and investment partners. However, since tax legislation in different countries varies considerably it is, of course, imperative that settlors and beneficiaries take independent tax advice prior to establishing an New Zealand trust.

In practice, the extensive DTA network may be of limited benefit as in many of the double tax agreements there are specific exclusions where the income earned would not be taxed in New Zealand.

Practical uses of New Zealand 'foreign' trusts

The range of uses to which a New Zealand 'foreign' trust can be put are similar, if not the same, as trusts in any 'offshore' trust jurisdiction. These include:

(i) Preservation of wealth

An New Zealand 'foreign' trust may be used to preserve the continuity of ownership of certain assets, such as a business or property, within a family. By vesting legal ownership of the assets in the trustee, the relevant individuals may be able to continue to benefit from the assets, whilst avoiding fragmentation of ownership amongst a large number of second and third generation beneficiaries. The use of a trust avoids, on the death of a beneficiary, the risk of a share of assets becoming owned outside the family, and therefore can assist settled assets to be preserved for the benefit of future generations.

(ii) Succession planning

The effect of a trust is to divest the settlor of ownership of the settled assets. Accordingly, upon the death of a settlor there will be no need to obtain a grant of probate or similar formalities in order to deal with the trust fund. A trust, therefore, provides an efficient vehicle for the transfer of beneficial ownership interests on the death of a settlor, particularly where the deceased has a large, complex and geographically diverse asset base.

Furthermore, because the interests of a beneficiary under a discretionary trust will not constitute a separate asset under New Zealand law, a trust structure may assist in the avoidance of stamp duty or inheritance taxes which might otherwise be payable on the death of a beneficiary. A trust may also be used to protect vulnerable and financially incapable beneficiaries and to make financial provision for those in need.

(iii) Asset protection

Historically, trusts have been established for the purpose of protecting assets from certain types of real or perceived risk. In a modern context, trusts may be employed to hold assets in a secure and stable political environment.

Trusts play a major role in financial planning for individuals, families and companies and are used as a shield to protect assets against the potential future liabilities of a settlor, such as litigation risk or punitive taxation. The use of an underlying company can also provide an additional layer of confidentiality as regards the ownership of assets. Trusts can also safeguard assets against confiscation or expropriation by the state in the country of the settlor's residence and maximize foreign investment allowances where exchange control restrictions are in place. A trust deed can provide for the governing law of settlement to be moved from one jurisdiction to another.

New Zealand does not have the elaborate asset protection and artificially short statutory limitation periods provided for in the legislation of some 'offshore' jurisdictions. Nevertheless, there are some protections to be gained from having assets held in trust.

(iv) Forced heirship

There are no specific anti-forced heirship provisions under New Zealand law which would directly assist international wealth planners in a way that can often be found in the legislation of the 'offshore' financial centres.

However, where a settlor disposes of assets during his lifetime by settling them on trust, the trust assets will not form any part of the settlor's estate upon his death. This may enable a settlor to avoid heirship rules which may be mandatory under the laws of his domicile, residence or nationality and which would otherwise dictate the persons to whom and proportions in which a settlor's estate will be distributed.

New Zealand trusts can be drafted so as to comply with Sharia law.

(v) Commercial trusts

The most frequent use of New Zealand 'foreign' trusts is for structuring personal and family wealth. Although it is not yet particularly common in an international context, New Zealand 'foreign' trusts can also be used for commercial purposes such as:

(a) employee share option and executive incentive schemes;
(b) off-balance sheet transactions;
(c) asset securitization schemes; and
(d) private equity investment arrangements.

It is possible given New Zealand's relative proximity to the emerging markets of Asia that these types of structures will be used more frequently.

It is also possible for an New Zealand unit trust to be used for collective investment purposes. However, such a trust would be treated by the Inland Revenue Department in a manner similar to a domestic company. Therefore, it would not be possible to achieve tax neutrality for New Zealand domiciled funds as in many 'offshore' jurisdictions can provide. That said, an New Zealand limited partnership could be used to achieve similar objectives.

Regulatory safeguards in New Zealand

Generally speaking, New Zealand government policy encourages industry self-regulation and the New Zealand foreign trusts regime is on all fours with this historical approach to business efficacy in that, at least for now, there is no formal regulatory body which governs the private client trust company 'industry'.

> *There is no formal regulatory body which governs the private client trust company 'industry'.*

It is likely that more formal regulation of trustees will be implemented in the future. In the meantime, and in order to guarantee that a 'foreign' trust does not become liable to tax in New Zealand on its worldwide income, at least one trustee must be a 'qualifying resident foreign trustee'. To qualify as such the trustee or in the case of a company its directors, must be members of, and therefore are by default regulated by, the New Zealand Law Society, Institute of Chartered Accountants or Society of Trusts and Estates Practitioners. Each of these organizations demand high ethical and professional standards of their respective members together with continuing professional development obligations. As in all important jurisdictions it is important to deal with service providers with good reputations and high levels of technical expertise together with comprehensive professional indemnity insurance cover.

New Zealand has been a member of the FATF since 1991 and operates under a responsible anti-money laundering legislative framework. In 1996, the Financial Transactions Reporting Act became New Zealand's primary anti-money laundering legislation.

New Zealand's anti-money laundering regulatory regime has recently undergone a comprehensive review and enhancement with the new Anti Money Laundering and Countering Financing of Terrorism Act 2009 having been enacted in October 2009. The law imposes significant obligations on financial institutions with severe penal and financial consequences for breaches of the legislation.

An OECD alternative

Today, traditional 'offshore' financial centres face increasing challenges and unprecedented levels of scrutiny. An OECD and FATF member trust jurisdiction such as New Zealand can offer broadly the same tax, succession planning and asset protection benefits for a particular type of client searching for a cross-border wealth management solution.