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New Zealand Pre-Migration Trust (PMT)

Introduction

A person who intends to migrate to New Zealand (including a returning expatriate of New Zealand) (“Migrant”) should settle assets on a Cook Islands trust (“PMT”) prior to arrival in New Zealand. If no further settlements are made upon the PMT after the Migrant takes up residency, a tax deferral opportunity is available.

Rationale for the PMT

The main issues facing a Migrant are:

- New Zealand taxes residents on their worldwide income, which can include unrealised gains from foreign investments. Personal rates of income tax reach a maximum of 39% on gross income of more than \$60,000.
- Potential for re-introduction of death taxes. Although this legislation was abolished by the former Government and its reintroduction is no longer part of the present Labour Government's policy, policy may change or its reintroduction may be forced on a left-wing government by a smaller party under New Zealand's proportional representation system.
- New Zealand law relating to relationship property claims by an estranged spouse or de-facto partner (3 years co-habitation generally qualifies a partner for 50% of assets acquired during the relationship) and family claims on probate.
- Most wealthy New Zealanders hold substantial personal assets via New Zealand domestic trusts for creditor protection, but must either pay gift duty to transfer their assets to the trust or must sell their assets to the trust with a debt back. The debt (itself an asset) is only able to be forgiven by a person at the rate of \$27,000 every 12 months without attracting gift duty. (Gift duty is payable at progressive rates according to the value of dutiable gifts made by the donor within a 12-month period, the highest rate being \$5,850 plus 25% of excess over \$72,000.)
- There is no comprehensive capital gains tax in New Zealand, but many capital gains are subject to income tax (e.g. profits made on active share trading and certain land transactions).

Timing

New Zealand's rules on tax residence necessitate some planning, because the date a Migrant gains residency in New Zealand may not necessarily coincide with the date he arrives in New Zealand to live.

A person who is physically present in New Zealand for 183 days in any 12 month period, whether consecutive or not, is deemed to be resident in New Zealand. The deemed residence is backdated to the first day of presence in New Zealand during the relevant 12-month period. This statutory backdating has significant implications a Migrant who has employment interviews in New Zealand or who makes an advance visit to New Zealand.

Once a Migrant becomes resident in New Zealand, the opportunity to settle a PMT is lost, with potentially significant tax consequences. Foreign sourced income derived by a trust settled by a New Zealand resident is subject to New Zealand income tax. By contrast, if a PMT is settled before the Migrant gains New Zealand residency, foreign sourced income of the trust will not be liable to New Zealand tax.

Overall Strategy

The most effective strategy is to set up a nest egg structure in which a Migrant places a portion of his wealth that he will not need to draw on in the foreseeable future in the PMT, where it can accumulate in a tax advantaged environment. The structure is ideal for a Migrant who is in a position to leave funds in income-producing investments offshore, untouched, for a significant period of time.

The Migrant should bring into New Zealand (and leave out of the PMT) sufficient funds for purchasing personal assets, setting up a business, and other such expenditure that might be incurred in New Zealand.

Tax Implications of the PMT

If the PMT is settled before the Migrant gains New Zealand residency, foreign sourced income of the trust will not be liable to New Zealand tax.

The corpus of the trust can be distributed tax free at any time, subject to ordering rules which deem income and capital gains to be distributed first. There are strategies for minimising the effect of these rules if distributions are essential.

Additionally, with careful structuring, the PMT may make capital investments into New Zealand which will not be deemed distributions, and at the same time minimise New Zealand tax on those investments by using a high level of offshore financing.

Distributions made to New Zealand resident beneficiaries after the Migrant becomes New Zealand resident are subject to a tax at varying rates, the most severe being 45%. Although this is 6% above the maximum personal tax rate of 39%, there is still a substantial advantage in using a PMT because of the deferment of tax on growth of the investment.

Gift duty in New Zealand is not related to tax residence but rather to a person's domicile. If a Migrant is not domiciled in New Zealand, the initial transfer of assets to the PMT will not be subject to gift duty in New Zealand. If the Migrant is domiciled in New Zealand (e.g. a returning New Zealand expatriate who retained New Zealand domicile during his period overseas), the initial transfer of assets to the PMT will technically be subject to gift duty in New Zealand. If this is the case, there are various ways of minimising the gift duty payable.

Trust Structure

The Cook Islands is recognised as a world leader in formation of international trusts, safeguarding the assets of high net worth clients. Cook Islands law is up to date and contains a number of unique features that make the operation of a trust both efficient and effective. In addition, a Cook Islands international trust is tax exempt in the Cook Islands.

The trust is formed in the Cook Islands, with a non-New Zealand resident trustee. The Migrant (and New Zealand resident beneficiaries) may have fixed beneficial interests, but trustees should retain discretion as to the amount and timing of any distributions, as well as the discretion to accumulate.

Investment Structure

The assets and investments of the PMT should be situated outside New Zealand. The trustee may delegate asset and investment management to a third party, who should not be New Zealand resident.

Exit Strategy

At some point in time the Migrant may want to wind up the PMT and liquidate the assets. There are various ways of achieving this.

Throughout the initial 12 month period after becoming New Zealand resident, the Migrant has the opportunity to opt out of the PMT structure (i.e. the Migrant may elect to satisfy the New Zealand income tax liability of the trust, enabling the trust to convert to a domestic trust).

After the initial 12 month period, the only way for a Migrant to convert the PMT to a domestic trust is for the PMT to re-settle the trust assets on to a domestic trust. This is likely to be viewed as a distribution, as the domestic trust is likely to be viewed as a New Zealand resident beneficiary. Such a distribution will be subject to a tax at varying rates, the most severe being 45%.

The PMT could make a distribution of the entire trust fund to a New Zealand resident beneficiary. Again, the distribution will be subject to a tax at varying rates, the most severe being 45%.

A person who relinquishes New Zealand residency for more than five years can then withdraw accumulated income from the PMT without incurring any New Zealand tax liability (and can then subsequently regain New Zealand residency). For periods of less than 5 years New Zealand tax liability will apply.

Reporting Obligations

For the first 12 month period calculated from when the Migrant becomes New Zealand resident, the PMT is treated as a foreign trust. There is no obligation to disclose the existence of the trust to the New Zealand Inland Revenue, unless a distribution is made to a New Zealand resident beneficiary.

Thereafter, the PMT is treated as a non-qualifying trust unless an election is made within that 12 months for all income of the trust to be subject to New Zealand tax. There is no obligation to disclose the existence of the trust to the New Zealand Inland Revenue.

If the PMT made a distribution to a New Zealand resident beneficiary (including any deemed distributions) then the beneficiary would have an obligation to include that distribution in his tax return. The non-resident trustee is unlikely to have any reporting obligations. (Note that if an extremely large distribution was made to a New Zealand resident beneficiary then the provisional taxpayer rules may apply giving rise to additional reporting obligations.)