



# White Paper - N°5

## New Zealand: A Tax Haven for Foreign Trusts

*Trusts are widely used in New Zealand for asset protection, succession planning and flexibility. It also continues to be common for wills to establish a testamentary trust. It is not uncommon to see a Trust being used for commercial purposes as well. However the purpose of this article is to look at the Foreign Trust Tax Regime in New Zealand and how New Zealand is actually a tax haven, at least in respect of certain trusts.*

Thanks to the beneficial Foreign Trust Tax Regime there is a substantial Foreign (Offshore) Trust industry in New Zealand. Very briefly, the Foreign Trust Tax Regime prevents the assets and foreign sourced income of a Foreign Trust from being subject to income tax in New Zealand.

**Whilst New Zealand is traditionally regarded as having a robust tax system that operates with a broad tax base and low tax rates, the absence of a comprehensive capital gains tax and the beneficial treatment of Foreign Trusts from a tax perspective makes New Zealand an attractive choice of jurisdiction for Foreign Trusts.**

Whilst New Zealand is not generally regarded as tax haven, it is just that, when it comes to Offshore Trusts. New Zealand Trust Law is based on the English law.

With this said the principles surrounding Trusts in New Zealand largely follow those of United Kingdom. Whilst the business environment and the nature of the Trusts have evolved the trust rules and principles have largely remained the same. The Trustees Act promulgated in 1956 is out-dated and has not been reviewed since its enactment. The New Zealand Law Commission recognises this fact and has instituted a review of the New Zealand Trust law as they consider it is in need of modernisation. Taxation principles will not be affected by this review.

**A Foreign Trust is defined by reference to the time a distribution is made from a Trust. Effectively, it is a Trust that does not have a New Zealand resident settlor from the time of establishment to the time of distribution. One must be careful with New Zealand assets settled on the Trust as any income derived from these will not enjoy the same tax advantages as foreign based assets. Settlement of New Zealand assets on a Foreign Trust may jeopardise the Foreign Trust status of the Trust. New Zealand assets should be settled on a New Zealand Onshore Trust.**

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## Taxation Principles

Briefly, Foreign Trusts in New Zealand established by a Foreign Resident settlor, benefit from tax legislation. This does not impose New Zealand income tax where neither the assets nor income of the Trust has a New Zealand Source; and where the settlor or beneficiaries are not New Zealand Residents, or whilst they are transitional residents.

New Zealand, a member of the OECD, is not normally regarded as a tax haven country. In effect, it is viewed as a "Good Country". New Zealand does not have a central registry body where Trusts are registered, although the existence of foreign trusts is subject to a registration regime with the New Zealand Inland Revenue Department who may share this information with the revenue authorities of other countries. In the absence of the central Trust Registry, the existence of a beneficial Foreign Trust Tax Regime makes New Zealand a perfect jurisdiction of choice for the location of Foreign Trusts. Furthermore, the application of the Transitional Resident Regime for individuals (who either have not been tax resident in New Zealand previously or as former residents, who have been non-resident for greater than 10 consecutive years) in conjunction with the Foreign Trust Tax Regime can result in a tax-free flow of foreign sourced income and capital gains from a Foreign Trust to the non-resident Beneficiaries of the Foreign Trust or beneficiaries who qualify as transitional residents. In addition, the combination of these two regimes can also facilitate, if carefully planned, a tax free entry of foreign accumulated wealth held by a Foreign Trust to New Zealand.

**A natural person can qualify as a transitional resident only once, provided that the person is a tax resident of New Zealand, has not been a tax resident of New Zealand within last 10 years and who has not been a Transitional Resident before. Transitional resident exemption provides for broad exemption from income tax for a period of 49 months. Persons eligible will be exempt from New Zealand tax on foreign sourced income during the period they are classified as transitional residents.**

Since the trustees are agents for the settlor or beneficiaries the logic is that the trustee's residence should not exist. The existence of foreign trusts is subject to a registration regime with the New Zealand Inland Revenue Department who may share this information with the revenue authorities of other countries. In the absence of the central Trust Registry, the existence of a beneficial Foreign Trust Tax Regime makes New Zealand a perfect jurisdiction of choice for the location of Foreign Trusts. Furthermore, the application of the Transitional Resident Regime for individuals (who either have not been tax resident in New Zealand previously or as former residents, who have been non-resident for greater than 10 consecutive years) in conjunction with the Foreign Trust Tax Regime can result in a tax-free flow of foreign sourced income and capital gains from a Foreign Trust to the non-resident Beneficiaries of the Foreign Trust or beneficiaries who qualify as transitional residents. In addition, the combination of these two regimes can also facilitate, if carefully planned, a tax free entry of foreign accumulated wealth held by a Foreign Trust to New Zealand.

**Taxation of Trusts in New Zealand is based on the settlor's residence and not the trustee's residence.**

Since the trustees are agents for the settlor or beneficiaries the logic is that the trustee's residence should not determine the residence of a Trust for New Zealand tax purposes. New Zealand tax legislation looks at the residence of the settlor for determining whether the Trust is a Foreign or an Onshore (complying) Trust. In addition to this the source of income becomes relevant.

Taxation principles that will apply to a particular Trust will depend on the classification of the Trust as a Foreign Trust or an Onshore Trust as well as the source of its income. Regardless of the classification of a Trust either as an "Onshore" or an "Offshore/Foreign" or the residence of the recipient of the income from the Trust, New Zealand sourced income is taxed in New

Zealand because it has its source in New Zealand. It is therefore imperative for a Foreign Trust, that wishes to benefit from the Foreign Trust Tax Regime, that none of its income or assets have a New Zealand source, as this would jeopardise the benefits afforded by the Foreign Trust Tax Regime. This also means that the trustees will usually execute documents and contracts outside of New Zealand so as to avoid them having a New Zealand source. Trusts themselves are not subject to tax in New Zealand as they lack corporate personality.

Taxation in New Zealand in the domestic context is levied by reference to the Trustee income (income retained in the Trust) or the Beneficiary income (income distributed to beneficiaries). This distinction is relevant for Foreign as well as for Onshore Trusts. Whilst this may sound daunting, it truly is not. In brief:

- Beneficiary income that has foreign source, regardless of the residence of the Trustees:
  - Is taxable to the beneficiary if the Beneficiary is a New Zealand Resident.
  - Is not taxable for a period of up to 4 years if the Beneficiary qualifies as a Transitional Resident.
  - Is not taxable if the Beneficiary is a New Zealand non-resident
- Trustee income, regardless of the residence of the Trustees
  - Is taxable in New Zealand if the settlor is resident in New Zealand at the time any settlement is made, and for taxation purposes settlement is very widely defined.
  - Is not taxable in New Zealand if the settlor qualifies as a Transitional resident except to the extent it was sourced in New Zealand
  - Is not taxable in New Zealand if the Settlor is a New Zealand non-resident

Whilst the Foreign Trust Tax Regime has its advantages it can be unattractive for settlors and beneficiaries who wish to migrate to New Zealand if not carefully planned. Therefore caution needs to be exercised. You may be wondering how these rules apply when you either cease to be classified as a Transitional Resident or if you do not qualify as such. Without careful planning bringing the accumulated assets and/ or wealth of a Foreign Trust into the New Zealand tax net can have adverse tax consequences. For example, capital distributions from a trust to beneficiaries may be taxed either at 33% or at a penal rate of 45% if the criteria of Foreign Trusts are not met. For tax purposes, a Trust can have more than one settlor. It is enough for one settlor to be a New Zealand resident for the triggering of the adverse tax consequences.

**With this said, with careful planning and timing, it is not difficult to avoid such circumstances and to bring the assets/ wealth accumulated in the Foreign Trust into the New Zealand tax net without the imposition of any such New Zealand tax.**

## Summary

New Zealand offers a beneficial Foreign Trust Tax Regime whereby foreign sourced income and capital gains are not subject to New Zealand Tax. The Foreign Trust Tax Regime, in combination with the Transitional Migrant Regime, facilitates the migration of offshore wealth and assets to New Zealand without imposition of a New Zealand tax cost.

If you are thinking of establishing a New Zealand Foreign Trust or migrating to New Zealand, planning and timing are imperative for the successful migration of your offshore wealth to New Zealand.

Our team has no 'one size fits all' approach; We would welcome the opportunity to work with you to tailor a solution to fit you personally, drawing on our up-to-date specialist knowledge and years of experience.

## Conclusion

**New Zealand is a country with good governance and strong legislation and is perceived as a good country in the eyes of other jurisdictions. New Zealand offers great tax advantages in relation to Foreign Trusts. These tax advantages coupled with strong legislation make New Zealand a great alternative to various tax havens which have negative inherent stigma attached to them.**

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## *About Covisory*

The Covisory Group specialise in International and Domestic Tax Services, Trust Management, Succession Planning, Strategic and Business Planning, Accounting Services and Business Valuations.

Established in 2007, The Covisory Group has grown from one business to four with a diversity of clients. Covisory clients are owners of family businesses, operating both in New Zealand and globally. Our team of specialists work either one-on-one or alongside our clients' team of professional advisers to develop appropriate short- and long-term solutions.

We build strong relationships with our clients based around trust, accessibility, and responsiveness. There is no 'one size fits all' about our services. Our solutions are bespoke to each client, drawing on our up-to-date specialist knowledge and our years of experience. providing one-on-one expert advice.

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