Inland Revenue
Te Tari Taake

INTERPRETATION STATEMENT | PUTANGA WHAKAMĀORI

Income tax – Whether money or property received by New Zealand tax residents from overseas is income from a foreign trust

Issued | Tukuna: 7 August 2025

IS 25/18

This interpretation statement considers the income tax treatment of amounts of money or property that New Zealand tax residents receive from a person overseas, including through inheritance. It addresses how to determine whether the person who transfers the money or property is a trustee of a trust and when the resident taxpayer has derived beneficiary income or a taxable distribution from a foreign trust.

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

REPLACES | WHAKAKAPIA

- **IS 19/04**: Income tax – distributions from foreign trusts

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Key terms | Kīanga tau tāpua

1. The discussion in this interpretation statement uses terms that may be unfamiliar to some readers. To improve understanding, this section describes these terms in a non-technical way.

Table | Tūtohi 1 – Key terms

Term	Description
Administrators	People appointed by the court to administer an estate.
Assent	Describes what occurs at the point of administration of an estate when, either expressly or by implication, personal representatives accept that estate property can be distributed or should be held on trust.
Bare trust	A trust where the trustee's only duties are to guard trust property and transfer it to a beneficiary when required to do so. A bare trust is treated in the same way as a nominee for tax purposes.
Beneficiary income	Income a trustee derives but is vested in a beneficiary or paid to a beneficiary within prescribed timeframes.
Civil law countries	Countries that have legal systems based on Roman civil law or law other than English common law, such as France and Germany.
Common law countries	Countries that have legal systems based on English common law, such as Australia and New Zealand, rather than Roman civil law or other law.
Complying trust	A trust in which the trustee has paid tax on worldwide income and can distribute amounts other than beneficiary income tax free.
Corpus	The value (at the time of settlement) of property settled on a trust.
Executors	Executors are people the testator appoints to carry out the instructions in a will.
Foreign trust	A trust that has had no New Zealand tax resident settlor.
Non-complying trust	A trust that is neither a complying trust nor a foreign trust.
Non-discretionary trust	A trust where trustees have no discretion to determine the source, nature and amount of distributions to beneficiaries.
Ordering rules	Rules in s HC 16 that specify the components of a distribution to determine whether they are a taxable distribution from a foreign trust or non-complying trust.
Personal representatives	Executors or administrators.

Settlors	Persons who transfer value to a trustee for the benefit of beneficiaries.
Taxable distributions from a foreign trust	Transfers of value that trustees of foreign trusts make to beneficiaries, other than transfers of value that are in any of the categories listed in s HC 15 (eg, beneficiary income, certain capital gains and corpus).
Testators	People who make wills disposing of their property after death.
Trustee income	In general, income a trustee derives that is not beneficiary income.
Trust	A trust is not an entity but a fiduciary obligation on someone to hold property for beneficiaries or charitable purposes.

Summary | Whakarāpopoto

Trusts

2. New Zealand tax residents who are not transitional residents[1] are generally liable to pay income tax on income they derive from sources in New Zealand and worldwide. Their assessable income includes money or property someone offshore transfers to them as "beneficiary income" or a "taxable distribution from a foreign trust"[2].

3. The concepts of beneficiary income and taxable distributions require that the money or property comes from a "trust" as that term is interpreted under New Zealand tax law. When determining the application of New Zealand tax legislation to an arrangement to which the laws of a foreign jurisdiction apply, the Commissioner considers that a two-step approach is required:

    - The first step is to determine the legal rights and obligations that exist between the parties. The contractual arrangements and foreign law are used to determine those legal rights and obligations.

[1] Transitional residents are, in general, taxpayers who have become tax resident in New Zealand for the first time or previous residents returning to New Zealand after an absence of 10 or more years. They generally do not pay tax in New Zealand on income from foreign sources for approximately 4 years.

[2] The distribution could also come from a foreign trust with a New Zealand tax resident trustee but this scenario is not the focus of the statement.

- The second step is to consider the application of the New Zealand law contained in the Act to those legal rights and obligations. The foreign law is irrelevant at this stage.

4. It follows that the person transferring the money or property must have held it according to arrangements where the essential features of a trust under New Zealand law are present. This means the person must have held the money or property as trust property with an equitable obligation to deal with it for the benefit of a person or charitable object.

5. Whether such an obligation exists depends on whether the circumstances give rise to something that would be within the concept of a trust if the issue were to be decided under New Zealand law. No matter where in the world property is situated, if the legal basis on which it is owned or controlled and the surrounding circumstances involve obligations that New Zealand law would recognise as trust obligations, then a trust exists. The trust exists whether or not the law of another country would recognise the situation as a trust and whether or not the trust law of another country is the same as trust law here.

6. Where a trust exists (unless it is a "bare trust" – see [138]), a distribution from it will be beneficiary income if it:

   - is current-year income that trustees derive but that vests absolutely in interest in a beneficiary in the income year; or
   - is paid to a beneficiary in the income year (or within the extended time period provided by s HC 6(1B)).

7. For an amount that is not beneficiary income to be a "taxable distribution from a foreign trust", the trust must have had no New Zealand tax resident settlor. In addition, the transfer must amount to a "taxable distribution".

8. A transfer of money or property to a New Zealand resident taxpayer as a beneficiary of a foreign trust is a taxable distribution if it is not excluded by s HC 15(4) (eg, beneficiary income, certain capital gains and corpus[3]). However, the ordering rules in s HC 16 (see from [84]) may apply and may override what would normally be the character of the components of the distribution based on the terms of the trust deed or the trustee's description of the distribution. Applying the ordering rules requires the trust to keep good financial records. The onus is on the beneficiary to obtain that information; otherwise, the entire amount they receive will generally be treated as a taxable distribution.

[3] Distributions that are a foreign superannuation withdrawal or a pension are also excluded as these are taxed under other parts of the Act.

9. An important exception to the requirement to apply the ordering rules is for distributions from non-discretionary trusts created by will or arising after intestacy (see [90]).

10. A New Zealand tax resident pays tax on beneficiary income and taxable distributions from a foreign trust at their marginal tax rate. Beneficiary income that a minor or a close company derives is excluded income and taxed to the trustee at 39%[4].

11. If a bare trust exists instead of a foreign trust, a New Zealand tax resident may have income from property they hold overseas. Such income may include interest, dividends, financial arrangement income, foreign investment fund (FIF) income, controlled foreign company (CFC) income and rental income.

Estates

12. Where the money or property transferred to a New Zealand tax resident is an inheritance, it may be subject to tax if a foreign trust arises following administration of the deceased's estate. This is unlikely to be the case (although it is possible) where the deceased was a tax resident in a country that does not have the concept of a trust as part of its law. Where an inheritance does not come from a trust because the law in the country concerned provides for immediate succession to the heirs on the person's death, the New Zealand resident taxpayer may need to account for income in New Zealand that they derive from the property inherited as described at [11].

13. To administer an estate in a country with a legal system like that in New Zealand, personal representatives identify the property available for distribution, pay expenses owed by the deceased and then either transfer the property to beneficiaries or vest it in someone acting in the capacity of trustee. Until they have assented to such transfers or vesting, the personal representatives have the legal and beneficial interests in the property which comprises the estate and no trust arises.

14. Where personal representatives are also trustees of a testamentary trust, the residue (or part of it) will vest in those representatives following assent and they will hold it on trust and in their capacity as trustees. Where separate trustees are named, the equitable interest in the property vests following assent but personal representatives must do what is necessary to transfer legal title to the trustees.

15. A bare trust may mark the interval between assent and the time when any beneficiary under the will takes legal title. Where a trust following assent is a bare trust, there is effectively no trust for tax purposes. As described at [11], a New Zealand tax resident may need to account for income they have derived from the property overseas.

[4] See ss HC 7(2) and HC 7(2B).

16. In contrast, testamentary trusts can take the form of express trusts, life interests and minority interests (see [121]). They will not be bare trusts.

17. Like other foreign trusts outside the context of deceased estates, when a foreign trust arises from a deceased estate offshore, amounts distributed to beneficiaries in New Zealand may be beneficiary income or taxable distributions. Any foreign-sourced amounts that an individual derives will not be "reportable income". This means the amounts will not have been pre-populated in the individual's return. Unless the total of income other than reportable income is under $200[5] or the income is beneficiary income of a minor or close company taxable to the trustee, the individual will need to include it separately as "other income" in their tax return. Tax is payable at marginal tax rates.

Tax rules for distributions from foreign trusts

18. This section contains detailed analysis about the tax rules that apply when a New Zealand tax resident who is not a transitional resident inherits or receives a distribution of money or property from someone overseas. If the money or property comes from a foreign trust, the tax resident may have a tax liability.

Tax for New Zealand residents generally

19. This interpretation statement is concerned with the tax rules that apply to a New Zealand tax resident who is not a transitional resident. For the Commissioner's views on the tests for whether somebody is a tax resident in New Zealand, see **IS 25/16**: Tax residence.

20. A New Zealand tax resident is generally liable to income tax in New Zealand on income they derive from sources in New Zealand and worldwide. Exceptions exist for exempt income and excluded income (although excluded income can be taxable under other provisions such as taxable distributions from non-complying trusts: s BF 1(b)). However, for a New Zealand tax resident, if an amount is income, whether it comes from New Zealand or overseas will not generally make a difference to its taxability.

21. Further, an amount may be income that a New Zealand tax resident derives regardless of whether the amount itself ever comes to New Zealand.

22. This principle of taxing the worldwide income of New Zealand tax residents includes income from trusts established overseas. If tax is also paid overseas on current-year income, New Zealand will generally allow a foreign tax credit if the tax is provided for

[5] Section 22K(1) of the Tax Administration Act 1994.

in a double tax agreement or is of substantially the same nature as income tax imposed in the Act.[6]

Taxation of income from trusts – overview

23. The laws dealing with trust taxation[7] (referred to here, for convenience, as the "trust rules") generally tax amounts derived through trusts as "trustee income", "beneficiary income" or "taxable distributions".

24. Trustees are liable for tax on trustee income. Beneficiaries are generally liable for tax on beneficiary income and taxable distributions.

25. Trustee income is generally income trustees derive that is not beneficiary income. Whether an amount a trustee derives is trustee income or beneficiary income depends (broadly) on whether the amount is income that the trustees retain (trustee income), or that is transferred to beneficiaries (beneficiary income) either because:

    - it vests absolutely in the beneficiary; or
    - it is paid within prescribed timeframes.

26. New Zealand tax residents (other than transitional residents) are generally taxable on beneficiary income from all trusts, whether the trustees derived the income from New Zealand or offshore and whether or not it is repatriated. Some beneficiary income is taxed at the trustee level rather than to the beneficiary as noted at [10]. For transitional residents, foreign-sourced beneficiary income is exempt income[8] – that is, it is not taxable.

27. The trust rules classify trusts as complying trusts, foreign trusts or non-complying trusts. These classifications are relevant to determining whether distributions of amounts other than beneficiary income are taxable to New Zealand tax residents. A trust may be both a complying trust and a foreign trust. For the purposes of distributions, a "dual-status trust" is treated as a complying trust.

28. Distributions from complying trusts to beneficiaries are not taxable income to a beneficiary unless they are distributions of beneficiary income.

29. Distributions from foreign trusts to beneficiaries are called "taxable distributions", unless they are distributions of beneficiary income, corpus or certain capital profits.

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[6] For more information, see **IS 21/09: Income tax – foreign tax credits – how to calculate a foreign tax credit** *Tax Information Bulletin* Vol 34, No 1 (February 2022): 27.

[7] For more information, see **IS 24/01: Taxation of trusts** *Tax Information Bulletin* Vol 36, No 2 (March 2024): 8.

[8] See ss HR 8 and CW 27 of the Act.

They are taxable to New Zealand tax resident beneficiaries when those beneficiaries derive them.

30. Distributions from foreign trusts with non-resident trustees of beneficiary income and taxable distributions to New Zealand tax resident beneficiaries are the focus of this statement.

31. In most cases, a trust is a foreign trust where no settlor has been a tax resident in New Zealand at any time since a settlement was first made on the trust.

32. Any trust other than a complying trust or a foreign trust is a non-complying trust. Beneficiary income from non-complying trusts is taxable to New Zealand tax residents. Distributions to New Zealand tax residents from non-complying trusts that are not distributions of beneficiary income or corpus are taxable distributions. These are taxed at a rate of 45%. Distributions from non-complying trusts are not the main focus of this statement.

33. With some exceptions (see [90]), "ordering rules" override the nature of distributions from a foreign trust (or a non-complying trust) that would otherwise apply based on the trust deed or the exercise of the trustee's discretion. Broadly (for more detail, see from [84]), these rules determine whether a distribution is treated, for tax purposes, as a distribution of beneficiary income, accumulated trustee income, capital gains of current or previous years, or of corpus. This in turn helps determine whether a distribution is a taxable distribution or not under s HC 15. The ordering rules require current income to be distributed first, then accumulated trustee income, then capital gains and, lastly, corpus. This order applies regardless of what the minutes or records of the trust state.

34. If it is not possible to determine the elements of a distribution accurately from the records of a foreign trust or a non-complying trust, the entire distribution is treated as taxable. The onus is on the beneficiary to obtain information to establish the nature of the components of distributions made to them and to apply New Zealand tax law when determining the character of those components under the ordering rules. This characterisation includes the nature of the income and gains that have been derived by the trustee. Note that if the trustee is non-resident and the trust is a foreign trust, then neither the international tax regime (eg FIF/CFC regimes) or the financial arrangements rules apply when calculating income derived by the trustee under the ordering rules.

35. Table 2 summarises the taxation of distributions from different types of trusts for New Zealand tax residents. It assumes sufficient records exist to apply the ordering rules and identify non-taxable components.

Table | Tūtohi 2 – Summary of the taxation of distributions to New Zealand tax residents

Type of distribution from the trust	Complying trust	Foreign trust	Non-complying trust
Beneficiary income	Taxed at the beneficiary's marginal tax rate	Taxed at the beneficiary's marginal tax rate	Taxed at the beneficiary's marginal tax rate
Accumulated trustee income	Not taxable	Taxed at the beneficiary's marginal tax rate	Taxed at 45%
Non-associated capital gains and profits	Not taxable	Not taxable	Taxed at 45%
Associated capital gains and profits	Not taxable	Taxed at the beneficiary's marginal tax rate	Taxed at 45%
Corpus	Not taxable	Not taxable	Not taxable

36. A New Zealand tax resident beneficiary who receives beneficiary income or a taxable distribution from a foreign trust or non-complying trust is required to complete a disclosure for the income year in which they derive the distribution. To do so, they complete the form **Schedule of beneficiary's estate or trust income** – IR307.

Taxation of beneficiary income and taxable distributions

37. This statement is concerned with money or property that is distributed or transferred to a New Zealand tax resident except where that money or property is distributed or transferred through a sale or purchase or other transaction and the resident gives market value in return.

38. As noted above, the money or property does not have to be in New Zealand. It can be located offshore – for example, in a bank account in the United Kingdom or a holiday home in Australia.

39. Under ss CV 13, HC 6, HC 17 and HC 18, beneficiary income and taxable distributions that a person derives through foreign trusts are "income".

CV 13 Amounts derived from trusts

An amount derived by a person is income of the person if it is—

(a) beneficiary income to which sections HC 6 (Beneficiary income) and HC 17 (Amounts derived as beneficiary income) apply; or

(b) a settlement on trust of property of the kind described in section HC 7(3) (Trustee income); or

(c) a taxable distribution from a foreign trust to which section HC 18 (Taxable distributions from foreign trusts) applies.

40. Money or property therefore will not be taxable as beneficiary income or a taxable distribution from a foreign trust (or from a non-complying trust) if it does not come from a trust. For income or a distribution to come from a trust, it must be established that the transfer is from something that amounts to a "trust" in terms of the use of that word in the Act.

Whether an arrangement is a "trust"

41. The Act does not define "trust" (other than in a limited definition that relates to superannuation schemes and unit trusts).

42. Section 10(1) of the Legislation Act 2019 sets out how statutes are to be interpreted:

> The meaning of an enactment must be ascertained from its text and in the light of its purpose and its context.

43. In *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36, [2007] 3 NZLR 767 at [22], the Supreme Court commented as follows on this requirement in relation to the Interpretation Act 1999 (which was the predecessor to the Legislation Act 2019 and in place at that time):

> It is necessary to bear in mind that s 5 of the Interpretation Act 1999 makes text and purpose the key drivers of statutory interpretation. The meaning of an enactment must be ascertained from its text and in the light of its purpose. Even if the meaning of the text may appear plain in isolation of purpose, that meaning should always be cross checked against purpose in order to observe the dual requirements of s 5. In determining purpose the Court must obviously have regard to both the immediate and the general legislative context. Of relevance too may be the social, commercial or other objective of the enactment.

44. In relation to the text, an important consideration is the natural and ordinary meaning of "trust". Although the *Oxford English Dictionary* gives several meanings, the only one that seems apt is the meaning focused on "law":

> A legal arrangement whereby assets, property, etc., are put in the possession of a trustee or trustees to be held or administered for the benefit of another; assets, property, etc., held in this way.

45. The Trusts Act 2019 (the Trusts Act), which came into force for most purposes from 30 January 2021, has a definition of "express trust". This definition is regarded as consistent with current common law but is not a codification of it.

46. Section 12 of the Trusts Act specifies that, among other things, an "express trust" is a "trust" that must have each of the characteristics set out in s 13:

> **13 Characteristics of express trust**
>
> The characteristics of an express trust are as follows:
>
> (a) it is a fiduciary relationship in which a trustee holds or deals with trust property for the benefit of the beneficiaries or for a permitted purpose; and
>
> (b) the trustee is accountable for the way the trustee carries out the duties imposed on the trustee by law.

47. To be covered by s 12, an arrangement must be a "trust", which the Trusts Act does not define. Also, although s 12 defines an "express trust", it is only "for the purposes of [the Trusts Act]". As a consequence, the provisions in the rest of the Trusts Act will not generally apply to arrangements that are outside the definition of "express trust". Therefore, such arrangements may still be trusts if law other than the Trusts Act would recognise them as trusts. In s 5(8) and (9), the Trusts Act makes it clear that it does not codify trust law relating to express trusts and that common law and equity rules can still apply if they are consistent with the Trusts Act and other enactments do not require otherwise.

48. For present purposes, the tax laws do not specify that it is necessary to adopt the definition of "express trust" in the Trusts Act. This means that although it is likely that considering the definition of "express trust" will assist with and influence determining what is or is not a "trust" for tax purposes, the meaning to be given to the word "trust" in tax legislation is not limited to the meaning that the Trusts Act gives to "express trust". It is still necessary to consider other possible meanings and descriptions of a trust.

49. *Garrow and Kelly Law of Trusts and Trustees*[9] contains the following definition (at para 1.1):

> A trust is an equitable obligation under which a person (the "trustee") has control of property but is bound to deal with that property either:
>
> a) for the benefit of definite persons (that trustee may be one of them) and any one of them may enforce the obligation; or
>
> b) for some object or purpose permitted by law.

50. Trusts can arise in the following ways:

> • **An express trust**
>
> A person (the settlor) creates an obligation during his or her lifetime. This is often done by the execution of a deed which names the settlor, trustees and beneficiaries and directs how the trust is to be administered.
>
> • **An implied or presumed trust**
>
> The intention to create a trust has not been expressed but is implied or presumed from the circumstances. This includes resulting trusts where property is transferred to trustees for a specific purpose and when the purpose is fulfilled there is a surplus left over. The trustees then hold this surplus for the creator of the trust.
>
> • **The operation of law**
>
> Examples include constructive trusts, or in the case of an intestacy under the Administration Act 1969. In this case an intention to create a trust is imposed by the Court despite the fact that the person in whom the property is vested at the time had neither expressly nor impliedly undertaken any trust.

51. Three certainties must exist for a valid trust:

- certainty of intention;
- certainty of subject matter; and
- certainty of objects.[10]

52. The following points are described as "essential requirements for a valid trust" (*Garrow and Kelly* at para 1.31):

> • There must be a trustee, who is the nominal owner of the trust property. However, a trust will not lapse or fail simply because no trustee has been

[9] C Kelly and G Kelly *Garrow and Kelly Law of Trusts and Trustees* (online 8th ed, LexisNexis, Wellington, 2022).

[10] See s 15(1)(b) of the Trusts Act and *Knight v Knight* (1840) 3 Beav 148.

appointed, nor because there is no trustee living, or willing or able to act. It is a maxim of equity that no trust will be allowed to fail for want of a trustee. So, if it happens that no trustee has been appointed (or a trustee was duly appointed but later dies or refuses or is unable to act) then the court will appoint someone to fill that office. The requirements for legal capacity to be a trustee are generally the same as the requirements for legal capacity to hold property, but there are exceptions.

- There must be property of a nature capable of being settled on a trust. This would exclude all property that by law cannot be transferred or given away. The property may be real or personal. The legal title to the property is usually, but not necessarily, vested in the trustee. There may be a valid trust in respect of a purely equitable interest; for example, an interest as purchaser under an agreement for sale and purchase of land may be held on trust, or an interest created by another trust may in turn be held on trust.

- There must be a beneficiary or beneficiaries. A trustee may also be one of the beneficiaries, but cannot be the sole beneficiary, that is, a person cannot hold property on trust for himself or herself alone. This is because there would then be no separation of the nominal from the real ownership of the property. A beneficiary, who is of full age and is absolutely entitled to the property, can call on the trustees to transfer the property to that beneficiary and thus put an end to the trust.

- There must be an obligation on the trustee to deal with the trust property for the benefit of the beneficiaries. This obligation is purely an equitable one, which means: —it is enforceable only in a court which has equitable jurisdiction; —it gives rise to defences applicable only to equitable rights; and —purely equitable remedies are available.

53. Note that these descriptions of the legal concept of a trust appear materially similar to the definition of "express trust" in the Trusts Act. It could therefore generally be expected that an arrangement that meets the Trusts Act definition of "express trust" would also be a trust for tax purposes, while an arrangement that does not have the characteristics listed in s 13 of the Trusts Act would be highly unlikely to be a trust for tax purposes. However, while it may reflect the current state of equity and common law on the concept of a trust and therefore be influential, it is possible that court decisions in the future may move from the position in the Trusts Act so it should not be taken as **determining** whether an arrangement is a trust for tax purposes.

54. *New Zealand Trusts and Asset Planning Guide*[11] notes (at para [120-201]) that the question of whether a trust arises is to be determined objectively:

[11] *New Zealand Trusts and Asset Planning Guide* (online looseleaf ed, CCH New Zealand).

> It is not necessary that at the creation of a trust, the settlor or testator should appreciate that their acts or words have the legal consequences inherent in a trust, for it to be valid. The assessment has been held to be an objective one, so that **where a transaction objectively appears to be a trust, it will be held to be a trust**, even if it is unclear whether the settlor actually intended for there to be a trust, and the settlor's ignorance of the law of trusts would not necessarily be determinative: *Ochi v Trustees Executors Ltd* (2009) 2 NZTR ¶19-044 (HC) at [30]. [Emphasis added]

55. The position under New Zealand law (both generally and under the Trusts Act) is, therefore, that a trust is not an entity but a description of an equitable obligation the law imposes on a person holding property to deal with that property in a certain way; namely, for the benefit of beneficiaries or a charitable purpose. The circumstances required to give rise to a trust are that there is such a person (the trustee), as well as property that can be the subject of the trust and someone (a beneficiary) for whose benefit the property is held, and the law imposes the required obligation. It is an objective exercise to determine whether a trust exists.

56. The legal concept of a trust is consistent with dictionary meanings for present purposes. No other concept would be commonly understood to be a "trust", in New Zealand at least. Other countries that have the concept of a trust have similar requirements for identifying arrangements as trusts. These circumstances suggest that the legal concept of a trust is likely to be what is intended generally in the trust rules in the Act when the word "trust" appears.

57. These circumstances also suggest that the natural and ordinary meaning of "trust" in the tax legislation is along the lines of what would be held to be a trust under New Zealand law. That is, a trust is not an entity but a description of the obligations and duties on persons who hold property for the benefit of other persons.

58. The trust rules include, relevantly, subpart HC, which contains most of the provisions concerning taxing trusts and distributions from trusts. Section HC 1(1) describes what these provisions do:

> **HC 1 What this subpart does**
>
> *What this subpart does*
>
> (1) This subpart, together with the trust rules, —
>
> (a) provides for the taxation of distributions from trusts, for this purpose defining—
>
> (i) beneficiary income:
>
> (ii) a taxable distribution:
>
> (b) provides for the taxation of trustee income:

> (c) classifies trusts into the following 3 categories for the purposes of determining the treatment of distributions that are not beneficiary income:
>
> (i) complying trusts:
>
> (ii) foreign trusts:
>
> (iii) non-complying trusts:
>
> (d) determines who is a settlor, and sets out their income tax liability:
>
> (e) sets out the treatment of trusts settled by persons becoming resident in New Zealand.
>
> ...

59. Section HC 1(1)(c) states that trusts are to be classified into three categories for the purposes of deciding the tax treatment of distributions that are not of beneficiary income. Section HC 9 provides that:

> **HC 9 Classifying trusts**
>
> A trust is classified at the time it makes a distribution as—
>
> (a) a complying trust under section HC 10:
>
> (b) a foreign trust under section HC 11:
>
> (c) a non-complying trust under section HC 12.

60. As mentioned at [27], a dual-status trust is both a complying trust and a foreign trust. Each category is a classification of a trust, so belonging to two such categories does not address the question of whether something that would not be a trust according to New Zealand trust law should be a trust for the purposes of the trust rules.

61. However, nothing in the legislative context suggests that the word "trust" is intended to have a special meaning when it is used in the sections dealing with "foreign trusts" or that something needs to expressly describe an arrangement as a trust for a trust to exist. If the surrounding circumstances, considered objectively, show that an arrangement has the essential features of a trust under New Zealand law, the property should be seen as held on trust for the purposes of the trust rules.

62. One way of illustrating this intention as to meaning is to consider what the trust rules would clearly apply to and why. It is uncontroversial, for instance, that the trust rules apply to real estate situated in New Zealand that a New Zealand resident trustee holds on the terms of a conventional trust deed for the benefit of someone else. This status applies whether the beneficiaries of the property are resident or are not. The property would be regarded as held in trust for the beneficiaries under New Zealand law, and

there could be no argument about treating the arrangement as a trust that is subject to the trust rules. If the arrangement has a New Zealand settlor, then it would not be a foreign trust, but it would still be a trust.

63. The same applies to foreign property that a foreign trustee holds. Distributions to New Zealand tax resident beneficiaries can be taxable if they satisfy the criteria in the relevant provisions of the Act. The location of the property, the settlor or the trustee need not make a difference to identifying whether a trust exists although the tax residency of the settlor, trustee and beneficiaries can affect the tax treatment.

64. Many of the provisions in the Act that apply to "foreign trusts" can be taken to assume that property in foreign jurisdictions can be subject to a "trust" or that persons (trustees) can owe duties in relation to a New Zealand–situated property, wherever those persons might be resident (although the settlor must not be a New Zealand tax resident). For these provisions to have meaningful effect, it must have been intended that the "trust" concept is not limited simply because another jurisdiction might not have the same rules as to what a trust is or how a trust operates or might not have any such rules for that matter.

65. It is New Zealand tax law that is being applied to a "taxable distribution from a foreign trust" and New Zealand tax law (the trust rules) that is being interpreted. It is therefore appropriate that it should be the New Zealand law concept of a trust that applies; that is, what a trust is according to the law of this country. Otherwise, in any situation that would clearly be a trust under the law here, it would be possible to argue that it is not subject to the trust rules because the laws of another country would not recognise the situation as a trust.

66. A proposition in *Bennion, Bailey and Norbury on Statutory Interpretation*[12] is consistent with this position. At 22.9, it states that a "term is presumed to have its ordinary meaning in the territory to which an enactment extends, even if it applies in relation to a foreign context". A comment then discusses the proposition:

> Difficulties may arise where an enactment refers or applies to something outside the territory to which it extends, and uses words which have a different meaning outside the territory from the meaning they have within it. The presumption is that the words should be given 'their ordinary meaning in the English language as applied to such a subject-matter' (*Clerical, Medical and General Life Assurance Society v Carter (Surveyor of Taxes)* (1889) 22 QBD 444 per Lord Esher MR at 448). Here the reference to the English language means that language as understood in the territory to which the enactment extends.

[12] D Feldman, D Bailey and L Norbury, *Bennion, Bailey and Norbury on Statutory Interpretation* (8th ed, LexisNexis, London, 2020).

67. Identifying whether a distribution comes from a trust would seem to involve a similar question to the question of whether an enterprise is a body corporate so as to be a "company", a defined term for New Zealand tax purposes. Professor John Prebble[13] summarised what he considered should be the analytical steps to determine whether an entity organised under foreign laws met the requirements to be a company:

> That is New Zealand would refer to the foreign law to determine the nature of the entity, but would characterise the entity according to its own notion of what is, and of what is not, a body corporate. The question as to whether the participators were shareholders or partners, and, if the former, whether they had derived a dividend, would follow, more or less automatically, being determined in the same manner, by reference to rights and duties established pursuant to the foreign law, but characterised according to New Zealand law.

68. *C L Dreyfus v IRC* (1929) 14 TC 560 (CA) and *Ryall v The DuBois Company Ltd* (1933) 18 TC 431 (CA) are examples of cases in which the courts, for English revenue law purposes, have given significance to the way the law applies in a foreign jurisdiction. In *Dreyfus*, the separate legal personality of an entity in France meant it was not a "partnership" for the purposes of the Income Tax Act 1918 (UK). In *Ryall*, the court considered the German entity in question had similar attributes and was the same in nature as an English limited company. The decision was, therefore, that amounts the taxpayer received in England were income from "stocks" or "shares" even though they came from an entity that was incorporated in a different jurisdiction.

69. In the Canadian case of *Sommerer v The Queen* (2011) TCC 212, the Tax Court of Canada considered that, to determine whether a foreign arrangement (an Austrian "foundation") should be treated as a trust, it was necessary to identify the essential elements of a trust under Canadian law and compare them with the elements of the foreign arrangement. On appeal (*Sommerer v The Queen* (2012) DTC 5,126), the Federal Court of Appeal reached a conclusion in the case on different grounds but did not disagree substantively with the lower court's approach on this point. It preferred to express the test in terms of the property in question being subject to conditions that are "analogous to the legal and equitable obligations of a trustee in a common law jurisdiction".

70. Conflict of laws principles may also offer some guidance. *Dicey, Morris & Collins* on the *Conflict of Laws*[14] suggests that academic opinion favours a "domestic law of the forum" (or *lex fori*) approach as a solution to the problem of characterising the question to be decided and which law to apply. At [2.0011], it states:

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[13] J Prebble, Recognition of foreign enterprises as taxable entities, *Cahiers de Droit Fiscal International* Vol LXXIIIa (1988): 493, at 496.

[14] Lord Collins of Mapesbury, J Harris (Eds), *Dicey, Morris & Collins on the Conflict of Laws* (15th ed, Sweet & Maxwell, London, 2012).

> If the forum has to characterise a rule or institution of foreign law, it should inquire how the corresponding or most closely analogous rule or institution of its own law is characterised and apply that characterisation to the foreign institution or rule.

71. Unless an anti-avoidance provision applies, it is the true nature of the legal arrangements actually entered into and carried out that will determine the tax consequences. It is not their substance or what name the parties give to an arrangement: *Marac Life Assurance Ltd v CIR* [1986] 1 NZLR 694 (CA).

72. The legal arrangements can include the rights and obligations arising for the parties under the laws of a foreign jurisdiction. It does not follow, however, that all arrangements treated as valid trusts in a foreign jurisdiction will be trusts for New Zealand tax purposes, or vice versa. Moreover, New Zealand is not a signatory to the Hague Convention and consequently is not obliged to recognise the existence of a trust on the basis that it is seen as such in a foreign jurisdiction.

73. Each situation requires analysis to determine whether it would give rise to a trust for New Zealand law purposes taking into account the rights and obligations arising under foreign law. For example, it may be appropriate to conclude that an arrangement is not a trust because of the degree of control the settlor retains over trust property, including having it returned to the settlor or where a settlor/trustee has no accountability for what would otherwise be considered a breach of trust. As another example, a foundation in a civil law country might equate to a purpose trust in a common law country but would be treated as a company under New Zealand law.

74. Case law illustrates occasions where arguments have successfully established that arrangements, described as trusts in documents, may not be treated as effective trusts. In *Re the AQ Revocable Trust, BQ v DQ* [2010] 13 ITELR 260, a Bermudan court did not recognise an arrangement as a trust where it was a valid trust under United States trust law. In the United Kingdom, *Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) considered "trust" deeds which established New Zealand foreign trusts that allowed a former Russian oligarch to retain his beneficial ownership of assets. The court concluded these "trusts" were either bare trusts for his benefit or were a sham. In *Webb v Webb* [2020] UKPC 22, the Privy Council found that as the New Zealand settlor had the power at any time to secure the benefit of all of the trust property for himself and could do so regardless of the interests of other beneficiaries, the trust was invalid. In such circumstances, the rights of the settlor in the trust assets were indistinguishable from ownership.

75. On this basis, the Commissioner considers that the Act uses the word "trust" to refer to the situation where the true nature of the arrangement is that someone who holds property for the benefit of a person or object is under a legal obligation of a particular type. Whether such an obligation exists depends on whether circumstances exist that give rise to something that has the essential features of a trust under New Zealand law.

Namely, those circumstances are that a person (trustee) holds trust property and has a fiduciary obligation to deal with the property for the benefit of the beneficiaries or for a charitable purpose. Wherever in the world property is situated, if the legal basis on which it is owned or controlled and the surrounding circumstances are such that there are obligations that New Zealand law would recognise as trust obligations, then a trust exists for tax legislation purposes.

76. In other words, when considering whether an arrangement overseas is a trust for New Zealand tax purposes, the first step is to determine the legal rights and obligations of the parties under the foreign law. The second step is to apply New Zealand law to those rights and obligations.

Beneficiary income and taxable distributions from foreign trusts

77. Once it is established that money or property comes from a trust, the next question is whether anything is taxable in the hands of the recipient. The answer will depend on whether anything is "beneficiary income" or a "taxable distribution" from a "foreign trust".

78. Beneficiary income is defined in s HC 6(1) as:

> **HC 6 Beneficiary income**
>
> *Meaning*
>
> (1) An amount of income derived in an income year by a trustee of a trust is beneficiary income to the extent to which—
>
> (a) it vests absolutely in interest in a beneficiary of the trust in the income year; or
>
> (b) it is paid to a beneficiary of the trust in the income year or by the date after the end of the income year referred to in subsection (1B).
>
> ...

79. A "distribution" is defined broadly in the Act and in terms of a transfer of value to a person because they are a beneficiary of a trust (s HC 14). Section YA 1 defines "transfer of value". It is a net concept in the sense that it takes into account the market value of what the trustee, in this context, provides and the market value of what (if anything) the beneficiary provides in return.

80. Under s HC 11, a trust will be a "foreign trust at a moment in time if no settlor is resident in New Zealand at any time in the period that starts on the later of 17 December 1987 and the date on which a settlement was first made on the trust; and ends with the moment in time". In general terms, a "settlor" is anybody who has transferred value to a trust, such as money or property, without getting something (of at least equivalent value) in return. Therefore, in determining whether a foreign trust is

involved, it will be important to know the residence of each person that has transferred value and when these transfers occurred.

81. An amount of beneficiary income will be taxable to a New Zealand tax resident no matter what the classification of the trust is, with two exceptions. The exceptions are where it is minor or close company beneficiary income. This income is taxed to the trustee.

82. Amounts that are distributions from a foreign trust will be taxable if they are a "taxable distribution" as defined in s HC 15(4) to the extent that the distribution does not fall within any of the categories identified in subs (4)(a) to (4)(d):

> **HC 15 Taxable distributions from non-complying and foreign trusts**
>
> ...
>
> *Taxable distributions: foreign trusts*
>
> (4) The distribution is a taxable distribution to the extent to which it is not a distribution of—
>
> (a) beneficiary income; or
>
> (b) a part of the corpus of the trust; or
>
> (c) a profit from the realisation of a capital asset or another capital gain; or
>
> (cb) a foreign superannuation withdrawal; or
>
> (cc) a pension; or
>
> (d) a payment or a transaction that represents a distribution of either the corpus of the trust referred to in paragraph (b) or a capital gain referred to in paragraph (c).
>
> ...

83. This legislative framework makes it important to identify the components of a distribution. For this exercise, the ordering rules in s HC 16 need to be applied to every distribution from a foreign trust unless an exclusion exists.

Ordering rules (section HC 16)

84. Because some distributions are taxable and others are not, opportunities to avoid or defer paying tax on income accumulated in trusts could arise by distributing otherwise taxable amounts to non-resident beneficiaries or by distributing non-taxable amounts before taxable amounts. The ordering rules for distributions in s HC 16 limit such opportunities for manipulating distributions from foreign trusts and non-complying trusts. These rules determine the order in which amounts are treated as having been distributed from such trusts.

85. The rules override the treatment of the distributions that would otherwise apply based on the terms of the trust or the exercise of the trustee's discretion. The rules can affect whether a distribution is treated as a distribution of income, a capital gain or corpus, in turn determining whether it is a taxable distribution or not. For this reason, it is necessary to interpret the definition of taxable distribution and the ordering rules together.

86. The ordering rules in s HC 16 apply when a trustee of a foreign trust or non-complying trust makes a distribution to a beneficiary. The rules treat a distribution as being made up of elements in a certain order as follows (s HC 16(2)):

> **HC 16 Ordering rule for distributions from non-complying and foreign trusts**
>
> ...
>
> *Order of elements of distribution*
>
> (2) The distribution is treated as consisting of the following elements in the following order:
>
> (aa) first, an amount derived by the trustee that is beneficiary income of the beneficiary in the previous income year:
>
> (a) second, an amount of income that the trustee derives in the income year:
>
> (b) third, an amount of income, other than beneficiary income, that the trustee has derived in an earlier income year:
>
> (c) fourth, an amount that the trustee derives in the income year from the realisation of a capital asset of the trust or another capital gain and that is not income under section HC 15(5B) for the purposes of this section:
>
> (d) fifth, an amount that the trustee has derived in an earlier income year from the realisation of a capital asset of the trust or another capital gain:
>
> (e) last, the corpus of the trust.
>
> ...

87. The ordering rules apply on an end-of-year basis. That is, a distribution is not characterised at the time it is made. Rather, distributions are characterised at the end of the income year in which they are made by reference to the total income and capital gains the trustee derived in that income year (and previous income years). The ordering rules are generally applied individually to each distribution the trustee makes in the order in which they make the distributions.

88. The amount of each element (eg, current-year income) is finite. Once an amount of an element has been treated under s HC 16 as included in a distribution, that amount is no longer available to be treated as included in another distribution (s HC 16(3)(a)). This means the order in which the distributions are made can have a significant impact on tax payable.

89. For each distribution, the elements must be applied in the order that s HC 16(2) sets out. The next element is relevant only to the extent that the total of the available amounts in the elements so far considered is less than the amount of the distribution (s HC 16(3)(b)).

90. The ordering rules have four exceptions. The most important for present purposes is the exception for "non-discretionary trusts" arising on death in s HC 16(6)(b):

> **HC 16 Ordering rule for distributions from non-complying and foreign trusts**
>
> …
>
> *(6) Exclusions: terms of trust*
>
> …
>
> (b) a distribution from a non-discretionary trust—
>
> (i) created by will or codicil, or by an order of court varying or modifying the provisions of a will or codicil; or
>
> (ii) created on an intestacy or partial intestacy; or
>
> (iii) on which no settlement has been made after 17 December 1987; or
>
> …

91. A "non-discretionary trust" is a trust where the trustee has no discretion to determine the source, nature and amount of distributions to beneficiaries. This means, among other things, that the trustee has no discretion to classify trust property as capital or income. Where s HC 16(6)(b) applies in respect of a non-discretionary trust, it is the terms of the trust that determines the source of a distribution. These terms should be referenced in the corresponding trustee resolution.

92. If no exception to the ordering rules is relevant, to apply the ordering rules a beneficiary needs information on the trust's circumstances and history. Ideally, this information will take the form of good financial records (modified as necessary to show current-year income, accumulated income, capital gains and corpus according to New Zealand income tax law). It should include details of all settlements on the trust, gains in value of trust property and distributions that the trust has made, in the year in question and in previous years. In the absence of financial statements, other material and evidence are potentially relevant but the onus is on the beneficiary to prove the elements of a distribution to a satisfactory level of accuracy. If adequate records are available relating to corpus but not to income or capital gains, it is still possible for a final distribution not to be taxable to the extent the amount does not exceed the corpus.

93. Therefore, where s HC 16 and the ordering rules apply, the recipient of a distribution must point to evidence that allows them to apply the rules. If this is not possible, the distribution will be deemed to be taxable under s HC 15(7).

94. Given the consequences if a distribution is taxable in this way, a beneficiary may often consider it is worthwhile to make a concerted effort to locate the required information. Finding the information may be difficult, but the onus is on the beneficiary to demonstrate that the ordering rules apply in the way they contend.

95. Note that non-discretionary trusts created by a will may still give rise to taxable distributions when distributing accumulated income and certain capital gains, but the records requirement is less likely to be an issue than it is for other trusts. This is because the ordering rules will not apply and it is potentially less complex to determine what has been distributed.

Beneficiary income and taxable distributions from non-complying trusts

96. For completeness, an amount of money or property a person receives from overseas may have come from a non-complying trust. Under s HC 12, a non-complying trust in relation to a distribution is neither a complying trust nor a foreign trust. It could arise, for example, when a New Zealand tax resident settles property on trust with a non-resident trustee, the non-resident derives non-resident passive income that is not distributed as beneficiary income and no election is made to pay New Zealand income tax on that amount at the trustee tax rate.[15]

97. A taxable distribution from a non-complying trust is broader than one from a complying trust. Section HC 15(2) provides:

> **HC 15 Taxable distributions from non-complying and foreign trusts**
>
> ...
>
> *Taxable distributions: non-complying trusts*
>
> (2) The distribution is a taxable distribution to the extent to which it is not a distribution of—
>
> (a) beneficiary income; or
>
> (b) a part of the corpus of the trust; or
>
> (c) a payment or a transaction that represents a distribution of the corpus of the trust.

[15] Due to the absence of a New Zealand tax resident trustee, the New Zealand tax resident settlor must disclose the existence of the trust to Inland Revenue on **Settlors of trusts disclosure – IR462**. Penalties may apply if they do not make this disclosure.

...

98. The ordering rules apply in the same way as they do to foreign trusts to determine the components of a distribution. Beneficiary income is taxed at the marginal rate of the New Zealand tax resident beneficiary. However, s HC 19(1) provides that a taxable distribution is excluded income under s CX 59 but taxed under ss BF 1(b) and HC 34 at a rate of 45%. Section HC 19(2) provides that the amount of income may be reduced by losses calculated under s HC 22.

Administration of estates

99. Different countries have different laws for the administration of estates. It follows that the legal basis on which property is owned or controlled may be different too and could lead to a different conclusion on whether a trust arises. However, many other countries, especially common law countries, have laws like those in New Zealand. Therefore, some discussion of the law here in New Zealand relating to the administration of estates is useful to illustrate the situations in which a trust (that is not a "bare trust" and is ignored for tax purposes – see [138]) might arise when a deceased estate is being administered overseas.

New Zealand estate administration and trusts

100. When a person dies, the law determines what happens to the money and property that they owned (their estate) at the date of death. If the deceased died without a will (intestate), the law provides for the appointment of an administrator and succession to the estate (that is, who inherits) after a process of identifying and collecting assets, satisfying liabilities and distributing what is left (the residue). If the deceased made a will, the named executors administer the estate following the instructions of the deceased.

101. The instructions in a will may include paying out or distributing legacies or gifts of specific amounts or specific property to named people. These legacies or gifts may be referred to as "specific legacies".

102. The instructions in a will may also expressly provide for testamentary trusts. A will might direct executors to hold property on trust for specified beneficiaries or to establish a trust to hold property for specified beneficiaries (for which a trust deed is usually formalised). If executors make a distribution from a trust established under such instructions, the Act generally applies in the same way as it would for any distribution from a trust that a person established during their lifetime.

103. Whether the deceased left a will or not, and even where a will does not expressly instruct executors to establish a trust, a trust may still arise at some point. This may be because, for example, heirs are not yet of an age to inherit or there is a life interest[16].

104. However, a trust does not arise immediately on the death of the deceased. **Tax implications of certain asset transfers – an officials' issues paper**[17] describes the legal process in New Zealand for property moving from a deceased person to beneficiaries (at pages 11 and 12):

> 4.4 On the death of a taxpayer, the estate can be dealt with in several ways, depending on whether a will exists and, when a will does exist, the taxpayer's intentions as set out in the will (for example, whether there are to be a trust, legacies, and so on). Normally, it takes one to two years to wind up an estate and distribute the assets to the beneficiaries. There are several discrete points in this process at which a property disposition could be deemed to have occurred – on death, on transfer from executor to trustee, or on distribution to legatees and beneficiaries.
>
> 4.5 A will usually provides for the appointment of one or more executors. In the absence of a will, a court will appoint someone to administer the deceased's estate. **Legal and beneficial ownership of the deceased's property vests in the executors or administrators from the time of death through to the end of the period of executorship or administration. The beneficiaries have a right to have the deceased's estate administered properly during this period but do not, with the exception of specific legacies, have more than an inchoate right in the assets.**[18]
>
> 4.6 The duties of the executor or administrator are to collect the assets of the deceased, pay all debts, testamentary expenses and taxes and to distribute the legacies. **At the end of the period of executorship or administration, the executor or administrator becomes a trustee of the residual assets on behalf of the beneficiaries.**
>
> 4.7 Property that has been bequeathed or devised under a will may be gifted as a specific legacy, general legacy or residuary gift. Under the "doctrine of relation back", specific legacies take effect from the date of death, whereas general and residuary legacies vest in the beneficiary(ies) at the time of distribution. [Emphasis added]

105. Other commentaries (and cases, eg, *Commissioner of Stamp Duties (Queensland) v Hugh Duncan Livingston* [1965] AC 694) confirm that, although executors and administrators are subject to fiduciary duties during the period of their executorship or

[16] A common example of a life interest is when someone is permitted to remain living in a family home after the death of the owner,

[17] Tax implications of certain asset transfers – an officials' issues paper (Policy Advice, Inland Revenue, 2003).

[18] This comment is not consistent with the view expressed at [112] which states that specific legacies are also an inchoate right until assent. That is, the right is not fully established or complete until the specific legacy is recognised by way of assent. However, often specific legacies are immediately recognised.

administration, neither the beneficial nor the legal interest in the estate assets (that are not the subject of specific legacies) moves to those who stand to inherit. For instance, *Laws of New Zealand: Trusts*,[19] in Part 1(3) states:

> **8. Personal representatives and trustees**. In a loose sense, a legal personal representative (while acting as such) is a trustee for the creditors and beneficiaries claiming under the deceased estate since the personal representative holds and administers the real and personal estate of the deceased, not for their own benefit, but for the benefit of the deceased and others.
>
> However, **during the administration of the estate of the deceased, whether the deceased died testate (with a will) or intestate (without a will), neither a legatee (someone who is left a gift under a will) or the next of kin (someone who may succeed to an intestate estate) have any beneficial interest in the assets being administered;** he or she has merely an equitable right to have the estate administered properly. This right is enforced by means of a devastavit action. [Emphasis added]

106. In England, the position is similar. *Williams on Wills*[20] notes at [1.8]:

> Although the title to the assets vests in the personal representative and the will is said to take effect in equity only, the property comprised in residue is not held on trust for the beneficiary under the will so as to vest any equitable interest in him. It is in fact a fallacy to seek for the separate existence of the equitable beneficiary interest in the assets during the period of administration. … Thus the legatee of a share of the residue has no interest in any of the property of the testator until the residue has been ascertained. … It has been held that this right is in the nature of a chose in action. … Likewise, persons entitled on intestacy have no interest in the deceased's assets during administration.

107. Being an executor is not the same as being a trustee: *In re Jane Davis, In re T H Davis, Evans v Moore* [1891] 3 Ch 119. *New Zealand Trusts and Asset Planning Guide* notes (at para 123-40) the difference between the two roles of executor and trustee and refers to authority as to the time at which an executor becomes a trustee:

> An executor carries into effect a deceased's will. The duties of an executor include to collect and get in the assets of the deceased, pay expenses and debts and discharge legacies under the will (*Re Branson (Deceased)* (1911) 31 NZLR 79, at p 82). In comparison, the essential duties of a trustee of a trust created under the will are to obtain possession or control of the trust property, get in funds due to the trust estate, preserve the trust property and to secure it from loss or risk of loss and to conform to and carry out the terms of the trust.

[19] *Laws of New Zealand: Trusts* (online ed, LexisNexis, Wellington).

[20] R Barlow, R Wallington, S Meadway, J MacDougald and J Kirby, *Williams on Wills* (online ed, LexisNexis, London, 20 November 2021).

> "The change in character from personal representative (executor) to trusteeship occurs when the estate has been fully administered, in the sense that all the debts and liabilities have been discharged and the residue ascertained …" (*Hansen v Young* [2004] 1 NZLR 37 (CA), at para [29]).

108. These comments suggest that, strictly, any trust from which distributions are made to beneficiaries will arise only once the personal representatives are ready to distribute. This is because, under the law of estate administration in New Zealand, personal representatives have the legal and beneficial interest in property passing on the death of a person, but they do not hold the legal interest on a trust under which those ultimately entitled to the property have a beneficial interest (or under which they might receive a distribution as a beneficiary of a trust). Such a beneficial interest does not arise, whether for particular property or the residual estate, until the personal representatives have completed their duties in the administration of the estate and transition to the role of trustee.

109. This position is not altered by the fact that, under the Act, an executor or administrator is treated as a trustee (specifically, s YA 1 defines "trustee" to include an executor or administrator). Although a personal representative is to be considered a trustee for tax purposes, it does not follow that a trust arises on death or during administration. It just means that provisions referring to "trustee" may have a broader application than they otherwise would. In interpreting a section that refers to "trust" but not "trustee", it is necessary to consider what meaning to give to the word "trust". A trust would not generally include an estate during administration.

110. A personal representative will become a trustee at the point at which they have identified the residue of the estate and assent to the property in the estate becoming subject to a trust: *Re McGregor (deceased)* [1960] NZLR 220 at 229 (CA). The dispositions in the will become operative on such assent: *George Attenborough & Son v Solomon* [1913] AC 76 (HL).

111. Such assent can happen for property outside of residue and at different times for different property. The commentary in *Laws of New Zealand: Trusts* Part 1(3) (set out at [105] above) continues:

> Once a personal representative realises that property left on trust is not going to be used to pay debts and expenses, or discharge liabilities, he or she may assent to that property being held on trust in the strict sense. It is often important to determine when a personal representative has completed his or her functions in relation to the estate, and holds trust property solely as a trustee. Not only are there differences in the powers of personal representatives and trustees, but the period of limitation applicable to an action may depend in certain cases upon whether the defendant holds property as a personal representative or as a trustee. Moreover, since the duty of personal representatives is owed to the estate as a whole, they, unlike trustees, do not have to hold the balance evenly between those interested in income and those interested in capital.

112. *Laws of New Zealand*: *Administration of Estates* Vol II[21] further explains "assent" in Part IV Assents:

> *457. Necessity for assent.* **The bequest of a legacy, whether general or specific, or of real estate transfers only an inchoate property to the legatee: the executor's assent is necessary to render it complete and perfect**. The right is one which devolves on the legatee's personal representatives should the legatee die before the assent is given. In the case of a release of a debt by will, the executor's assent is necessary, as the release in effect amounts to a legacy of the debt.
>
> **The necessity for assent by an executor applies to residuary bequests and to interests arising under a partial intestacy. An executor may assent to part of a residuary gift without assenting to the whole**. The assent of one of several representatives to a bequest of pure personalty is sufficient; even though the bequest is to that representative. An executor may assent before probate. The assent will not be affected by their dying without having obtained probate, provided the will is subsequently proved. An executor may be compelled by the legatee to assent should they refuse to do so without just cause. [Emphasis added]

113. The assent need not take any particular form, and it is a question of fact whether assent has occurred:

> *459. Assent by implication.* **An assent to the vesting of real or personal estate may be express or implied; it need not be in writing nor need it be given in any particular form. Informal expressions, if sufficiently clear to indicate intention, may amount to an assent**. The assent may also be implied from the executor's conduct: thus, the application in the maintenance of minors, of rents of leaseholds bequeathed to the executor in trust for maintaining them during minority, and afterwards in trust for the legatee on attaining their majority; allowing a legatee of a term to receive the income; the payment by the executor of rent, coupled with the charging of the legatee with the payments in account; or the payment of a charge subject to which a legacy is given; would amount to an assent to the bequest. However, an executor may, and often does, make general payments to a legatee without binding themselves to an assent; and the Court will not infer an assent in such circumstances unless there is evidence that the executor intended to assent as, for instance, by representations to that effect or by special payments out of or on account of rents to which the legatee would be entitled after assent.
>
> In case of dispute, **the question whether there has been an assent or not is generally one of fact**. An expression which is ambiguous and applies equally to either view is no evidence of an assent.

[21] *Laws of New Zealand: Administration of Estates* Vol II (online ed, LexisNexis, Wellington).

> An assent to a life interest is an assent to the interest in remainder and, conversely, an assent to an interest in remainder enures for the benefit of the tenant for life. [Emphasis added]

114. The assent, once given in respect of property, vests title to a legacy immediately:

> *461. Irrevocability and relation back.* The assent once given is irrevocable. **The title to a legacy vests immediately upon the assent in the legatee**; so as to enable them to bring an action at law against the executor or any other person in possession of the bequest. The legatee of a specific legacy has the right to recover the intermediate profits of the thing bequeathed. **Where executors who are also trustees under the will have assented, they cease to hold the property as executors and from then on hold it as trustees**. [Emphasis added].

115. The power to assent belongs to a personal representative:

> *462. Assents in relation to trusteeship.* The power to assent is confined to personal representatives. Difficulties can arise as to whether a personal representative who may have fully administered and become a trustee still has power to assent and whether they need to assent in their own favour as trustee. The capacities of personal representative and trustee are not mutually exclusive, and a personal representative who has fully administered the estate and holds the residue as a trustee is not thereby necessarily and automatically discharged from their obligations as personal representative. A personal representative retains their character as such (as distinct from their statutory powers of management) for all time; or, in the case of a grant of administration for a limited period, until the termination of the period of the grant.

116. One of the ways in which a personal representative becomes a trustee is when they have assented:

> *463. When a personal representative becomes a trustee.* If property is specifically devised or bequeathed to an executor upon trust they become trustee of it when they have assented; or when they have severed the property from the rest of the estate; or when they have executed a declaration of trust. **As regards residue, the major change in character from representation to trusteeship occurs when the estate has been fully administered in the sense that all debts and liabilities have been discharged and the residue ascertained. When the trusts affecting the residue are designed to continue after completion of the administration, the executor should thereupon execute an assent to the vesting of the residue in themselves as trustee.** [Emphasis added]

117. For further discussion on testamentary trusts, "assent" and related aspects of administration of estates in New Zealand, see the cases of *Re Estate Eagle; Barbalich v Kennedy* (1997) 1 NZTR 7-003 (HC Auckland M721/97), *Sullivan v Brett* [1981] 2 NZLR 202 and *Re Maguire (deceased)* [2010] 2 NZLR 845.

118. The cases confirm the following interpretation of the law:

- Until assent, beneficiaries do not have any proprietary interest in the residue and the executors do not hold the residue on trust in a relevant sense.
- An executor, at some point, either transfers the residue to beneficiaries or assents to the vesting of that property in someone, who can be the executor, acting in the capacity of a trustee.
- Assent is evidence that an executor is ready to end their interest in the property in question and it can pass according to the terms of the will.
- Assent can be for particular estate property before the residue is ascertained. (It is possible to infer from the fact of distribution that assent has occurred.)
- An express or formal assent is possible although not common in New Zealand.
- Where no formal assent has occurred, it is possible to infer assent once administration has got to the point that all debts and legacies have been paid and the residue has been "ascertained".
- The only action remaining following assent is for the personal representative to pass legal title to the beneficiaries of the will (or to a trustee to hold for beneficiaries, who is someone other than the personal representative).
- The question of whether there has been assent does not depend on what the personal representative believes or intends. It rests on what the facts demonstrate.
- If vested in a trustee, the trustee either holds the property on the trusts specified in the will (ie, testamentary trusts) or, if no trusts are specified, on trust according to the beneficiaries' rights and interests under the will (ie, on a bare trust).

119. It seems reasonable to conclude that the certainties required before a trust arises will be present on assent. At this stage, the existence and identity of property will have been established, as will the beneficiaries. Assent will provide certainty of intention to create a trust.

120. An equitable obligation amounting to a trust, therefore, arises only after the personal representatives have given assent to a trustee or trustees holding the property in question on trust. Such assent can be express or alternatively inferred from the circumstances.

121. If laws similar to the laws of administration of estates in New Zealand apply, where a testamentary trust or a life interest or a minority arises from a non-resident deceased's estate, then following assent, a person (trustee) subject to that trust from assent will hold the property. This may mean an executor changes their role or "hat" (from assent) if they are going to be that ongoing trustee. Such a trust will be a foreign trust because the settlor is the deceased who is not a New Zealand tax resident and has executors carrying out their intentions to create a will trust (an indirect transfer of value

as provided for in s HC 27(4)). To determine the tax treatment of property or amounts transferred to a New Zealand beneficiary, it is necessary to consider the possibility that what is transferred to a New Zealand tax resident is a taxable distribution. However, in many cases the trust will not be discretionary so that the ordering rules do not apply (see from [84]).

122. Where a New Zealand beneficiary of a foreign deceased estate has a vested interest after assent, a "bare trust" will arise as a matter of law. As discussed from [138], this situation can be ignored for tax purposes. Although the personal representative will be a trustee according to trust law, they will be a bare trustee. They now hold the property subject to the direction and control of the beneficiary and, for New Zealand tax purposes, the beneficiary is treated as the owner of the property and needs to account for income generated from it.

Estate administration and trusts in other countries

123. The position outlined above for New Zealand estate administration and trust law is likely to be similar to the position in other common law jurisdictions such as Australia, the United Kingdom and the United States. However, some countries may have materially different laws of succession and administration of estates. Many countries do not have the concept of a trust and have laws different to New Zealand's law governing devolution of property on death. In Switzerland (a civil law country like France and Germany), for example, the entire estate of a person passes automatically by way of direct succession to the heirs on the person's death. This happens whether the deceased dies testate or intestate. Switzerland does not recognise trusts as a legal arrangement, although it does recognise the existence of trusts in other countries.

124. Because of their substantially different laws, the position in such civil law countries is materially different from common law jurisdictions like New Zealand. In civil law countries, a trust will not arise on death or following estate administration as the heirs have a vested legal interest immediately on death. Unlike common law countries, they have no "interregnum" when the executor has the legal interest. In addition, transfers by personal representatives in civil law jurisdictions will not be a "distribution" for New Zealand tax purposes because they do not transfer value to heirs. The heirs already own what they inherit and will need to account for income it generates if they are New Zealand tax residents.

125. Further, the test for determining whether a "trust" exists is whether in all the circumstances a trust can be said to arise under New Zealand law. The facts relevant to concluding on that issue under the two-step approach mentioned at [76] will include what legal obligations a person has in relation to property. In that case, the rules of another country as to what happens on death will affect those legal obligations. The

fact that no property vests in a personal representative is critically relevant to the question of the existence or otherwise of a trust under New Zealand law.

126. As noted, a trust is an equitable obligation or set of obligations in respect of property under which a person holds property for the benefit of a person or object. One person holds the legal interest and another holds the beneficial interest. However, where the legal and beneficial interests in property move straight from a deceased to an inheritor, nobody will be holding the legal interest in property other than the people who stand to inherit it. There will also be nothing that would expressly create a trust, such as a will or trust deed.

127. New Zealand law would not recognise a "trust" where the arrangement involves property that is not owned by someone with obligations to deal with it for the benefit of someone else. This kind of arrangement in civil law countries will not meet the requirements under New Zealand law to be a "trust".

128. Depending on the situation in the particular country (and this must always be reviewed), it follows that an amount distributed to a New Zealand tax resident heir from an estate administered in a civil law country, either during or following administration, would not be a "taxable distribution from a foreign trust". The reason is that it is not a transfer of value made because the recipient is a beneficiary of a trust.

129. For example, suppose person A acts as administrator of person B's estate on B's death in Switzerland, a civil law jurisdiction. After several years, A carries out the instruction in B's will and transfers the proceeds of the sale of shares in a Swiss company that B owned at his death to person C, who lives in New Zealand. The process of administering and maintaining the estate may have taken several years but a trust will not arise because A did not own the shares, and the shares vested in C on B's death. Therefore, the question of a taxable distribution from a foreign trust does not arise.

130. Likewise, no distribution from a trust will occur when A transfers to C the dividends that have accumulated on the shares during the administration. They will be treated as taxable income C has derived from date of death, while A is a bare trustee, as discussed from [138]. Tax paid in Switzerland may be available as a credit against liability for tax in New Zealand. If C has not returned the dividends or CFC/FIF income (if applicable) for tax in New Zealand, they will need to make an adjustment to their assessments. Penalties and use of money interest may apply.

131. The situation is likely to be different where a New Zealand tax resident receives a transfer from an estate being administered according to laws materially like the succession and administration laws in New Zealand (eg, the laws in a common law jurisdiction). The transfer may be properly characterised as being "from a foreign trust" because the transferor is someone who has the legal interest in the property and has been holding it for the recipient who has the beneficial interest in it.

132. The outcome would be different if the situation were similar to the example at [129] and [130], but B died leaving a will with instructions to establish a trust for C and the shares, and A and B were both in Australia. The Australian laws on trusts and estate administration are like those in New Zealand, so a trust will have arisen once A assented to the shares vesting in a trust (which will not be a bare trust). Then, when a subsequent transfer of the sale proceeds for the shares and of the dividends to C occurs, the transfer would be a "distribution".

133. In short, in some countries, the legal interest in property devolves directly to inheritors. In others, like New Zealand, the legal interest is vested in someone other than the inheritors for a while. It follows that in the context of inheritance, to determine whether an amount is a distribution from a trust, one relevant circumstance that needs to be considered is the effect of applicable laws of other countries. This is part of the first step in the two-step approach.

Effect on tax status of deceased's estate during administration

134. In New Zealand, a trust will arise only once personal representatives are ready to distribute and have assented. From that point, the beneficiaries have an equitable interest in property subject to a trust, either a bare trust (ignored for tax) or an express or implied trust.

135. Before then, although it seems personal representatives are sometimes described as holding property "on trust", the legal position is that they hold both the legal and the beneficial interests in the estate property "in right of the deceased".[22] They do not hold interests in the estate as trustee for beneficiaries. Heirs do not have any beneficial interest and can rely on only their right to force the representatives to carry out their duties. It therefore seems more appropriate to consider the representatives as not (yet) trustees. This position is likely to apply to deceased estates in common law countries in general but is unlikely to apply in civil law countries.

136. As a result, a New Zealand tax resident will not derive anything that will be beneficiary income or a taxable distribution from a foreign trust unless either:

- for common law countries, administration of an estate has at least reached the stage that personal representatives have assented to holding the property on trust; or
- for civil law countries, something has happened to the property before transfer to the resident that New Zealand law would consider gives rise to a trust. (For

[22] See L Breach, *Nevill's Law of Trusts, Wills and Administration* (14th ed, LexisNexis, Wellington, 2023) at [20.12.6].

instance, the property was transferred to someone in another common law country to hold on trust for the resident in New Zealand.)

137. Even if a New Zealand tax resident does not derive beneficiary income or a taxable distribution from a foreign trust, it is necessary to consider whether they have derived other types of income from property held overseas.

Bare trusts

138. Commentary in *Laws of New Zealand: Trusts* Part 1 (see [111] above) suggests that a trust can still arise by assent even though the personal representative has not got to the point of identifying the residuary estate. For instance, an executor may choose to distribute a specific legacy to the person named in the will as entitled to that legacy. Assent in relation to the property or amount forming that specific legacy would be inferred once the executor makes that distribution and, technically, there might be a brief time when what is distributed is subject to a trust under general law. This situation would not give rise to a taxable distribution, however, for two reasons.

139. The first reason is that if it were a distribution from a foreign trust, it would be a distribution of corpus. That is, it is a specific legacy distributed from a specific non-discretionary trust created by will (and so s HC 16(6)(b) excludes it from the ordering rules).

140. The second reason is that not every distribution that would otherwise meet the legislative definition of "taxable distribution" will necessarily be a "taxable distribution from a foreign trust". If the property is held on a "bare trust", s YB 21 would have the effect of establishing that the person holding the property has not made a distribution. Section YB 21 provides:

> **YB 21 Transparency of nominees**
>
> *Treatment of nominee*
>
> (1) In this Act, unless the context otherwise requires, **if a person holds something or does something as a nominee for another person, the other person holds or does that thing and the nominee is ignored.**
>
> *Who is a nominee?*
>
> (2) A person holds or does something as a nominee for another person if the person acts on the other person's behalf. **However, a trustee is a nominee only if the trustee is a bare trustee.**
>
> *Nominal settlements*

> (3) A person making a nominal settlement at the request of another person is treated for the purposes of this Act as a nominee in relation to the settlement.
>
> [Emphasis added]

141. In practical terms, and in the context of trusts arising in the administration of estates, the consequence of a trust being "bare" is that inheritors do not derive beneficiary income or taxable distributions, but they do derive any income from the property in question. This income could include, for example, interest income, dividends, financial arrangement income and/or FIF income.

142. **IS 12/01: Income tax – Timing of share transfers for the purposes of the continuity provisions**[23] summarises the principles developed through the courts on what amounts to a "bare trust":

> 112. Three principles can be distilled from these authorities:
>
> - A "bare trustee" is a person who holds property on trust for the absolute benefit and at the absolute disposal of other persons, and has no beneficial interest in the property.
> - A "bare trustee" does not have any duties to perform in regard to the property, except to convey or transfer it to a person entitled to hold it when required to do so.
> - For a bare trust relationship to exist, the three certainties of a trust must be satisfied.

143. **QB 16/03: Goods and Services Tax – GST treatment of bare trusts**[24] describes a "bare trust" in this way:

> 5. A bare trust is a type of trust under which the trustee holds property on trust without any duties to perform other than to convey the trust property to the beneficiary or as the beneficiary directs. The reference to "duties" in this definition is to duties that the settlor has specified. For example, the trustee may have been appointed to hold the property as nominee, or the settlor may have required that the beneficiary be maintained until becoming entitled to call for capital and income on reaching the age of majority. Once the beneficiary reaches the age of majority, the trustee no longer has a duty to maintain the beneficiary. In both situations, the trustee is "bare" of any duties specified by the settlor. However, so long as a trustee holds property on trust, they always retain their legal duty to take reasonable care of the trust property. The

[23] IS 12/01: Income tax – Timing of share transfers for the purposes of the continuity provisions *Tax Information Bulletin* Vol 24, No 7 (August 2012): 20.

[24] QB 16/03: Goods and Services Tax – GST treatment of bare trusts *Tax Information Bulletin* Vol 28, No 5 (June 2016): 16.

trustee cannot escape this duty: *Herdegen v FCT* 88 ATC 4995 (FCA); *Waters' Law of Trusts in Canada* (4th ed, Carswell, Toronto, 2012) at 33–34.

6. Therefore, a bare trustee has not only a duty to transfer the trust property to the beneficiary (or as directed by the beneficiary), but also a legal duty to take reasonable care of the trust property in the meantime: *Herdegen; CGU Insurance Ltd v One Tel Ltd (in liquidation)* [2010] HCA 26; *Corumo Holdings Pty Ltd v C Itoh Ltd* (1991) 24 NSWLR 370 (CA); *ISPT Nominees Pty Ltd v Chief Commissioner of State Revenue* [2003] NSWSC 697.

7. What a bare trustee must do to fulfil their duty to protect trust property depends on the nature of the trust property and any threats to the trust property. However, a bare trustee must refrain from active management that does not fall within the duty to maintain the trust property: *Bruton Holdings Pty Ltd (in liquidation) v FCT* (2011) 193 FCR 442 (FCAFC).

144. The question, for s YB 21 purposes, is whether a bare trustee (assuming that is the appropriate legal characterisation of someone's capacity) "acts on behalf of" the beneficiary. The answer will depend on the circumstances, but it would be unusual for someone holding property on a bare trust not to be acting on behalf of the person for whom they are holding the property.

145. In the context of estates, a trust will therefore arise only when the personal representative completes their role in relation to property and assents in relation to that property. Then it will depend on the facts as to what is being distributed, and whether any transfer of the property to an heir is a transfer by a bare trustee. In that case, the trust rules will not apply because, for tax purposes, there is no trust. Section YB 21 treats the beneficiary, not the trustee, as holding the property from the date of assent and as liable to any income generated from it if they are a New Zealand tax resident. If, on the other hand, the personal representative is more than a bare trustee, the transfer (or part of it) might be of beneficiary income or a taxable distribution to the extent that the application of s HC 15 does not exclude it.

Consequences of an arrangement being a trust

146. A trust technically arises under the general law of many common law countries on assent.

147. The trust that arises following assent and before distribution is often a bare trust that will not be recognised as a trust for tax purposes. In many instances, therefore, a transfer of property to a New Zealand tax resident will not be a taxable distribution. This would be the case if a personal representative continued to hold the property for a time because of practical difficulties in locating the beneficiary or transferring the property to them. During that time, the representative would have held the property

for the absolute benefit of the beneficiary, who has the right to call for the property at any time, and the trustee must act on that direction.

148. Following payment of all debts, an administrative delay in selling property in order to distribute the proceeds of sale to heirs would not follow assent so would not give rise to a taxable distribution. Another situation that might hold up assent is where the will is contested or there is a claim on the estate. That would cause a delay in sorting out who is entitled to the property, but the personal representatives would be dealing with that in their capacity as representatives, not as trustees. They would not give assent for property that the contest or claim affected until the contest or claim were sorted.

149. However, if an executor continues to hold property in the capacity of trustee on a trust, expressly or impliedly, provided for in a will, and the trust is not a bare trust, then any transfer to beneficiaries may be a taxable distribution. Assuming an assent is express or can be inferred from the circumstances, a distribution when it is made might then give rise to a taxable distribution. This would occur where, for instance, heirs of an intestate deceased are not of age or where a will provides for a life interest before the property goes to the heirs. In these situations, there will be contingencies and more than protection of the property before distribution, so the trust will not be a bare trust.

150. In the example discussed at [132], where an executor in Australia distributed the proceeds of sale of Australian shares to a New Zealand tax resident heir of a deceased Australian, the distribution was from a foreign trust. This is because the proceeds were part of the residuary estate that the executor held undistributed for a time. The deceased had died with a will that expressly provided for establishing a trust for the heir so a trust arose following assent. The ordering rules in s HC 16(2) would need to be considered, unless the trust was a non-discretionary trust covered by s HC 16(6)(b).

151. Assuming it was a discretionary trust, if the trust records were not good enough to allow the ordering rules to be applied, the transfer of the proceeds of sale of the shares and the accumulated dividends would together be a taxable distribution: s HC 15(7). If the records showed that only the accumulated dividends represented income derived since the trust started, then s HC 15(4) would not exclude them from being a taxable distribution, but any capital gains the trust made on the shares and their value when the trust started (corpus) would be excluded and would not form part of a taxable distribution from a foreign trust.

Summary

152. Other common law countries are likely to have estate administration laws that are similar to those in New Zealand. This means that personal representatives, in that capacity, do not hold the property of a deceased person on trust for the heirs. Property will be subject to a trust only when personal representatives hold legal title subject to the terms of a trust, express or implied. This can happen only after they

have given assent in relation to that property. Assent can be inferred from the circumstances and can be for individual items of property and before the residuary estate has been determined. Before such assent, the legal position is that the personal representatives hold both the legal and the beneficial interest in the estate property "in right of the deceased" rather than as trustee for beneficiaries.

153. A trust under general law and following assent can still arise for property distributed following administration. However, in a straightforward will disposition, such a trust is likely to be a bare trust for tax purposes and any distribution will not be a taxable distribution. Alternatively, where there is a testamentary trust or a will providing for life interests or no distributions to heirs who are minors, the property may continue to be held in trust and may be a taxable distribution when transferred to beneficiaries. A distribution in these circumstances could comprise more than corpus and could be subject to the ordering rules in s HC 16, as well as comprising current-year beneficiary income.

154. Distributions from estates of residents of civil law countries are less likely to be from trusts because heirs have a legal interest from the date of death. Even if there is no trust, New Zealand tax residents should consider whether they have derived income from the property held overseas.

Examples

155. The following seven examples help to explain how the law applies.

Example | Tauira 1 – Whether a trust exists – United States "trustee" sends money to a New Zealand tax resident

Facts

- Adam is a wealthy United States (US) citizen. Five years ago, he set up a "living trust", which is a common estate planning method in the US. He appointed himself as trustee. The trust deed recorded that the trust was revocable during his lifetime (a "revocable living trust") but would become irrevocable on his death (an "irrevocable living trust"). Until then, income from the property, if distributed, must be paid to him and nobody else. He can direct the trustee to pay the corpus of the trust to him or on his behalf at any time. Further, one provision in the trust deed allows Adam to absolve himself as trustee from any breaches of trust.
- As settlor he instructs himself as trustee to send some money from the trust's assets to his son Orson who lives in New Zealand. His intention is for Orson to use the money to set up a business here.

Question

- Orson wonders if the money is taxable in New Zealand.

Discussion

- Orson is a New Zealand tax resident and has received a transfer of value without providing anything in return. Whether the amount is a taxable distribution from a foreign trust depends in part on the money coming from a trust.
- The first step under the two-step approach is to identify the legal rights and obligations of Adam's revocable living trust under foreign law. Adam is able to occupy the roles of settlor, trustee and beneficiary of his trust under US law. He can require all the property held in trust to be returned to himself at any time and he cannot be called to account as trustee under the law in his state. The second step is to apply New Zealand law to these rights and obligations.

- The likely conclusion is that the essential features of a trust are not present. This is not because the arrangement is revocable by Adam while he is alive. A valid trust can exist in New Zealand where the trust is revocable. However, in this case Adam can reclaim the trust's assets at any time, which indicates a lack of intention to establish a trust.
- In addition, a valid trust does not result because a sole trustee cannot be the sole beneficiary. The lack of accountability by Adam for the way he carries out his duties as trustee is another factor that points to no valid trust existing under New Zealand law - see ss 14 and 13(b) of the Trusts Act respectively.
- The amount Orson received would be treated for New Zealand tax purposes as a gift from his father in the US, rather than as a taxable distribution from a foreign trust. Further, nothing in the facts suggests the amount is of an income character and subject to New Zealand tax in Orson's hands.
- On the death of Adam, a bare trust or foreign trust might arise depending on the terms of the irrevocable living trust. If, for example, the sole duty of the trustee was to transfer the assets of the trust to Orson it is likely a bare trust would exist and s YB 21 would apply. If the duties were more extensive, a foreign trust might arise and a distribution to Orson might be a taxable distribution.

Example | Tauira 2 – Whether a trust exists – property held in Switzerland transferred to a New Zealand tax resident

Facts

- Carl has lived in Switzerland for all of his life and has accumulated several properties that he decides to dispose of. One is an apartment in Zurich that he wants to keep in the family. He transfers legal title to his brother Roger, who is also resident in Switzerland. They sign an agreement that Roger is responsible for maintaining the apartment and meeting outgoings. The agreement also provides that Roger can live in the apartment or rent it out but will transfer it and any accumulated rental income to Carl's daughter Ursula when she turns 25. If Ursula dies before she turns 25, Roger is to give the apartment and accumulated rental income (if any) to his own children.

- Ursula moves to New Zealand as a 20-year-old. Five years later (after she has lost her transitional tax resident status), on the day she turns 25, Roger transfers title in the apartment to her. He also deposits net rental income for 3 years into her New Zealand bank account.

Question

- Ursula wonders whether she has any tax obligations in New Zealand.

Discussion

- The tax treatment of this for Ursula will depend on whether the arrangement between Carl and Roger has the essential features of a trust under the law of trusts in New Zealand. The first step would involve an examination of the rights and obligations of the parties under the contract in the context of Swiss law. It seems Roger can benefit under the contract by living in the apartment but ultimately he has to pass it and any rental income to Carl's daughter or his own children. It is not known if Carl can cancel the contract and reclaim the apartment. Without further information it is not possible to proceed to the second step and apply New Zealand law to the legal rights and responsibilities. However, it can be observed that even though Roger appears to have some duties resembling fiduciary obligations he can use the property for his own benefit in the interim. This aspect points to the arrangement not being a trust in New Zealand as a trustee must not exercise a power for their own benefit – see s 31 of the Trusts Act.
- Assuming though the arrangement is a trust for New Zealand tax purposes, it would be a foreign trust for the purposes of any distribution as the trust has not had a settlor who is a New Zealand tax resident. The ordering rules in s HC 16 would apply because it was not a non-discretionary trust created by will or on intestacy. Roger has kept very good records of his time owning the apartment, so it is possible to apply the ordering rules to treat:
  - any current-year rental income as beneficiary income (because it is income the trustee derived and paid to Ursula);
  - the accumulated rental income as a taxable distribution (because it is income Roger, as trustee, derived in earlier income years); and
  - the apartment itself as corpus or capital gains (and so excluded by s HC 15(4) from being a taxable distribution).

  Roger must calculate rental income and other amounts applying New Zealand's tax laws, not those in Switzerland.

- Tax credits are potentially available for tax Roger paid (if he paid it by deduction at source rather than as legal owner) in Switzerland to reduce Ursula's tax liability on current-year income. Article 22(1) of the double tax agreement (DTA) with Switzerland would seem to permit a credit for Swiss tax paid by deduction or by Ursula against New Zealand tax payable on the rental income distributed as beneficiary income or derived after title is transferred to her. The mechanism is via the domestic provisions such as ss LJ 1 and LJ 2. The DTA with Switzerland, however, does not expressly recognise fiscally transparent vehicles so if Roger was assessed for Swiss tax, then arguably it would not be treated as Ursula's tax liability under that DTA.
- No tax credits would be available for tax paid on Roger's accumulation of rental income for previous years as a trustee. This would be treated as a taxable distribution if it was distributed in a lump sum to Ursula after her transitional resident status had ended. Under s LJ 6, only any tax equivalent to non-resident withholding tax deducted in Switzerland from a taxable distribution would be available as a credit in New Zealand.
- If the arrangement is not a trust, the transfer of the apartment and any rental income Roger accumulated before Ursula turned 25 are unlikely to be treated as income in New Zealand. These two items would essentially be treated in the same manner as gifts. Because the facts do not suggest Roger is an agent for Ursula at any stage, current-year rental income derived before Ursula was 25 would also not be taxable in New Zealand.
- Ursula would have an ongoing obligation as a New Zealand tax resident to account for any income generated from the apartment. She could refer to IS 20/06: **Income tax – Tax issues arising from owning foreign residential rental property**[25] to help her understand these obligations or she could seek advice from a tax advisor.

Example | Tauira 3 – Ordering rules

Facts

- In 2008, Charles, a celebrity chef, and Joanna, a successful banker, in the City of London settle an investment portfolio and a house in the Cotswolds on a trust for their two children, Mary and Elizabeth. Charles and Joanna

[25] IS 20/06: Income tax – Tax issues arising from owning foreign residential rental property *Tax Information Bulletin* Vol 32, No 7 (August 2020): 98.

are trustees along with the family's lawyer in London. They are all tax residents in the United Kingdom.

- In 2010, Mary moves to Australia. In 2012, Elizabeth moves to New Zealand, becoming a tax resident here. Using the discretion given in the trust deed, in 2024 the trustees transfer the investment portfolio and accumulated income to Mary in Australia and the house to Elizabeth in New Zealand. Until that time, the trustees had retained all the income that the portfolio had generated.

Question

- Elizabeth wonders whether she has any tax obligations in New Zealand.

Discussion

- Under the law in United Kingdom, which is a common law country, Charles, Joanna and the family lawyer hold assets for the benefit of Mary and Elizabeth. These are features New Zealand is likely to recognise as creating a valid trust. The settlors have never been New Zealand tax residents, so the trust is a foreign trust. The exclusions in s HC 16(6) do not apply so the tax treatment of the distribution for Elizabeth in New Zealand is going to depend on the application of the ordering rules.
- This means that Elizabeth will not be able to treat the entire distribution of the house to her as corpus and capital gains. Instead, she must take account of the components of the investment portfolio. Under s HC 16(2), a proportion of the accumulated income in the portfolio needs to be treated as income that the trustee derived and is a taxable distribution under s HC 15(4). This amount is calculated according to New Zealand tax law. Because the trustees are non-resident and the trust has not had a New Zealand settlor, there is no need to calculate FIF income or financial arrangement income.
- IS 24/01 **Taxation of trusts** discusses taxable distributions (from [8.58]) and the ordering rules (from [8.113]).

Example | Tauira 4 – Testamentary trust settled overseas

Facts

- David moved to New Zealand from Australia with his mother when he was 12 years old. His parents had separated, and David was their only child. Later, when David was 18, his father Joe was killed in a mining accident.

Joe's will left a direction to create a trust with the balance of his residuary estate (mostly comprising commercial properties in Perth). The trustee, a resident in Australia, was to hold that on trust, accumulating rents and reinvesting, until David turned 21.

- David has now turned 21. The trustee has sold the properties and sent the proceeds of the trust to David in New Zealand.

Question

- David wonders whether he has any tax obligations in New Zealand.

Discussion

- Assuming the law of administration of estates in Australia is not materially different to the law in New Zealand, no trust arises in the period between Joe's death and assent because the executor had the legal and beneficial ownership of the property. Income derived during this period on the estate's assets is likely to be taxable in Australia to the executor.
- At the point of assent, a testamentary trust is created from the residuary estate. The trust will be a foreign trust because Joe was never a New Zealand tax resident and he is the only person who settled anything on the trust.
- In the year of distribution, the trustee's current-year investment income paid to David will be beneficiary income. As the trust was created by a will, the ordering rules in s HC 16 do not apply as long as the trust meets the requirements for being a non-discretionary trust. If so, the terms of the trust deed will determine the income tax treatment. Accumulated rental and investment returns will be a taxable distribution, but the proceeds of sale of the properties will not, because s HC 15(4) excludes them as either corpus or capital gains. The amounts need to be calculated according to New Zealand's laws. This may involve recalculating rental income in a different way from how it is calculated in Australia.

Example | Tauira 5 – Deceased in a civil law country but New Zealand tax resident heir later settles trust overseas

Facts

- Thomas lived in Germany for most of his life. His only child Joseph moved from there with his family to New Zealand in 2005. When Thomas's wife died in 2010, he made a will leaving all his property to Joseph.
- When Thomas passed away in 2022, Joseph travelled to Germany and discussed his father's estate with the executor, Erich, a professional financial advisor in Berlin. Erich's advice was to appoint a company in the Cayman Islands to hold the estate on trust for Joseph until the funds were required due to the absence of local tax and for asset protection. Joseph follows Erich's advice without considering the tax laws in New Zealand.
- Circumstances change. In 2025 Joseph's family is short of money. The trust is wound up and everything from it is distributed to Joseph.
- The trustee does not file any IR6 returns nor pay any tax in New Zealand on the income generated from the estate's assets invested in the United States and Europe. Joseph did not disclose the existence of the trust to Inland Revenue.

Question

- Joseph wonders if he has any tax obligations in New Zealand.

Discussion

- As Germany is a civil law country, it is likely no trust arose when Thomas died. The inheritance to Joseph would not have been taxable. However, he would have needed to account for any income derived on the property from when Thomas died until the arrangement in the Cayman Islands was established.
- Under Cayman Islands' law, the company is holding assets for the benefit of Joseph. It is assumed its obligations are fiduciary in nature. New Zealand law would likely recognise the arrangement in the Cayman Islands as a trust. As Joseph was a New Zealand tax resident and no resident trustee existed, he had an obligation to disclose the particulars of the trust under s 59(1) of the Tax Administration Act 1994 within 3 months of settling the trust.
- The income that the non-resident trustee derived was subject to tax in New Zealand as Joseph was a New Zealand tax resident under s HC 25. For the purposes of calculating the trustee's taxable income, the trustee would be treated as being a tax resident in New Zealand in relation to the rules for foreign-sourced income listed in s HC 25(6). For example, the trustee would need to calculate FIF income if they held any attributing interests.

- As there was no New Zealand tax resident trustee, Joseph also had an obligation to meet the trustee company's New Zealand tax obligations on trustee income (s HC 29(2)).
- The trust was not a complying trust under s HC 10(1) because the trustee did not meet their tax obligations in relation to the trustee's income tax liability for every tax year. It was not a foreign trust because Joseph was a tax resident in New Zealand. It was therefore a non-complying trust.
- Taxable distributions from a non-complying trust include all amounts other than beneficiary income and corpus under s HC 15(2). Further, the amounts are treated as excluded income and taxed at 45%. Joseph has an obligation to report these amounts in his return.
- Joseph should make a voluntary disclosure about the non-compliance. If he does so, shortfall penalties may be reduced.

Example | Tauira 6 – Non-discretionary testamentary trust turns off ordering rules

Facts

- Cindy moves from Canada to New Zealand in 2005. Her parents die in a car accident in 2012. Their wills instruct their executors to establish a single non-discretionary trust for their three children in the event of both dying at the same time. The terms of the trust require that the trustees distribute 100% of the annual income in equal proportions to the beneficiaries and lump sum amounts totalling 50% of corpus to each beneficiary in equal proportions when the first one reaches the age of 50. Upon the last beneficiary reaching 50, the balance of assets is divided amongst the beneficiaries then living and distributed in equal proportions and the trust is to be wound up.
- In 2024, Cindy receives a substantial payment from the trustees in accordance with the terms of the trust on her eldest sibling reaching the age of 50.

Question

- Cindy wonders whether she has any tax obligations in New Zealand.

Discussion

- The wills instruct the creation of a non-discretionary trust. As Canada is a common law country, it is likely that the rights and obligations are those

that New Zealand law would recognise as being a trust. As no settlor has been a tax resident in New Zealand, it is a foreign trust.

- The annual distributions (and any part-year final income distributions when the trust is wound up) are beneficiary income and taxed to Cindy at her marginal tax rate.
- Because the trust is a non-discretionary trust created by a will, the ordering rules in s HC 16 do not apply, and the terms of the trust will determine the tax effect for Cindy. Because the lump sum proceeds are from corpus, Cindy does not receive a taxable distribution.

Example | Tauira 7 – Discretionary testamentary trust – ordering rules and the importance of records

Facts

- As in Example | Tauira 6, Cindy's parents die and leave wills. In this situation, however, the wills instruct the executors to establish a single discretionary trust.
- In 2024, Cindy asks the trustees for funds to support her daughter, who is about to go to university. The trustees agree to the request and sell some shares at a profit. They sign a resolution to the effect that they are distributing corpus and capital gains.

Question

- Cindy wonders whether she has any tax obligations in New Zealand.

Discussion

- In this situation, it is necessary to apply the ordering rules in s HC 16(2). This may mean that Cindy has received a taxable distribution from a foreign trust.
- To establish that Cindy has not received a taxable distribution from a foreign trust, the records of the trust would need to show that all income the trustees derived in the current or earlier years, as calculated according to New Zealand's tax laws, had been distributed to the beneficiaries earlier or at the same time. This requirement applies even though the intention is for the trustees' distribution to be of corpus and capital gains.

- Further, if Cindy cannot obtain adequate records to be able to determine the elements of the distribution under s HC 16(2), s HC 15(7) will apply to treat the entire distribution to her as a taxable distribution from a foreign trust.

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