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Rethinking traditional asset planning in New Zealand

Henry Brandts-Giesen and Sarah Kelly, Kensington Swan, Auckland, on New Zealand's peculiar situation

Asset planning in New Zealand is often motivated by a desire to preserve and enhance the value of private wealth for the benefit of current and future generations of a family. Sometimes this involves transferring property between generations. Other times it involves maintaining the status quo. There are usually two key elements to asset planning – investment and structure.

Financial institutions provide the investment strategy and execution. Nowadays, New Zealand investors have broad access to world class investment advice, brokerage and management services to help grow capital and generate income from financial assets. Sometimes the property involved in an asset plan will be operating businesses or real estate or esoteric assets such as art and antiquities.

Lawyers and accountants typically wrap up family assets in structures to protect them from risk. Risk to private wealth can manifest itself in many forms but in a New Zealand context often arises from:

a Business activities (for example, creditors and statutory liabilities).

b Family disharmony (for example, relationship breakdowns and sibling rivalries).

c Fragmentation (for example, farmland and family businesses).

d Death or incapacity of family members.

e Inflation, taxes, regulations and economic forces.

f Family members who are spendthrifts, have harmful addictions or are financially uninformed.

g Lack of cash flow and/or liquidity.

Private wealth is typically structured, governed and administered in New Zealand in a manner which is quite unique to this country. In other countries, trusts are typically utilised by the wealthy or for the vulnerable. In New Zealand, family trusts are ubiquitous, and it is common for people of quite modest means to hold assets in trust. Sometimes a family may have several trusts, each of which holds a single asset or only a few assets. Trusts have become a default setting for advisers and, furthermore, it seems to be the norm in New Zealand for trusts to be governed by the very same people who set them up and benefit from them. Often trusts are laden with bank debts (perhaps secured and guaranteed by the family) and have only minimal net asset valuations. It is common for family members to expressly or implicitly reserve powers which give them effective control over the assets.

This is all rather peculiar when compared with asset planning in most other countries.

THE EVOLUTION OF THE OFFICE OF TRUSTEE

The role of a trustee and its variants have evolved significantly over many centuries. Grain surpluses 7000 years BCE are purported to have led to the development of the concept of "bailment" and increasing trade in commodities and precious metals led to the concepts of "agency", "brokerage". "custody" and "mandate". The Greeks, Romans and Egyptians all had legal relationships and structures similar to modern day trusts which they used to hold and manage property for estate planning and commercial purposes.

The Knights Templar are perhaps the forerunners of the modern day trustee. In the 11th century, devout pilgrims from Europe sought to visit the Holy Land, but were frequently robbed or exploited on their pilgrimage across south-east Europe and the Middle East. In response, knights were assembled to guard the pilgrims on their travels.

Members of the Order of the Knights Templar developed a reputation as obedient, religious and unpaid defenders of Christians. They were granted exemptions from all local taxes and painted a Templar cross on their properties to declare their tax exemption to the authorities. Predictably, other property owners mischievously copied this and thereby carried out an early example of tax avoidance — until eventually stopped by anti-avoidance legislation.

Members of the Order of the Knights Templar took a vow of poverty. However, the finances of the Order prospered as benefactors endowed them with lands and buildings. In England, they were diligent property managers and consolidators of small parcels of land into large estates.

As a highly respected, well organised and progressively more prosperous religious order, the Knights Templar were entrusted with estates while the owner went on pilgrimage or crusade to the Holy Land. Their estate management and revenue-generation needs compelled them to become regular accumulators, managers and distributors of funds.

An important reason why the Knights Templar were so highly regarded and entrusted with such responsibility was that they were independent, experienced and qualified professionals. They were also subject to rigorously enforced moral, legal and religious codes. They were accountable, organised and structured and were fulfilling a calling that required them to put the interests of others ahead of their own.

It was on this basis that the office of trustee as we know it today evolved in England and then, with the advent of British imperialism, was transplanted to all corners of the globe. However, since Commonwealth independence after the Second World War the use of trusts and the role of trustees in

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various countries has arguably been less influenced by these English origins and jurisprudence as local advisers, courts and legislatures have customised the use of trusts to the domestic context.

In some countries this customisation has been very successful and led to profitable financial services industries and eminent judges, trustees and lawyers have become experts in the law, governance and administration of trusts. In other countries, the outcomes have been less successful. In this paper the authors suggest that in many respects the use, governance and administration of trusts in New Zealand has evolved in a way that leaves some things to be desired (K Wallace "The First Professional Trustees" (2018) 16(2) Trust Quarterly Review 12).

THE CONTEMPORARY NEW ZEALAND APPROACH TO ASSET PLANNING

Trusts are typically the centrepiece of a New Zealand family's asset plan. However, quite often people in New Zealand have assets held in trust in circumstances where they receive only limited benefit from the arrangements. In many cases, the trusts may just add unnecessary complexity and expense to people's lives. This soon becomes apparent when the family is refinancing, buying and selling property, preparing tax returns or adjusting succession planning settings. Some of these trusts may not withstand scrutiny from the court because of the way they are set up and/or operated.

Another unique aspect of New Zealand asset planning is the distinct lack of independent governance of trusts and family investment holding entities (such as underlying companies). Globally, there is an entire industry dedicated to the independent governance of private wealth. However, in New Zealand we tend to conflate the provision of two very distinct functions, legal advice and fiduciary services. In each case the providers of those services require different skills and have duties which are owed to different classes of people. As the New Zealand private wealth sector matures and aligns with other countries, there should be commercial opportunities for independent, professional (and perhaps regulated) trustees to fulfil important governance and administrative roles.

Trusts are one of the most complex legal relationships. Many lawyers do not properly understand trusts and fiduciary powers and duties, let alone lay settlors, trustees and beneficiaries. In New Zealand, most clients are averse to appointing an independent professional trustee who is not also the family lawyer or accountant. A problem with that approach is that the family lawyer or accountant could be conflicted by a long-standing relationship with the people who set up the trust (whose interests may become misaligned with the next generation) and unaware of, or unable to fulfil, fiduciary duties to the wider family. In many cases he or she will not have the specialist skills to perform the role in an increasingly complex and regulated modern professional environment.

In many other countries, it is generally considered undesirable for family members to be the trustees and/or have effective control over the trust. Instead, truly independent, professional and licensed trustees in those countries are typically granted wide discretionary powers which they exercise judiciously, whilst mindful of fiduciary and other duties which are often enforced by the courts and sometimes even by regulators.

Historically, these idiosyncrasies were probably of only academic relevance in New Zealand, given net asset values may have been low and the interests of the beneficiaries and the trustees are often aligned whilst the second generation are young and uninformed. However, in recent years some asset classes have increased exponentially in value and many beneficiaries have grown into adulthood and are likely to be better educated, informed and advised in relation to trust matters. This represents both risks and opportunities for advisers.

SPECIFIC AREAS OF VULNERABILITY FOR TRUSTS

Recent case law has raised questions about the contemporary New Zealand approach to asset planning. There are also increasing avenues through statute and common law by which a trust can be attacked, and the exercise of powers impugned.

Powers as property

Following the decisions in *Clayton v Clayton* [2016] NZSC 29 and *Clayton v Clayton* [2016] NZSC 30, it has become more apparent to New Zealand advisers that where a family member has a high level of control over a trust, the perceived asset protection benefits of the trust may be compromised. In that case the Court of Appeal decided that certain powers reserved to the settlor were property belonging to the settlor on the authority of *TMSF v Merrill Lynch Bank & Trust Co (Cayman) Ltd* [2011] UKPC 17, 1 WLR 1721.

Whilst this decision caused some consternation in New Zealand the principle is fundamentally sound and consistent with international precedent. A personal power under a trust (e.g. a power to revoke the trust or a general power of appointment) that can be used to benefit the person exercising it has a value which may be correlated to the nature and value of the assets of the trust. A personal power is also a right in the general sense. Furthermore, the concept that powers are property long predates *Clayton* and indeed *TMSF*. For example, options to purchase are powers and it is generally accepted that they are property (*Wright v Morgan* [1926] AC 788 (PC)).

A consequence of this is that in respect of non-fiduciary powers reserved to a settlor, the court could, in proceedings brought by creditors or a former spouse or de facto partner, exercise its *in personam* jurisdiction over the power holder and oblige him or her to exercise powers and thus expose the assets to satisfy claims.

Disclosure of information to beneficiaries

An issue that trustees frequently face is how to deal with a beneficiary's request for trust information. The Supreme Court in *Erceg v Erceg* [2017] NZSC 28 is a recent, and leading authority with respect to disclosure of trust information to beneficiaries. In its decision, the Supreme Court held that the starting point where a request for disclosure by a beneficiary is made, is the obligation of a trustee to administer the trust in accordance with the trust deed and the duty to account to the beneficiaries of the trust. This creates a presumption of disclosure to beneficiaries. However, the Supreme Court went on to set out the following factors which should be considered by the trustees where a beneficiary has requested disclosure of trust information:

a The nature of the documents that are sought;

b The context for the request and the objective of the beneficiary in making it;

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c The nature of the interests held by the beneficiaries seeking access;
d Whether there are issues of personal or commercial confidentiality;
e Whether there is any practical difficulty in providing the information;
f Whether the documents sought disclose the trustees' reasons for decisions made;
g The likely impact on the trustee and the other beneficiaries if disclosure is made;
h The likely impact on the settlor and third parties if disclosure is made;
i Whether disclosure can be made while still protecting confidentiality (e.g. through redaction); and
j Whether safeguards can be imposed on the use of trust documents (e.g. undertakings and inspection by professional advisers only).

The Trusts Bill which is currently before Parliament proposes to deal with the issue of disclosure of trust information to beneficiaries by expressly stating:

a A presumption that trustees will give to beneficiaries and their representatives basic trust information;
b A presumption that trust information will be given to a beneficiary or their representative upon request; and
c An exception to the above presumptions if certain factors exist.

Clawback provisions available to creditors

Creditors may have a claim against assets in a debtor's trust pursuant to the Property Law Act 2007 (PLA) and the Insolvency Act 2006 (IA).

Sections 344 to 350 of the PLA enable the court to set aside certain dispositions of property. Where a certain disposition has been made to a trust, the court may be able to 'claw back' assets that are held in that trust.

Sections 204 to 213 of the IA concern voidable gifts. Under s 204, if a gift is made within two years of a person being declared bankrupt, the gift may be cancelled at the initiative of the Official Assignee. Under s 205, if the bankrupt person makes a gift within two to five years of being adjudicated bankrupt, and at the time of making the gift the bankrupt was unable to pay his or her due debts, the gift may be cancelled. A bankrupt is presumed to have been unable to pay his or her debts unless the party claiming under the gift proves that the bankrupt was — immediately after the making of the gift, or at any time after that up to his or her adjudication — able to pay his or her debts without the aid of the property subject to the gift. There is a defence under s 208 of the IA where a person receives a gift without reasonable grounds for suspicion of the donor's insolvency and alters his or her position in reliance upon that gift.

Clawback and compensation provisions available to spouses and de facto partners

Claims by a party to a previous relationship can also be made against a trust under the Property (Relationships) Act 1976 (PRA) and the Family Proceedings Act 1980 (FPA).

Section 44 of the PRA is a clawback provision which allows the court to set aside a disposition of property made to a person where the disposition is made with the intention of defeating the rights of that person's spouse or partner under the PRA.

Section 44C of the PRA allows the court to make orders compensating a spouse or partner whose rights have been defeated by a disposition of relationship property to a trust. The court will look at whether the disposition has the effect of defeating the rights of a spouse or partner, regardless of the intention of the party in disposing of the property to a trust. Section 44C is subordinate to s 44, so the court must be satisfied that s 44 does not apply before addressing a claim under s 44C.

Section 182 of the FPA gives the court a wide discretion to revisit the terms of any agreement or settlement made before or during a marriage or civil union. It is important to note that the FPA only applies to married, and not de facto, couples. However, it seems likely that this anomaly will be addressed in future legislative changes. Section 182 of the FPA was considered in *Clayton v Clayton* and orders made to the effect that the trust in question was a 'nuptial' settlement and therefore the assets held within it were subject to the jurisdiction of a s 182 claim. As a consequence, orders were made in favour of the former wife of the settlor in relation to those assets and to the prejudice of the settlor who argued unsuccessfully that those assets were not relationship property but rightfully belonged to the trust.

Anti-avoidance provisions in other legislation

Certain anti-avoidance provisions in legislation empower government departments to disregard a trust in certain circumstances. These include — the Social Security Act 1964 (SSA), the Child Support Act 1991 (CSA), the Income Tax Act 2007 (ITA) and the Criminal Proceeds (Recovery) Act 2009.

Under s 147A of the SSA, if the Chief Executive of the Ministry of Social Development is satisfied that an applicant for social welfare benefits or his or her partner has 'directly or indirectly deprived himself or herself of any income or property' (other than an exempt asset) the Chief Executive may conduct a means assessment of the applicant on the basis that the deprivation had not occurred. This means that assets that have been transferred to a trust, or income that is earned by a trust, may still be included in an applicant's means assessment. This could result in an applicant being ineligible to receive a residential care subsidy, for example.

Amendments to the CSA regulate the use of trusts to avoid child support payments. A person's income for the purposes of assessing child support now includes:

a Income retained in a close company where the person is a major shareholder;
b Trustee income where the person is a settlor of a trust, other than by virtue of providing personal services for less than market value in the administration or the maintenance of trust property. A 'settlor' for these purposes is defined in the ITA and includes any person who transfers value to or for the benefit of a trust.
c Other payments received by a person and used to replace lost income or to meet their usual living expenses where the total payments exceed $5000 per year. This includes capital distributions from a trust, regardless of whether the person is a settlor of that trust.

Trust structures intended to enable tax avoidance are dealt with in the ITA. Where a single step in an arrangement or transaction is for the principal purpose and has the effect of tax avoidance, the arrangement, as a whole, can be considered tax avoidance. Where this occurs, the Commissioner

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may revise the taxable income of those affected by the arrangement to eliminate any advantage obtained.

Real or personal property that is the proceeds of, or used in the commission of, serious offences may be forfeited to the Crown under the Criminal Proceeds (Recovery) Act 2009. This could occur even if such property is held in a trust rather than by the offender personally.

Common law considerations

A trust may also be compromised under common law principles.

Sham

A sham trust is an oxymoron. However, where there is intention to deceive as to the true nature of a transaction a court may order that arrangements which purport to be a trust are a sham and therefore disregarded. Generally, a common intention to deceive is required at the time of creation of the trust, or when property is transferred into the trust (known as an 'emerging sham'). Where there is an emerging sham, only the property transferred into the trust at the relevant time is at risk. The common intention between the settlor and either the beneficiaries or the trustees must be evidenced, and is determined by the court by looking at the subjective intention behind the documentation. The evidential criteria to be satisfied is onerous. As such, poor administration, breaches of trust and lack of legal knowledge are not in themselves sufficient for a court to make the finding. This high threshold exists to preserve the certainty of commercial arrangements and beneficiary rights.

The recent decision in *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) highlights some issues that lawyers and their clients need to consider before establishing a trust and which hitherto were not necessarily considered to be badges of sham.

Mr Pugachev was an extremely wealthy Russian oligarch. He founded Mezhprom Bank in 1992 and was involved in Russian politics. Following the global financial crisis, Mezphrom Bank was struggling and ultimately failed. Mr Pugachev fled Russia after criminal investigations were opened against him and formed five New Zealand foreign trusts. The value of the assets settled on the five trusts was over US$95 million. Mr Pugachev was the protector under each trust and retained significant power and control. Mr Pugachev had in practical effect:

a a right to information from the trustees;
b the power to appoint new discretionary beneficiaries;
c the power to appoint and remove trustees; and
d a right to veto all major decisions of the trustees, including investment, distribution of income and variation of the trust deed.

Numerous proceedings were brought around the world relating to the collapse of Mezhprom Bank, including a worldwide asset freezing injunction against Mr Pugachev. These particular proceedings were brought by Mezphrom Bank and its liquidator. It was claimed that the beneficial interest in the assets held by the five New Zealand trusts belonged to Mr Pugachev.

The court considered two claims in relation to the trusts. The first was whether Mr Pugachev transferred control of the assets to the trusts at the time they were established or whether beneficial title to the assets remained with Mr Pugachev. The court also considered whether the trusts were shams.

In considering whether Mr Pugachev transferred control of the assets to the trusts at the time they were established, the court relied on the decision in *Clayton v Clayton*. The court held that Mr Pugachev's powers as protector were personal (as opposed to fiduciary powers), because of the extensive nature of the powers combined with the fact that Mr Pugachev was also the settlor and one of the discretionary beneficiaries. This meant that Mr Pugachev could exercise his powers as protector for his own benefit, without considering the interests of the discretionary beneficiaries. On this basis it was held that the terms of the trusts did not divest Mr Pugachev of the beneficial ownership of the assets he transferred into the trusts.

The court also went on to consider the sham claim in case the proper construction of the trusts deeds was that the protector's powers were fiduciary. It was held that if the protector powers were fiduciary rather than non-fiduciary then the trusts were shams. The court noted that in determining whether a sham exists, it is necessary to look to the documents establishing a trust or the acts that purport to set up a trust. In considering whether a document is a sham, the focus is on the subjective intentions of the relevant parties. The conclusion that the trusts are a sham was reached because at all material times Mr Pugachev regarded all the assets in the trusts as belonging to him and intended to retain ultimate control over such assets. The point of the trusts was not to cede control of his assets to someone else, it was to hide his control of them. In other words, Mr Pugachev intended to use the trusts as a pretence to mislead other people by creating the appearance that the property did not belong to him when really it did.

This case is unusual, and the judgment may be questionable. However, it is an example of a court making an adverse ruling against trusts where a person is seen to be exercising effective control over the assets. Practitioners should be cautious of the need to diversify trust powers so as to ensure that no one individual can be seen to be effectively controlling the trust.

Alter ego

A trust may be deemed to be the alter ego of the settlor where the settlor has exerted too much control over the administration of the trust, and by extension, the trustees. This issue has primarily arisen in the context of de facto or marital relationships, where there is a question as to whether a partner is entitled to receive a share of the trust property on relationship breakdown. Features of an alter ego arrangement include a lack of independence by the trustees (acting at the instruction of the settlor), reservation of powers for the settlor (e.g. sole ability to appoint and remove trustees), and a lack of records regarding the administration of the trust. Despite the finding of alter ego, the trust may not automatically be disregarded by the courts as it is not an independent cause of action, but rather, it may constitute evidence to prove a sham argument.

Illusory trust

The concept of an illusory trust is relatively new and may arise when a settlor maintains wide powers of control over the trust property. Like an alter ego arrangement, a trust cannot be declared invalid merely because it is deemed to be illusory. Instead, relevant evidence may support an argument that the trust is invalid because it is a sham.

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Constructive trust

A constructive trust is a trust that arises by operation of law, rather than by express declaration of the settlor or trustees. A constructive trust may be imposed by the court on the basis that it would be unconscionable for the person on whom the trust is imposed to deny a beneficial interest to the claimant.

Constructive trusts were sometimes claimed by former de facto partners and sometimes imposed by the courts on personal property before the PRA was extended to apply to de facto relationships. Where a constructive trust was imposed, a party to a de facto relationship was typically able to claim an interest in trust property.

It is also possible for constructive trusts to be imposed over property owned by an express trust. This occurred in *Vervoort v Forest* [2016] NZCA 375. In that case, the settlor of an express trust, Mr Duffy, was also one of two trustees but was able to exercise a high level of control over the trust, due to a lack of involvement from the other trustee in the management and decision-making of the trust. The Court of Appeal found that where one partner has de facto control of a trust and contributions have been made and expectations between the parties to the relationship have arisen, the non-controlling partner may make a claim. In such situations, a constructive trust can and should be imposed over the assets of an express trust if it is equitable to do so.

Where a constructive trust is found, the remedy will depend on the contributions made to the trust property by the prejudiced relationship partner. The remedy is unlikely to be an equal share in the trust property, but it may be significant.

Resulting trust

Resulting trusts arise by operation of law, where property transferred to a trust is held for the benefit of the transferor. For example, it could be held that a resulting trust exists where a family home is held by a trust and that trust is in fact controlled by one spouse. In such a situation, the family home could be found to be beneficially held by the controlling spouse and therefore subject to the rules of the PRA. Resulting trusts have not yet been considered in the context of family trusts in New Zealand, but it is conceivable that the concept may be extended to them in certain circumstances.

INCREASING COMPLIANCE BURDEN FOR TRUSTEES

Another emerging theme in the law and administration of trusts in New Zealand is the increasing compliance burden being imposed on trustees and their advisers. This too is having an impact on the contemporary New Zealand approach to asset planning. Over recent years the governments of developed countries have increased their efforts to combat tax evasion and organised crime by introducing onerous and complex compliance regimes and extending their scope beyond financial institutions.

These compliance regimes are resulting in significant changes to the ordinary course of business for lawyers, accountants and trustees in New Zealand and, in a trust context, require them to gather much more information about settlors, beneficiaries, trustees and the provenance of the underlying property. The regimes also impose obligations to disclose information to law enforcement and government agencies, in certain circumstances. This is a paradigm shift from the traditional role of a trusted adviser. It will also likely increase the time and cost involved in setting up and running trusts.

These regimes are also part of a paradigm shift in the way that laws are enforced. Enforcement agencies and revenue authorities have shifted emphasis from the traditional approach of investigating offenders directly. Instead they are imposing information gathering obligations on the third parties and intermediaries with whom offenders interact and have professional relationships. In terms of effectiveness, this is likely to be as successful as it is controversial.

There are all manner of public policy issues that arise from this new approach to law and revenue enforcement. However, the reality is these compliance regimes have been implemented and are here to stay. The Rubicon has been crossed and now lawyers, accountants and trustees must meet the challenge of compliance.

FATCA

The Foreign Account Tax Compliance Act (FATCA) is US legislation with global effect designed by the United States Internal Revenue Service (IRS) to detect and prevent tax evasion by people with funds held in offshore accounts who should be paying tax in the United States.

FATCA made its way into New Zealand law when an intergovernmental agreement was made between the United States government and the New Zealand government in 2014. The legislation places the onus of reporting to the IRS on foreign financial institutions which hold financial assets, as opposed to the individual account holder themselves.

The definition of 'financial institution' under FATCA is extremely wide, and the regime may impose on some trusts the obligation to register on the IRS website as a 'financial institution'. Remarkably, this is so even though the trust is not involved in the financial services industry and may have no US citizens or tax residents or US investments connected with it.

Every trust in the known universe will be either a FFI (foreign financial institution) or a NFFE (non-financial foreign entity) for FATCA purposes. The terms are all encompassing and mutually exclusive. The precise classification of a trust will depend on what assets are held and who 'manages' it. This requires trustees and their advisers to actively engage in an entity classification process for every trust for which they have responsibility.

If a trust is a FFI for FATCA purposes, it must register as such on the IRS website and obtain a Global Intermediary Identification Number (GIIN) – even where there is no US person controlling or otherwise connected to the trust (e.g. beneficiaries and settlors). If there are US persons controlling the trust then the trustee will need to report certain information to the IRS in relation to them.

CRS

The Common Reporting Standard (CRS) is essentially a global version of FATCA. CRS builds on FATCA with its aim being to combat offshore tax evasion on a global scale. Like FATCA, CRS applies only to entities and not individuals and a trust is an entity for these purposes. Again every trust in the known universe will be either a FI (financial institution) or NFE (non-financial entity) for CRS purposes. This requires trustees and their advisers to actively engage in an entity classification process for every trust for which they have responsibility.

If a trust is a FI for CRS purposes, it must register as such with the IRD and if there are controlling persons who are

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resident in a foreign country then the trustee will need to report certain information to the IRD, which will then exchange that information with the relevant foreign country.

It is very possible for an orthodox New Zealand discretionary family trust to be caught by the FATCA and/or CRS regimes and become subject to reporting requirements. Failure to comply can result in financial penalties to the trustees (and directors of corporate trustees) under the Tax Administration Act 1994.

AML/CFT

The Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (AML/CFT Act) is the cornerstone of the New Zealand anti-money laundering and countering terrorist financing regime. As with related legislation around the world, the AML/CFT Act requires a 'reporting entity' to conduct customer due diligence on a customer before undertaking any business activities with them.

In New Zealand, the definition of reporting entities includes:

a Financial institutions;
b Financial advisers;
c Trust companies;
d Casinos;
e Lawyers and conveyancers (from 1 July 2018);
f Accountants (from 1 October 2018);
g Real estate agents (from 1 January 2019); and
h Businesses trading in high value goods (from 1 August 2019).

Where a reporting entity (for example, a bank or law firm) establishes a relationship with a trust, that reporting entity must conduct an enhanced form of customer due diligence on the trust and certain persons associated with the trust. This is because trusts are internationally recognised as presenting a high risk of money laundering and terrorist financing.

In practice, this means that where a trust wishes to establish a relationship with a reporting entity, the trustees are required to provide detailed and comprehensive documentation so that the reporting entity can satisfy its obligations under the AML/CFT Act. This includes verified documentation about the trust, settlor, trustees, protector, beneficiaries, and the source of wealth.

EU's 4th Anti-Money Laundering Directive

On 26 June 2017 the European Union's 4th Anti-Money Laundering Directive was implemented into United Kingdom law by the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (the Regulations).

The Regulations update the United Kingdom's existing anti-money laundering regime. In doing so, they introduce new beneficial ownership reporting requirements for trusts which are subject to United Kingdom taxation. A trust set up anywhere in the world could be subject to United Kingdom taxation by virtue of owning property (for example, real estate or shares in listed or unlisted companies) or having a United Kingdom resident trustee, settlor or beneficiary or a United Kingdom domiciled settlor. The reporting aspects of the Regulations have extraterritorial effect as they purport to apply regardless of where the settlor, trustee and beneficiaries are resident for tax purposes.

Affected trustees are required to report a wide range of information to Her Majesty's Revenue & Customs. Due to the complexity of the United Kingdom tax system, reporting obligations may arise in unexpected ways, such as owning shares in United Kingdom listed companies. There are civil and criminal penalties for non-compliance, and so it is important for New Zealand-based trustees, lawyers and accountants to have a basic understanding of the circumstances in which United Kingdom taxation (and therefore a reporting obligation) may arise in respect of a trust for which they have responsibility. With the automatic exchange of information under the CRS detection and enforcement is more likely than ever before.

CONCLUSION

The traditional approach to asset planning in New Zealand is starting to present issues. Tens of thousands of trusts in New Zealand have been set up by Baby Boomers over the past few decades. Many of these trusts are now pregnant with substantial wealth which the next generation of the family are, or will be, keen to access. It is likely that well advised beneficiaries will scrutinise the decisions of the trustees and may find defects in governance or administration which could lead to legal challenges and, ultimately, transactions being invalidated and trustees being found personally liable.

Furthermore, families are now more likely to be blended and living across different borders, creating additional complexities. Tax should not be a driver in the establishment of trusts given the relatively benign fiscal environment in New Zealand (there is currently no inheritance tax, stamp duties or wealth tax, which is unusual for an OECD country). In any event, revenue authorities nowadays typically 'look through' trusts and corporate entities to the beneficial owners. So trusts in New Zealand should be used more judiciously and for the purposes that they were always intended, such as succession planning, asset protection and philanthropy.

In many cases, succession planning and asset protection objectives might be better achieved through other legal devices such as wills, family charters, testamentary trusts, relationship property agreements, limited liability companies and financial products such as insurance and annuities or fixed interest securities. Corporate and commercial tools such as share schemes, drag and tag rights, option agreements, rights of pre-emption, preferential shares and shareholder agreements can also be utilised to good effect and without the constraints of fiduciary duties.

Nevertheless, there will always be applications for trusts when asset planning for certain clients. Some New Zealanders are now starting to enjoy the benefits of private wealth which has been aggregated over several generations (something that has not hitherto been common in a relatively young country) and many new migrants are bringing substantial wealth into the economy from offshore. There will also always be a need for trusts to protect the vulnerable. Where a trust is appropriate, good governance and proper administration is far more important than complex and purportedly clever planning. ❐