

Article

Beware the hidden traps in the new foreign trust

Tax Alert - April 2017

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New Zealand resident trustees of foreign trusts have a very short period of time to get familiar with the new foreign trust disclosure rules, enacted on 21 February 2017. A wide-ranging overhaul of the rules, as recommended by the Government's 2016 Inquiry into Foreign Trust Disclosure Rules (the Shewan Report), will require much greater information be provided both on registration and annually. Failure to comply exposes the trust to New Zealand income tax, and as we discuss below, the ambit of the rules is broad enough that some trustees may be subject to the rules without having any awareness that they even exist, while some trusts will not be able to comply with the rules at all. We consider the rules as currently enacted will result in unintended and unworkable outcomes, and should be amended to remove non-professional trustees from their ambit.

Existing foreign trusts have until 30 June 2017 to comply, whereas any trust formed after 21 February 2017 must comply with the rules within 30 days. A concession for trustees who are non-professional individuals allows four years and 30 days to comply with the rules.

The Shewan Report concluded that foreign trusts had very limited disclosure requirements and further, the requirements were not effectively policed. The Government, concerned to protect New Zealand's reputation, has greatly enhanced those disclosure requirements. There are three main parts to the new rules: registration, annual returns, and ongoing compliance. Failure to comply with any of those three parts will result in loss of the exemption from New Zealand income tax for that trust.

Inland Revenue have launched a new foreign trusts website with an overview of the information requirements and links to the forms that must be filed. These requirements and forms are discussed below later, but first we have highlighted some serious concerns with the new rules.

Issues with the new disclosure rules

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We think it is very likely that some trusts will be caught unaware by the rules, and that some trusts will have difficulty complying with the rules at all.

It is of serious concern that trusts without a trust deed cannot register at all under the rules, and therefore cannot ever access the tax exemption. This compromises New Zealand taxing trusts based on the residence of the settlor vs the trustee. For example, the Special report released by Inland Revenue to further explain the rules confirms that a testamentary trust is a trust for the purposes of the rules, but the will under which it is established is not considered a trust deed. It would appear therefore impossible for such trusts to ever register under the foreign trust rules, meaning that if a New Zealand resident is appointed trustee, executor or administrator of the testamentary trust or estate, that foreign trust will be subject to New Zealand income tax.

As the rule applies to all trusts, including bare trusts (which can arise inadvertently), it is inevitable that trusts will become liable to New Zealand income tax without any person associated with that trust being aware of the liability, or there being any way of removing that liability.

This is a very unfortunate outcome and one that certainly doesn't appear to be contemplated by the Shewan Report. The Shewan Report strongly advocated for preventing foreign trusts exploiting our rules to avoid tax or conceal assets. Extending the scope of the new trust disclosure rules to tax testamentary trusts with extremely limited connections to New Zealand is far beyond the intention of the Shewan Report recommendations.

New Zealand's broad residence rules are also likely to mean that a New Zealand resident trustee (which includes executor or administrator) may be a New Zealand resident despite having only a tenuous connection with New Zealand, and may not even currently be in New Zealand. For example:

- A person could be a New Zealand resident by reason of having a permanent place of abode or breaching the day-count rule but not actually be in NZ currently or for the foreseeable future.
- A trustee company may be New Zealand resident because a director exercises control of the company from New Zealand.

If these trusts do not comply with the disclosure requirements, they will be subject to New Zealand income tax from the 2017/18 income year. This includes full compliance with initial registration, annual returns, and ongoing disclosure requirements. This would apply whether a Double Tax Agreement would treat the individual as a non-resident for tax purposes.

There is a grace period for individuals (not entities) who are not in the business of providing trustee services. They will have four years and 30 days to register the trust.

A further condition of maintaining the tax exemption is disclosure of any additional settlements. Settlements can take different forms, including low interest loans to a trust or services performed for the trust for no payment. It is very likely that such settlements on foreign trusts could take place without anyone being aware that this simple act, if not disclosed, will create a New Zealand income tax liability. Again, this seems beyond the original intention of the rules.

A trust that is subject to New Zealand income tax is subject, among other things, to the foreign investment fund rules, the financial arrangement rules, and taxable distribution rules. These all add a layer of complexity which is out of step with the fact that many if not all of the assets and most of the beneficiaries may be non-resident. Considered in the context of the intention of the Shewan Report, we consider this an unintended and unworkable outcome. In our view the foreign trust disclosure rules should only apply to professional trustees and structures that have been put in place to take advantage of our rules.

Requirements

A foreign trust is one which has a foreign settlor and no New Zealand resident settlor. A trust may have trustees and beneficiaries in New Zealand but will not be resident in New Zealand unless the settlor is New Zealand resident. Foreign trusts have been exempt from New Zealand income tax, but in the future will only be so if they comply with the registration requirements.

The first requirement is registration, which is required within 30 days from the date that the foreign trust is subject to the rules – eg, it is settled or the trustee moves to New Zealand. Trusts already in existence when the law was passed have until 30 June to ensure they comply with the new registration requirements.

It is important to note that all the information outlined below can be disclosed by Inland Revenue to the Department of Internal Affairs, New Zealand Police and, the tax authorities of other countries with whom New Zealand has a tax treaty.

Registration must be completed using three separate forms:

1. **IR607:** This is the foreign trust registration form.

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- This form will include the basic identifying information about the trust, trustees, payment of the registration fee, a copy of the trust deed, and a declaration that the information provided is true and correct.
2. **IR607A: Foreign trust connection person schedule.**
- This must be attached to the IR607 and includes information about any person connected with the trust, including settlors, trustees, parents or guardians and beneficiaries. Detailed information must be disclosed, including name, address, jurisdiction, email address and taxpayer identification number. The form also includes a declaration that the person completing the form and all people named on it are aware of their obligations under, and have complied with tax and anti-money laundering legislation.
3. **IR900A: Foreign trust settlements & distribution schedule.**
- This is also attached to the IR607 and includes details of all settlements and distributions made to or by the trust, including the name of the settlor or beneficiary, the amount, the currency and the date on which it was made. Upon the initial registration of the trust under the new rules, this will include all settlements dating back to the formation of the trust or, where all the trustees are individuals who are not in the business of providing trustee services, to the later of the trusts formation and four years prior to the date on which the trustee becomes required to register the trust.

Annual returns must be completed within six months of balance date or, if the trust has no balance date, by 30 September. An IR900 must be filed, including a copy of the trusts financial statements and an IR900A detailing all settlements and distributions during the year. An Order in Council will be made at some point to specify minimum standards for foreign trust financial statements.

Ongoing disclosure of changes to any information supplied during the initial registration must be provided to Inland Revenue within 30 days of the trustee becoming aware of the change.

Although new foreign trust disclosure rules were an appropriate response to the Shewan Report, we are concerned that there will be widespread inadvertent non-compliance with the rules, as well as a total inability of some trusts to comply with the rules at all. We would like to see the rules amended to allow registration without a trust deed, to remove non-professional trustees from the rules, and to allow some lenience by Inland Revenue in enforcing the rules when trustees are not aware of their obligations.

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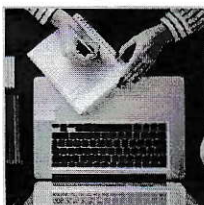
A snapshot of recent developments

Recommendations



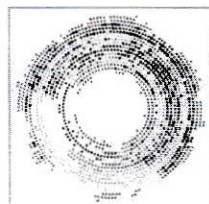
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