

# Trustees and settlors beware: Family trusts don't travel well

11 September 2017 by [Maurits van den Berg](#)

Jetlag is a temporary affliction for individuals; but crossing time zones can result in permanent financial damage to your family trust. In this article, we highlight the potential tax damage wrought on trusts when the individuals who happen to be the settlors or trustees of the trust relocate overseas for a period. The upshot is: don't let the Taxman become a major beneficiary of your family's wealth.

## Outbound settlor and trustees

Consider the Dinkum Family Trust. The Trust is established by a New Zealand resident settlor and with New Zealand resident trustees. The New Zealand tax rules apply to this trust in a fair and predictable way. That is, the income of the trust is typically taxed at 33% with no further tax applying to distributions from the trust. Let's say the trust has built up reserves of \$1m from accumulated income and capital gains.

Next step, consider the impact of international mobility on the trust. Let's say our settlor or trustees go and work overseas for a period of time. As a result, the New Zealand tax treatment of trust income after the overseas move may change (e.g. overseas income could be exempt from New Zealand tax) but this change in treatment could result in the trust permanently losing its favoured tax status. Future distributions from the trust could now be subject to an additional 45% tax (i.e. an additional \$301,500 in tax payable). That is, income and distributions from the trust could suffer a total New Zealand tax impost of 63%.

The carnage does not stop there. It is also likely that the trust will become tax resident of another country. For example, Australia in broad terms imposes tax residence (additional tax costs) on trusts that have Australian resident trustees or are controlled by Australian residents.

## Inbound settlors and trustees

The same types of adverse tax consequence operate when individuals (who also happen to be settlors or trustees) relocate to New Zealand for an extended period. Again, the

underlying trust tax rules are complex with ample scope to cause inadvertent and permanent financial damage to your trust.

It is highly recommended (if not essential) that non-resident individuals who are settlors or trustees take specialist tax advice before locating to New Zealand. That advice should devise a strategy and outline any elections required to preserve the trusts tax position.

## New foreign trust disclosure rules and tax rules

A foreign trust is defined under New Zealand tax rules as a trust established by a non-resident settlor where at all times that settlor (and any other settlors of that trust) continue to be non-resident. A foreign trust is generally not subject to New Zealand income tax on its foreign sourced income.

A trust can still be a foreign trust as defined even if it has New Zealand resident trustees. However, from the 2017/2018 income year, if a foreign trust has New Zealand resident trustees then (subject to certain concessions) the existence and details of the trust need to be disclosed to Inland Revenue. If the disclosure does not occur, the trusts foreign income will become subject to New Zealand income tax. Existing trusts (again subject to certain concessions) had until 30 June 2017 to comply with these disclosure requirements.

For these purposes a foreign trust includes a testamentary trust (a trust created under a will) and a trustee includes an executor and administrator.

## Pro-active tax planning

The worst tax effects associated with inbound/outbound trusts can often be managed with pro-active tax planning. Typically, this will involving considering whether:

- Additional settlements may be required to preserve the trust's status.
- A change of trustees or the use of a corporate trustee could preserve the trust's status.
- Changing the mix and source of trust income will avoid inadvertent loss of trust tax status.
- The trust income could be paid out in full as beneficiary income as a temporary measure.
- Elections are made to preserve an advantageous tax status.

*Talk to your Baker Tilly Staples Rodway's specialist trust and tax advisors to ensure that the taxman does not become an undeserving and unwanted beneficiary of more than 50% of your family trust estate.*

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