

TECHNICAL DECISION SUMMARY > PRIVATE RULING

WHAKARĀPOPOTO WHAKATAU HANGARAU > WHAKATAUNGA
TŪMATAITI

Distributions from private foundation on dissolution

Decision date | Rā o te Whakatau: 27 March 2023

Issue date | Rā Tuku: 11 July 2023

TDS 23/10

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Subject | Kaupapa

Whether the distributions by a private foundation on dissolution are taxable in the hands of a New Zealand resident taxpayer.

Taxation laws | Ture tāke

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

Facts | Meka

1. The Taxpayer is a New Zealand income tax resident.
2. In the early 2000s, the Taxpayer contributed funds to a Stichting Particulier Fonds (private foundation) established in, what was then, the Netherlands Antilles.
3. Under its articles, the private foundation was managed by a management board which, in turn, was supervised by a supervisory board. The private foundation's articles also regulate the appointment and dismissal of the members of the boards.
4. On incorporation, the registered office of the private foundation was in the Netherlands Antilles and the sole director of the private foundation was a limited liability company established in Curacao.
5. The private foundation was established with a small initial capital contribution, followed by an additional capital contribution of the funds mentioned above. Further capital contributions were made by the Taxpayer in subsequent years.
6. The capital contributed by the Taxpayer to the private foundation was in the nature of a gift.
7. The private foundation's purpose, as stated in its articles, is to make distributions from its assets to such institutions and persons as the board of directors shall decide, to render financial support to those institutions and persons by giving them loans, guarantees and through annuity agreements and similar arrangements.
8. The private foundation had previously distributed amounts to persons including the Taxpayer. The ruling did not consider or rule on:
 - The tax treatment of amounts that were distributed by the private foundation to the Taxpayer prior to the date a resolution was made to dissolve the private foundation.

- The application of subpart CQ.
9. The management board of the private foundation wished to dissolve the private foundation due to changes in overseas law around foundation structures, and distribute funds to the Taxpayer.

Issues | Take

10. The Tax Counsel Office (TCO) considered the following issues:
- Whether the distribution of an amount from the private foundation on dissolution to the Taxpayer is income under s CD 1.
 - Whether the distribution of an amount from the private foundation on dissolution to the Taxpayer is income under s CV 13 or an amount to which s BF 1(b) applies.
 - Whether the distribution of an amount from the private foundation on dissolution to the Taxpayer is income under s CA 1(2).

Decisions | Whakatauranga

11. TCO concluded that:
- The private foundation was a “company” as defined in s YA 1.
 - The Taxpayer was a “shareholder” as defined in s YA 1 in the private foundation at the time of the distribution of an amount from the private foundation on dissolution.
 - The distribution of an amount from the private foundation on dissolution to the Taxpayer is not income of the Taxpayer under s CD 1 to the extent it does not exceed the Taxpayer’s share of the “available capital distribution amount” calculated under s CD 44.
 - The distribution of an amount from the private foundation on dissolution to the Taxpayer is not income of the Taxpayer under s CV 13 or an amount to which s BF 1(b) applies.
 - The distribution of an amount from the private foundation on dissolution to the Taxpayer is not income of the Taxpayer under s CA 1(2).
12. The following conditions apply to TCO’s conclusion:

- The Taxpayer had no legal or equitable claim to the private foundation's assets before dissolution.
- The management board resolved to dissolve the private foundation in accordance with its articles and that amounts distributed by the private foundation to the Taxpayer were distributed after the resolution to dissolve the private foundation had been approved.

Reasons for decisions | Pūnga o ngā whakatau

Issue 1 | Take tuatahi: Is the distribution income from a trust?

13. The Taxpayer requested the Commissioner to rule that the distribution of an amount from the private foundation on dissolution to the Taxpayer was not income of the Taxpayer under s CV 13 or an amount to which s BF 1(b) applied.
14. Sections CV 13 and BF 1(b) apply to amounts derived from a "trust". It follows that the question considered by TCO was whether the private foundation should be characterised as a trust for New Zealand tax purposes.
15. When determining the application of the New Zealand tax legislation to an arrangement to which the laws of a foreign jurisdiction apply, TCO considered that a two-step approach was required:
 - The first step was to determine the legal rights and obligations that existed between the parties. The contractual arrangements and foreign law were used to determine those legal rights and obligations.
 - The second step was to consider the application of the New Zealand law contained in the Act to those legal rights and obligations. The foreign law was irrelevant at this stage.
16. In other words, TCO considered that the issue was not whether a trust relationship existed under the foreign law. The issue was whether the legal rights and obligations as determined under the foreign law would, when applied to the New Zealand context, be viewed as a trust. Whether the foreign law would consider that there was a trust was irrelevant. Under New Zealand law the nomenclature used was irrelevant, including any nomenclature used in the foreign jurisdiction.
17. TCO noted that this two-step approach was consistent with the approach outlined by the Commissioner in IS 19/04 *Income Tax – Distributions from foreign trusts*

(IS 19/04) in relation to the issue of how to determine whether an arrangement is a "trust" for NZ purposes.

Step One – The legal rights and obligations created under the foreign law

18. The first step was to determine the legal rights and obligations that exist between the parties. In this case the private foundations articles and the foreign law were used to determine those legal rights and obligations.
19. TCO was satisfied that the legal rights and obligations of the private foundation under the foreign law could be summarised as follows:
 - The private foundation was a legal person.
 - The private foundation had no members or shareholders.
 - The private foundation continued in perpetuity until such time as it was dissolved.
 - The private foundation owned the foundation's assets and could deal with the property on its own account.
 - The management board members were accountable to the stated purpose of the private foundation. The supervisory board supervises the board and has powers to provide prior consent in relation to important decisions.
 - There may be persons (the Taxpayer and their family) that could expect distributions to be made to them but they did not have any enforceable claim to a distribution of the private foundation's assets.

Step Two - Application of the New Zealand law to the private foundation's rights and obligations

20. The question at step two was whether the legal rights and obligations of the private foundation as determined under the foreign law would, when applied to the New Zealand context, be viewed as a trust.
21. An essential feature of a trust for New Zealand purposes is the existence of an obligation (fiduciary duty) on a person (the trustee) to deal with the property for the benefit of the beneficiaries or a charitable purpose.¹ TCO considered the private

¹ See *Law of Trusts (NZ)* (online ed, LexisNexis NZ, accessed 21 February 2023) at [1.6] and *Nevill's Law of Trusts, Wills and Administration*, 13th ed, 2018 (LexisNexis).

foundation lacked this essential feature and therefore was not a trust, nor was there a trust relationship between the parties. The reasons for TCO's conclusion were as follows:

- Legally the private foundation owned the assets in its own right and could deal with the property on its own account.
- While the Taxpayer could expect distributions from the private foundation of its assets, the Taxpayer had no legal or equitable claim to the private foundation's assets.
- The articles provided for the management board to decide on the time of any distribution from the private foundation and stated that a beneficiary was only a beneficiary and had no right whatsoever to claim a distribution.
- The Taxpayer, as founder, had no enforceable claim to the private foundation's assets (including the capital contributed by the Taxpayer). The Taxpayer's capital contributions to the private foundation were in the nature of a gift.
- The nomenclature used was irrelevant, including any nomenclature used in the foreign jurisdiction. That the articles of the private foundation referred to "beneficiaries" and some of the documents provided by the Taxpayer referred to the private foundation as a "trust", the management board as "trustees" and to "beneficiaries" did not result in the private foundation being characterised as a trust for New Zealand tax purposes.

22. The fact that the Taxpayer had no legal or equitable claim to the private foundation's assets before dissolution was crucial to TCO's conclusion that the private foundation was not a trust and that no trust relationship existed between the parties. TCO included a condition in the ruling as follows:

The Taxpayer has no legal or equitable claim to the private foundation's assets before dissolution.

Conclusion

23. TCO concluded that the distribution of an amount from the private foundation on dissolution to the Taxpayer was not income of the Taxpayer under s CV 13 or an amount to which s BF 1(b) applied.

Issue 2 | Take tuarua: Is the distribution dividend income under s CD 1?

24. The Taxpayer requested the Commissioner to rule that the distribution of an amount from the private foundation on dissolution to the Taxpayer was not income under s CD 1.
25. Section CD 1 provides that a dividend derived by a person is income. "Dividend" is defined in s CD 4. There are also a number of specific transactions that give rise to a dividend. TCO considered that none of these transactions were relevant in the context of the ruling.²

Is the private foundation a "company" for New Zealand tax purposes?

26. For an amount to constitute a "dividend" it must be transferred by a "company". Accordingly, the first question considered by TCO was whether the private foundation could be characterised as a "company" for New Zealand tax purposes.
27. As discussed at [15], answering this question involved two steps.

Step One – The legal rights and obligations created under the foreign law

28. The rights and obligations of the parties created under the foreign law were summarised above at [19].

Step Two – Application of New Zealand tax law to the rights and obligations

29. The question at step two was whether the legal rights and obligations of the private foundation as determined under the foreign law would, when applied to the New Zealand context, result in it being viewed as a "company" for New Zealand tax purposes.
30. "Company" is defined in s YA 1. The relevant part of the definition states that a company means a body corporate or other entity that has a legal existence separate from that of its members, whether it is incorporated or created in New Zealand or elsewhere.

² See ss CD 7, CD 7B, CD 8, CD 9, CD 10, CD 11, CD 12 - CD 14, CD 20.

31. In TCO's view, the private foundation was a "company" for New Zealand tax purposes on the basis that it had a separate legal existence and was incorporated or created in a foreign jurisdiction. TCO's reasons for this conclusion were:
- The private foundation was a legal person. It owned assets and could deal with property on its own account.³
 - Its legal personality was its "own", separate from the legal personalities of all other parties involved in the private foundation (being the Taxpayer (the founder), the management board, the supervisory board or any person that expected to or had received a distribution from private foundation).
32. TCO noted that its analysis was consistent with:
- The alternative approach used by the Commissioner in BR PUB 20/01 to 20/5 to determine that a US LLC was a "company" for New Zealand tax purposes.
 - The analysis and conclusion reached by the Australian Tax Office (ATO) in the context of a Stichting created under Netherlands law.⁴

Is the amount distributed to the Taxpayer by the private foundation a dividend?

33. The first question considered by TCO was whether the amount distributed to the Taxpayer by the private foundation was a dividend. The amount so distributed would be a "dividend" if the following criteria were satisfied:
- There was a transfer of company value from a company to a person;
 - The cause of the transfer was a shareholding in the company; and
 - None of the exclusions in ss CD 22 to CD 37 applied to the transfer.

Transfer of company value from a company to a person (s CD 5)

34. Section CD 5(1)(a) provides that a transfer of company value from a company to a person occurs when:
- the company provides money or money's worth to the person; and

³ Watts, Campbell and Hare in *Company Law in New Zealand* (2nd ed, LexisNexis NZ Limited, 2016).

⁴ See an Interpretative Decision of the ATO (ID 2008/62) that considers whether a Dutch Stichting constitutes a body corporate under Australian domestic law.

- if the person provides any money or money's worth to the company under the same arrangement, the market value of what the company provides is more than the market value of what the person provides.
35. Case law indicates that the expression "money or money's worth" requires that a benefit be in money or be convertible into money, either directly or indirectly.⁵
36. TCO considered this criteria would be satisfied. On dissolution the private foundation would provide money (proceeds from the sale of the private foundation's investments) and/or money's worth (the private foundation's underlying portfolio investments) to the Taxpayer. As the Taxpayer would not provide any money or money's worth to the private foundation on its dissolution, TCO considered that the market value of what the private foundation provided to the Taxpayer would be more than the market value of what the Taxpayer provided (ie, nil).

Cause of the transfer is a shareholding in the company (s CD 6)

37. Section CD 6(1) sets out the general test for when a transfer of company value from a company to a person is caused by a shareholding in the company. A transfer of company value is caused by a shareholding in the company if the recipient at *any relevant time*:
- holds shares in the company; or
 - is associated with a shareholder; and
 - the company makes the transfer because of that shareholding of the relevant shareholder.
38. "Share" is defined in s YA 1. TCO noted that the relevant definition for the purposes of the ruling was contained in para (a). That is, a "share" includes "any interest in the capital of a company". Neither the term "interest" nor "capital" are defined in s YA 1 for these purposes.

Meaning of "any interest in the capital of a company"

39. TCO considered that "any interest in the capital of a company" for the purposes of the definition of a "share" in s YA 1 may refer to the person's interest in issued share capital, and a right to a share in the surplus assets on a wind up, and may include rights to other distributions.⁶ An interest in a company's capital is an interest in the

⁵ *Tennant v Smith* (1892) 3 TC 158 (HL).

⁶ *Inland Revenue Commissioners v Tring* [1939] 2 All ER 105 (CA).

performance of the company that is of an equity nature (rather than a debt or contractual right to receive payments).

40. TCO noted that this was consistent with the position taken by the Commissioner in BR Pub 19/04.

Does the Taxpayer have any interest in the capital of the private foundation?

41. TCO was satisfied that the amount proposed to be distributed by the private foundation to the Taxpayer was “capital” of the private foundation. The amount proposed to be distributed came from the balance of the private foundation’s assets remaining after all debts had been paid off on a wind-up.
42. Although the proposed amount distributed to the Taxpayer came from the private foundation’s capital TCO had to consider whether the Taxpayer had “any interest” in the private foundation’s capital.
43. Section CD 6(1) provides that a transfer of company value is caused by a shareholding in the company if the recipient “*at any relevant time* holds shares in the company”. TCO considered that, in the context of determining whether an amount of capital distributed to a person on the dissolution of a company is a “dividend”, the “relevant time” to test whether a person holds a “share” in the company is at the time they receive the amount.
44. The description of the arrangement in the ruling application outlines the steps involved in dissolving the private foundation, including:
- The management board preparing a recommendation proposing to dissolve the private foundation for the supervisory board to consider.
 - Once a supervisory board resolution approving the dissolution of the private foundation has been obtained, the management board will determine who the beneficiaries are and how the assets will be divided between the beneficiaries.
 - The management board will then determine how the funds should be distributed.
45. TCO considered at that point the Taxpayer received the distribution they had a right to share in the private foundation’s capital on its dissolution and accordingly held a “share” in the private foundation at that time.
46. In addition to the requirement that the recipient of the distribution “hold shares” in the company for a transfer of company value from a company to a person to be caused by a shareholding, the company must make the transfer because of that shareholding of the relevant shareholder (s CD 6 (1)(b)).

47. One indication that a transfer is caused by a shareholding is if the terms of the arrangement that results in the transfer are different from the terms on which the company would enter into a similar arrangement if no shareholding were involved (s CD 6(2)). TCO's view is that, given that it is the management board's decision to make a distribution to the Taxpayer on the private foundation's dissolution that gives rise to the Taxpayer's interest in the capital of the private foundation (and therefore a "share" in the private foundation), it follows the distribution of capital is made because of that shareholding.
48. Accordingly, any amount distributed by the private foundation to the Taxpayer on dissolution will be a "dividend" unless one of the exclusions in ss CD 22 to CD 37 applies.

Do any of the exclusions in ss CD 22 to CD 37 apply here?

49. Sections CD 22 to s CD 37 contain a number of exclusions from the definition of "dividend". TCO considered the relevant exclusion was that contained in s CD 26 for amounts paid in relation to a share on the liquidation of a company.
50. "Liquidation" is defined in s YA 1 and includes the termination of the company's existence under any other procedure of New Zealand or foreign law. In TCO's view the dissolution of the private foundation under the foreign law and based on the process set out in the private foundation's articles would constitute a "liquidation" for the purposes of s CD 26.
51. Section CD 26(2) provides that when a shareholder is paid an amount in relation to a share on the liquidation of the company the amount paid is a dividend only to the extent to which it is more than:
- the available subscribed capital (ASC) per share calculated under the ordering rule; and
 - the available capital distribution amount (ACDA) under s CD 44.
52. ASC for a share in a company is calculated under s CD 43. Broadly, the concept of ASC refers to a company's share capital and include amounts received as consideration for the issue of the company's shares. As mentioned earlier, the private foundation has no share capital and therefore has no ASC. That the private foundation has no ASC is acknowledged by the Taxpayer in the ruling application.

53. A company's ACDA is calculated under s CD 44. Broadly, ACDA is a company's capital gain amounts and reflects the policy that a company can distribute its capital gain amounts to shareholders tax free on liquidation.⁷
54. TCO considered that the exclusion in s CD 26 applied in this case to the extent of the Taxpayer's share of the ACDA calculated under s CD 44.

Conclusion

55. TCO concluded that the distribution of an amount from the private foundation on dissolution to the Taxpayer was not income of the Taxpayer under s CD 1 to the extent it did not exceed the Taxpayer's share of the ACDA calculated under s CD 44.
56. This conclusion is subject to the following condition:

The Management Board resolves to dissolve the private foundation in accordance with the Articles of Incorporation and that amounts distributed by the private foundation to the Taxpayer are distributed after the resolution to dissolve the private foundation has been approved.

Issue 3 | Take tuatoru: Is the amount distributed by private foundation on dissolution income under s CA 1(2)?

57. The Taxpayer requested the Commissioner to rule that the distribution of an amount from the private foundation on dissolution to the Taxpayer was not income under s CA 1(2). The question considered by TCO was whether the amount distributed to the Taxpayer that did not constitute a "dividend" under s CD 1 (on the basis that it was a distribution of the private foundation's ACDA on dissolution) was income under ordinary concepts.
58. TCO considered the relevant factors for determining the character of receipts in the hands of the recipient included:
 - the scope of the recipient's business (if a business exists),
 - the periodicity, recurrence or regularity of the receipts,⁸
 - the consideration provided for the receipts,⁹ and

⁷ The Taxpayer did not ask for a ruling on the private foundation's ACDA.

⁸ *Reid v CIR* [1985] 7 NZTC 5,176 (CA).

⁹ *MIM Holdings Ltd v FCT* 97 ATC 4,420 (FFCA), *The Federal Coke Company Ltd v FCT* 77 ATC 4,255 (FCA).

- the purpose and reason for which the money is received.¹⁰

59. TCO concluded that:

- The distribution was not part of a business because the distribution on dissolution was at the discretion of the management board.
- The distribution was likely to be a one-off receipt.
- The Taxpayer did not provide any consideration for the distribution.
- The reason for the distribution was the management board's decision to distribute its net assets to such person as they determine, of which the Taxpayer was one. The amounts distributed to the Taxpayer were funded by the private foundation's ACDA and were capital in nature.

60. TCO considered that the above features indicated that the amount distributed to the Taxpayer and which was not a dividend under s CD 1 (on the basis that it did not exceed the private foundation's ACDA) would be capital in nature and not income under s CA 1(2) (income under ordinary concepts) of the Taxpayer.

Conclusion

61. TCO concluded that the distribution of an amount from the private foundation on dissolution to the Taxpayer was not income of the Taxpayer under s CA 1(2).

¹⁰ *McLaurin v FCT* (1961) 104 CLR 381, *Reid v CIR*, *The Federal Coke Company Ltd v FCT*, *Riches v Westminster Bank Ltd* [1947] AC 390.