

NEW ZEALAND TRUSTS FOR INTERNATIONAL WEALTH STRUCTURING

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1. INTRODUCTION

New Zealand ("NZ") has grown in prominence as an international trust jurisdiction over recent years for a variety of reasons including its tax neutrality as regards "foreign" trusts and its economic and political stability. NZ is a respected OECD and FATF member jurisdiction with a solid commercial, professional and judicial framework.

Unlike many other trust jurisdictions offering tax neutrality to trusts established by and for non-residents the NZ foreign trusts regime is based predominantly on deliberate tax concession rather than a contrived legislative framework intended to create a new industry for the economy. The fundamentals of NZ trust law have been in place and have gradually evolved since NZ was first colonised by Great Britain in 1840. NZ has an extensive network of international tax treaties and low level information disclosure requirements.

2. POLYNESIAN AND EUROPEAN HERITAGE

NZ 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.

In some circumstances, having a trustee in close geographic proximity to the UK and Europe can be disadvantageous and particularly as the trend continues for courts, revenue authorities and public policy fora in these regions to extend their reach beyond traditional borders. For quite legitimate reasons, clients may desire their assets to be held further afield – even if discretionary management is carried out within the same time zone.

3. AN EMERGING MARKET OUTLOOK

NZ is well situated to clients resident in the major and emerging markets of Asia and also offers many opportunities for Latin American and European clients who, in many cases, are constrained from using

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"offshore" financial centres due to "blacklisting" by central governments. Furthermore there is a strong Asian and Southern African cultural influence and synergy within NZ society due to high levels of foreign direct investment in and immigration to NZ in recent decades.

4. INTRODUCTION TO TRUSTS IN NZ

A trust is a legally binding arrangement whereby a person (the "settlor") transfers assets to another person (the "trustee") who is entrusted with legal title to the trust assets, not for the trustee's own benefit, but for the benefit of other persons (the "beneficiaries").

The instructions from the settlor to the trustee as to the distribution of trust assets will normally be contained in a document called the trust deed. The trust deed will usually provide that the trustee has the power to manage and distribute the trust assets in accordance with the terms of the trust deed and the high standards of prudence imposed on trustees under NZ law.

It is also common for a settlor to express to the trustee his wishes as to the management and distribution of the trust fund in a less formal manner. This expression is often contained in a letter of wishes which, although not legally binding, will generally be considered by the trustee to be of persuasive effect when performing the duties of trusteeship which include the distribution of the trust fund to beneficiaries.

5. THE COMPONENTS OF A TRUST IN NZ

The trust relationship is comprised of a number of important components, some of which are essential and others not.

(a) 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 and, in such capacity, 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.

However, a settlor may reserve to himself certain powers or grant such powers to a protector. These may 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.

(b) Trustee

Legal title to the trust assets is vested in the trustee under the obligations imposed by the trust deed and from then on 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.

(c) Beneficiaries

The beneficiaries are the persons entitled to benefit from the assets held on trust by the trustee. The settlor may be one of the beneficiaries. An express power for the addition of further persons to the class of beneficiaries may be 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.

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(d) Trust Fund

There are no restrictions on the type of assets which may be held in 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.

(e) Protector

NZ trust law recognises and permits the use of a protector to counterbalance the wide discretionary powers conferred on a trustee. Often 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.

(f) Custodian and Advisory Trustees

NZ trust law permits family advisors, settlors and beneficiaries to influence the exercise of powers by the trustees by the use of a mechanism which separates powers between custodian trustees, managing trustees and advisory trustees.

These "remote control" provisions were embedded in NZ trust law to facilitate early settlement by British migrants and are invaluable tools for the international wealth planner to cut across time zones and appease settlors unwilling to cede complete control to foreign trustees.

For example, a NZ resident custodian trustee could hold the assets whilst discretionary investment management could be delegated to an investment firm in Zurich. Meanwhile, a trusted family advisor resident in the jurisdiction in which the settlor resides could hold office as advisory trustee. The management and administration of the trust could be exercised by a managing trustee based in Jersey or under a delegated administration agreement. All transactions would be implemented by the NZ resident custodian trustee which would also retain the power to review directions given.

6. TYPES OF TRUSTS IN NZ

Various types of trust have been developed over time and the most appropriate structure for the settlement will depend on the settlor's particular circumstances and objectives. Some of the more common types of trust are described below.

(a) Discretionary trust

The discretionary trust provides maximum flexibility and is the most widely used and, often, the most effective solution for both settlor and beneficiaries. Under the terms of a discretionary trust 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 form of 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 to benefit when the trustee exercises his discretion.

(b) Fixed interest in possession trust

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Under a fixed interest trust a named beneficiary will normally be granted a vested interest in the income of the trust fund for life. 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).

(c) Accumulation and maintenance trust

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.

(d) Revocable trusts

Although for tax and other reasons it is generally 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.

(e) 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.

7. PRACTICAL USES OF NZ TRUSTS

In summary a trust is a relationship under which legal ownership of assets is vested in a trustee whilst the enjoyment of the trust fund is preserved for the benefit of the beneficiaries on terms determined by the settlor in the trust deed.

The range of uses to which a trust may be employed is widespread and constantly evolving but flexibility and confidentiality are the principal advantages which a trust has over other legal forms designed to hold, preserve and transfer wealth. The trust concept has proved to be enormously adaptable and is widely used in financial planning including:

(a) Preservation of wealth

Trusts may be used to preserve the continuity of ownership of particular 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 enables settled assets to be preserved intact for the benefit of future generations.

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(b) 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. Further, because the interests of a beneficiary under a discretionary trust will not constitute a separate asset under NZ law, a trust structure may assist in the avoidance of stamp duty or inheritance taxes which would 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 provisions for the improvident.

(c) Asset protection

Historically, trusts have been established for the principal purpose of protecting assets from certain types of 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. A trust deed can provide for the governing law of settlement to be moved from one jurisdiction to another.

(d) Asset Protection – divorce issues

Under New Zealand law, only relationship property can be divided on separation.

Property that is held on trust is neither relationship property nor separate property but trust property, and is therefore outside the reach of the ex, unless the ex can apply under the Property (Relationships) Act (NZ) for an order to vary or undo the trust.

The claiming ex would have to show that the property was transferred to defeat his or her interest in the property (i.e. it was once 'relationship property') or that it would result in a gross injustice.

For non-NZ domiciled settlors whose settled property relates to foreign movable and immovable property only, the parties should not qualify for an order under the Property (Relationships) Act (NZ). Instead, they would have to sue the trustee in their own jurisdiction and be successful in obtaining an order there, where the judgment would have to be a monetary judgment (awarding an amount of money), after which they would have to apply to have the order registered in NZ. If there is no reciprocity agreement with NZ, the order will not be registered there. If the order was incapable of being enforced in the international jurisdiction, it will not be registered. The trustee is then able to ignore such orders from the foreign jurisdiction.

(e) Creditor Protection

In relation to creditor protection, NZ has enacted the common law position - if you transfer assets for the purposes of putting them out of reach of known or contingent creditors, they can apply for an order under part 6 of the Property Law Act to have those assets placed back in the hands of the settlor.

Important to note is that a successful claim can be prevented where the transfer is for value with no notice. Where assets are sold into an LP with a trust as its LP, the structure would be sound in protecting its assets provided properly structured loan arrangements and prevention mechanisms are drafted into the LP deed.

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If the transfer was done when the creditor was a contingent creditor or was known to the settlor, the transfer can be reversed if the trustee knew.

(f) Forced heirship

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 forced 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.

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

(g) Commercial trusts

Aside from use in structuring personal and family wealth NZ trusts can also be used for the following commercial purposes:

- (i) collective investment of capital;
- (ii) off-balance sheet transactions;
- (iii) inter-creditor agreements;
- (iv) asset securitisation schemes;
- (v) employee share option and executive incentive schemes; and
- (vii) private equity investment arrangements.

8. TAXATION OF TRUSTS IN NZ

Where the settlor of the trust is resident outside NZ the trust will be exempt from assessment in respect of NZ tax on income and capital gains arising outside of NZ. Accordingly, the trustee may make distributions out of a trust fund established in NZ without any withholding or deduction for NZ income or capital gains tax. There are no inheritance, wealth or capital gains taxes levied in NZ nor is there any gift duty, stamp duty, value added tax or equivalent forms of indirect taxation charged on the creation or transfer of assets to a trust by a non-resident of NZ.

Successive NZ governments have reviewed and endorsed this long-standing tax treatment of foreign trusts and have emphasised that there is no intention to restrict what is fundamentally a rational and fair regime, which is commercially attractive to international wealth planners.

There are minimal reporting requirements to the Inland Revenue (but important record keeping requirements incumbent on the trustees). The government has stated that the Inland Revenue 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.

NZ has an extensive network of 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 NZ trust.

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9. CREATION OF A TRUST IN NZ

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 of 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 supplemented later.

Palladium is able to assist with preparation of all of the appropriate documentation and provide the following services:

- (a) initial advice and liaison with professional advisers;
- (b) drafting the trust deed and letters of wishes (or deed of retirement and appointment of trustees, as the case may be);
- (c) formation of underlying companies to hold trust assets;
- (d) preparing and reviewing documentation relating to commercial transactions; and
- (e) selecting an appropriate trustee to administer the trust.

10. REGULATORY SAFEGUARDS IN NZ

Generally speaking, NZ government policy encourages industry self regulation and the NZ foreign trusts regime is on all fours with this historical approach to business efficacy. Rather than being an area of weakness, this policy ensures that the highest professional standards are maintained – particularly where the trust corporation is a "qualifying resident foreign trustee" and directors and employees are members of, and therefore regulated by, the New Zealand Law Society or the Institute of Chartered Accountants. NZ trust law requires trustees to observe high standards of conduct.

NZ has been a member of the Financial Action Task Force since 1991 and operates under a responsible anti-money laundering legislative framework. In 1996 the Financial Transactions Reporting Act became law and constitutes NZ's primary anti-money laundering legislation. The law imposes significant obligations on financial institutions with severe penal and financial consequences for breaches of the legislation. NZ's anti-money laundering regulatory regime is currently undergoing further review and enhancement.

11. HEALTH WARNING

Whenever a trust (or foundation) structure is considered, the settlor must always consider the likelihood of cross-border attacks on the properties from any or all of disgruntled forced heirs (where civil law probate is involved); divorcing spouses; tax collectors; litigants; creditors; or regulators.

It is essential for the professional advisers to the settlor to conduct a detailed fact-find on his client's situation in order to unearth all potential family, fiscal and business factors which may be relevant.

12. 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 NZ can offer broadly the same tax, succession planning and asset protection benefits for the discerning client searching for a cross-border wealth management solution.

Summary of key features of the NZ foreign trusts regime

- Tax neutrality as regards "foreign" trusts
- Non-blacklisted, OECD and FATF member jurisdiction
- High-quality judiciary and legal profession well versed in trust law
- Ability to ameliorate time zone difficulties by using NZ entity as custodian trustee with a managing co-trustee or investment manager resident in a more convenient time zone
- Access to a clear and extensive body of substantive law based on an English model
- A tax regime that can be regarded as both rational and fair in determining the extent of tax liability incurred by non-residents associated with trust structures
- A relatively low level of reporting requirements
- Proximity in distance and time to Asia-Pacific region
- Responsible anti-money laundering legislative and regulatory regime
- Requirement for trustee or director of a trustee to be a member of NZ Law Society, STEP or a Chartered Accountant
- Neutral, non-interventionist government foreign policy