TRUSTS FOR PORTUGUESE RESIDENTS

Globally, individuals and families establish trusts for a number of reasons including asset protection, succession planning, estate planning, investment efficiency, and philanthropy. This article aims to explain how Portuguese residents can benefit from trusts, how trusts are taxed in Portugal, and the advantages that New Zealand offers as an international trust jurisdiction.

Whilst taxation can no longer be the primary focus for using trusts, tax efficiency and tax neutrality are major factors in trust planning. Like most EU families, Portuguese residents will not want to breach their domestic tax laws nor increase their overall burden of tax cost when utilising a family trust structure. Portugal is a civil law jurisdiction and does not recognise trusts, so Portuguese residents need to use foreign trusts for their wealth planning structures.

So how does Portugal treat foreign trusts for taxation purposes?

Portugal's tax law now taxes Portuguese residents on distributions from foreign trusts. In general terms any distribution (either income or capital) from a foreign trust is taxable to the recipient resident in Portugal at 35% if the trustee is located in a "blacklisted" country, or 28% if the trustee is domiciled in a non-blacklisted country such as New Zealand. Foreign investment income received directly by a Portuguese resident is taxed in a similar manner.

However distributions arising from the termination or revocation of a trust are treated differently. If the distribution is received by the settlor of the trust then the capital contribution to the trust is deducted from the termination proceeds to determine the taxable gain. That net gain is taxed on the same basis as described above. On the other hand if the termination distribution is received by a beneficiary who is not a settlor, the Portuguese resident beneficiary's distribution proceeds are exempt from income tax and treated as a gratuitous transfer which is subject to a 10% Stamp Tax. The Stamp Tax is territorial and there are circumstances when such distributions may not be subject to tax.

The Portuguese controlled foreign corporation (CFC) rules may apply to undistributed passive income in a foreign trust, particularly if a Portuguese resident retains control over the trust assets. The use of an irrevocable and discretionary trust domiciled in a non-blacklisted jurisdiction, such as New Zealand, will assist in negating the CFC risk.

There are separate rules for the taxation of "non-habitual residents" ("NHR's") living in Portugal. Whilst the NHR rules may provide for full exemption of foreign source income, the exemption rules are complex and generally foreign trust income will not be within the exemption.

In summary, properly structured foreign trusts should be tax neutral for Portuguese residents, and may provide tax deferral benefits on undistributed foreign source income. It will be apparent from the above commentary that professional advice needs to be taken in regard to Portuguese tax issues to ensure that the foreign trust structure is tax efficient for Portuguese residents.

So how can foreign trusts be of benefit to Portuguese residents?

There are essentially three categories of Portuguese residents - Portuguese nationals, foreign nationals (particularly British), and foreign nationals under the NHR programme. All of these Portuguese residents face similar issues in regard to wealth planning.

Globally the main drivers of trust based wealth planning for wealthy businessmen, investors and their families are asset protection, succession planning, and estate planning. Each of these factors are comprehensive subjects in their own right. We comment briefly on them to highlight their importance to Portuguese residents.

Asset protection:

Personal and family wealth is subject to a myriad of risk factors. One of the most significant is that of matrimonial dispute due to ever increasing rates of divorce and partner separation. Family wealth can be seriously impacted by claims from relationship partners against family members and the family estate. Pre-nuptial agreements are in most instances ineffective solutions.

Unprotected commercial risk in business ventures by spendthrift or inexperienced family members can put family wealth at risk. An ever increasing litigious world unwittingly supported by socially biased courts, particularly for spurious liability or damage claims, poses similar risks to family and business assets. Political risk is increasing globally. There is asset risk everywhere.

A Portuguese resident who places family wealth, or a significant part of such wealth, into a properly planned irrevocable discretionary family trust removes the asset from direct ownership of the "at risk" family members, and protects those assets from potential claimants.

The Asiaciti Trust Group has more than 30 years involvement in specialised international asset protection trust structuring. For more information, email assetprotection@asiacititrust.com.

Succession planning:

Over the past 50 years Portugal has lived through possibly the most significant wealth generation period in its modern history. Many families are at the point where that wealth is being passed to the next generations, and they face the need to properly plan that succession.

As a civil law jurisdiction Portugal adopts forced heirship laws in regard to the inheritance of wealth. These laws provide for the statutory distribution of the assets of the deceased to family members according to the defined relationships and percentages. The law applies to worldwide assets other than non-Portuguese real estate.

The transfer of assets as a consequence of death is subject to a statutory probate process in Portugal, and in many instances also in foreign jurisdictions where other estate assets are located. The probate process can be complex, costly and often take at least a year to finalise.

With proper planning a Portuguese resident can avoid the application of the forced heirship laws and the probate process by transferring assets into an irrevocable discretionary family trust. This provides a seamless continuation of asset ownership, saving significant lega; and administration costs, and potentially family legal disputes over inheritance entitlements.

Estate planning:

As noted above Portugal adopts forced heirship laws in regard to the inheritance of wealth. Portugal does not have an inheritance tax but the 10% Stamp Tax referenced above, applies to Portuguese assets transferred as a consequence of death. The tax must be paid by the recipient of the asset within a specified time and prior to legal transfer.

Where permitted, the transfer of ownership of Portuguese assets into a family trust as outlined for succession planning will overcome these disadvantages, particularly the need for the beneficiary to pay the Stamp Tax. That tax will have been paid at the time of the transfer to the trust.

Foreign nationals resident in Portugal including NHR's will need to consider home nation inheritance issues and in many cases a foreign trust will provide additional estate planning benefits.

In summary a foreign trust may benefit a Portuguese resident through (i) the protection of business and family assets; (ii) a seamless and cost effective transfer of family wealth to future generations; (iii) a simplified estate transfer process; and (iv) in some circumstances, tax deferral on foreign source income.

The advantages of New Zealand as an international trust jurisdiction

The tax law of Portugal includes a blacklist of jurisdictions considered tax havens and includes most Caribbean jurisdictions, Monaco, the UAE; Gibraltar; Hong Kong; the Isle of Man; Liechtenstein;

Guernsey; Jersey; and Uruguay. New Zealand is a rare example of a tax neutral and globally recognised trust jurisdiction that is not on this blacklist.

Under New Zealand tax law a trust established by a Portuguese resident, with a New Zealand resident trustee and no New Zealand resident beneficiaries, is exempt from New Zealand income tax on foreign source income. The structure and benefits of the New Zealand foreign trust are explained in our Technical Briefing, *The New Zealand Foreign Trust.*

In addition to its tax neutrality the New Zealand foreign trust offers some unique trust administration options. One of these is the role of the Special Advisor which would allow a Portuguese resident settlor to possess a degree of influence over the trust. The New Zealand Trusts Act 2019 (the 'Act'), defines the Special Advisor as a statutory function. The Act provides that the Special Advisor may advise the trustee on any matter relating to the trust but is not a trustee of the trust. It further provides that the Special Advisor does not have control over the trust and does not have the powers or duties of a trustee.

This means that a Portuguese resident settlor or beneficiary of a New Zealand foreign trust, in the role of Special Advisor, could provide advice to the trustee without having legal control over the trust. If a Portuguese resident is not in control of a foreign trust then the Portuguese CFC rules should not apply.

Ilustrations of the use of New Zealand foreign trusts for Portuguese residents

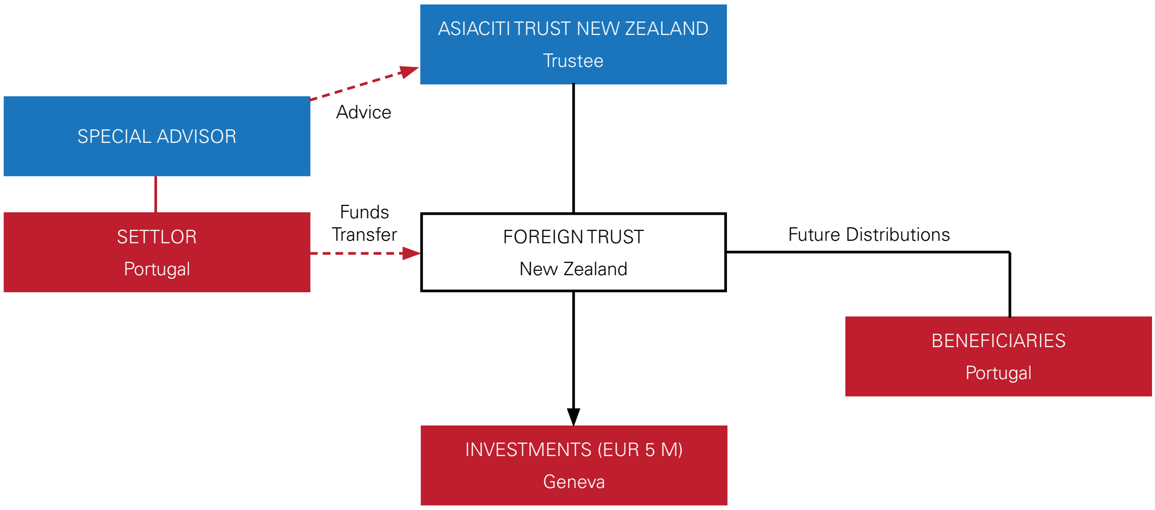
Example # 1

Portuguese resident, Mr A, holds a Eur. 5,000,000 investment account with a bank in Geneva, and intends to transfer the funds to his adult children. Mr A has some concerns that if he transfers the funds directly to his children now, the funds will be exposed to higher risks, as the three children do not have much experience in managing money and are in the early stages of their matrimonial relationships.

Mr A can protect the Eur. 5,000,000 by transferring the funds to a New Zealand foreign trust. As the funds are not located in Portugal the 10% Stamp Tax will not apply to the transfer. By taking on the role of Special Advisor, Mr A has the ability to advise the trustee on matters such as the investment of the funds, trust distributions, or the exclusion of beneficiaries. The trustee is not obliged to follow Mr A's advice but should the trustee do so it is not liable for such actions.

If properly structured, the income earned by the New Zealand foreign trust will not be subject to income tax in Portugal nor New Zealand. Any future distributions made to beneficiaries resident in Portugal will then be subject to Portuguese income tax.

Exampe #1 Structure Chart



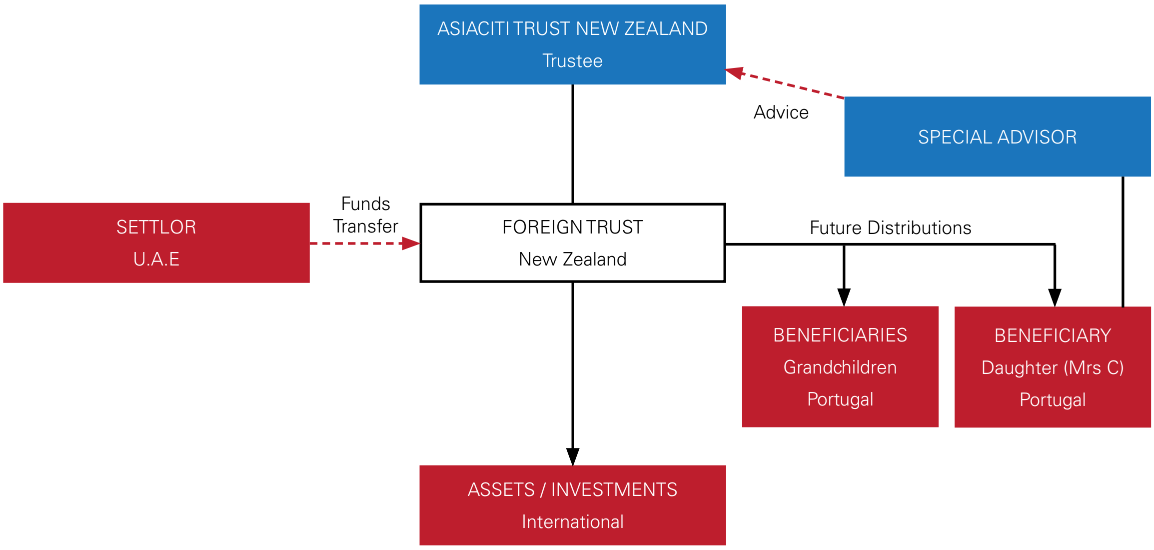
Example # 2

Mrs B, a Portuguese national, and her husband are resident in the UAE. Mrs B has independent wealth which she wishes to leave to her daughter, Mrs C, and her grandchildren who are resident in Portugal. Her primary intent is to benefit her grandchildren when they come of age, but Mrs B would like her daughter (an investment banker) to benefit should her financial circumstances change adversely. Mrs B is concerned, *inter alia*, about the potential application of forced heirship laws in the UAE and Portugal.

With proper advice and planning, Mrs B can settle a New Zealand foreign trust in which the beneficiaries are Mrs C and her children, with relevant provisions as to age of entitlement etc. Mrs C would be appointed as the Special Advisor to the trust, or alternatively, Mrs B could be appointed the Special Advisor with provision for Mrs C to succeed her in the role. The Special Advisor can advise the trustee on any aspect of the trust administration. In this case of particular relevance is the ability for the Special Advisor to recommend to the trustee that Mrs C benefit in the event of an adverse change in her financial circumstances.

The transfer of Mrs B's assets to the trust will place them outside the realm of the forced heirship laws and protect the assets from other contingent risks. The income earned by the New Zealand foreign trust will not be subject to income tax in Portugal nor New Zealand, with the exception of Portuguese income tax that may apply to income derived from any trust assets located in Portugal. Any future distributions made to the beneficiaries resident in Portugal will be subject to Portuguese income tax.

Exampe #2 Structure Chart



In summary, the New Zealand Foreign Trust that incorporates the statutory role of a Special Advisor, offers the Portuguese resident client a premium wealth planning structure for tax neutral asset ownership whilst retaining an operational role over the trust assets. Asiaciti Trust fees for structuring a New Zealand Foreign Trust are set out in our fee schedule, which is available on request

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