Inland Revenue
Te Tari Taake

TECHNICAL DECISION SUMMARY > PRIVATE RULING

WHAKARĀPOPOTO WHAKATAU HANGARAU > WHAKATAUNGA TŪMATAITI

Distribution and resettlement of trusts

Decision date | Rā o te Whakatau: 18 December 2024

Issue date | Rā Tuku: 30 April 2025

TDS 25/09

Subjects | Kaupapa

Income tax: disposal of trust assets; capital receipts; distribution of trust assets; settlement of trust assets; FIF income; FIF income calculation method

Taxation laws | Ture tāke

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

Summary of facts | Whakarāpopoto o Meka

1. The Arrangement in this ruling involves the distribution and resettlement of assets from several family trusts (the Old Trusts) on to new family trusts (the New Trusts).
2. The Old Trusts were set up by the settlor for the benefit of their children (the Siblings) and the Siblings' family members.
3. The Old Trusts have no gifting settlor who is not a natural person or deceased person. And at all relevant times, the Old Trusts will be complying trusts (other than a community trust) and mainly for the benefit of a natural person for whom the gifting settlors of the trust had natural love and affection.
4. The assets held by the Old Trusts include:
    - New Zealand shares (NZ Shares), including shares in companies, units in unit trusts, and shares or units in portfolio investment entities (PIEs);
    - ASX-listed shares (ASX Shares) – Australian listed shares that are exempt from being a foreign investment fund (FIF) attributing interest under s EX 31;
    - cash;
    - FIF Shares - shares that are direct income interests in foreign companies under s EX 30 and do not qualify for FIF exemptions in s EX 30 to s EX 43;
    - interests in New Zealand limited partnerships (NZ LP Interests); and
    - New Zealand and overseas fixed-interest investments (Debt Investments).
5. The Old Trusts' equity investments have the following features:
    - Their investment philosophy is to be a long-term investor, to preserve inter-generational capital and to generate income.

- Investments are generally held on a long-term basis – some have been held for up to 30 years.
- The Old Trusts have invested in accordance with long-term investment policy statements.
- The average number of share sale transactions over a four-year period for each of the Old Trusts is less than 10.
- Some of the shares in the portfolio are interests in managed funds.
- The Old Trusts invest for dividends and yield and do not actively seek out immediate returns or pursue short-term capital gains on shares.

6. The New Trusts will be settled by the Siblings for the benefit of themselves and their family members.

7. To settle the assets held in the Old Trusts on the New Trusts, a series of steps will occur, which involve the following:
   - The Old Trusts selling assets on the open market into cash.
   - Distribution of assets (comprising cash and unsold assets, including shares and limited partnership interests) from the Old Trusts to the Siblings.
   - Settlement of assets by the Siblings on the New Trusts.
   - The use of the fair dividend rate (FDR) or comparative value (CV) method under the FIF regime in the income year of resettlement by the Old and the New Trusts.
   - The New Trusts investing in PIEs from the settlement assets.

8. The Applicants have advised the reasons for the restructure are:
   - Simplify the existing structure and to provide better financial security and certainty for the family members.
   - Protect assets against potential creditor and relationship property claims.
   - The New Trusts will have modern trust deeds consistent with current best practice.
   - Settlement will simplify investment thereby reducing administration and compliance costs.

Issues | Take

9. The issues considered in this ruling were whether:

- the disposal of the NZ Shares, ASX Shares and NZ LP Interests (to the extent the limited partnership owned shares) (Shares) by the Old Trusts will give rise to income for the Old Trusts under any of ss CA 1, CB 1, CB 3, CB 4 or CB 5;
- any income derived by the Old Trusts from the disposal of the FIF Shares will be excluded income under s CX 57B;
- to the extent the distributions from the Old Trusts do not comprise a distribution of beneficiary income, the distributions will be exempt income for the Siblings under s CW 53;
- to the extent that the Siblings derive income under s CB 4 from the Shares that they settle on the New Trusts, they can deduct the market value of the property under s DB 23;
- any income arising to the Siblings from the disposal of the FIF Shares to the New Trusts is excluded income under ss CX 57B and EX 59(2);
- the New Trusts can choose to apply either the FDR method or the CV method to the FIF Shares under s EX 44 in the income year of the resettlement;
- the "opening value" component of the formula in s EX 51 or s EX 52 is zero for the Siblings and the New Trusts in relation to the FIF Shares acquired by the Siblings and the New Trusts; and
- s BG 1 applies to the Arrangement.

Decisions | Whakatau

10. The Tax Counsel Office (TCO) concluded:

- The disposal of the Shares will not give rise to income for the Old Trusts under ss CA 1, CB 1, CB 3, CB 4 or CB 5.
- Any income arising to the Old Trusts from the disposal of the FIF Shares will be excluded income under ss CX 57B and EX 59(2).
- To the extent the distributions from the Old Trusts do not comprise a distribution of beneficiary income, the distributions will be exempt income for the Siblings under ss CW 53 and HC 20.
- To the extent that the Siblings derive income under s CB 4 from the Shares that they settle on the New Trusts, a deduction for the market value of the Shares under ss DB 23 and FC 2(1) will be allowed.
- Any income arising to the Siblings from the disposal of the FIF Shares to the New Trusts will be excluded income under ss CX 57B and EX 59(2).

- The New Trusts can choose to apply either the FDR method or the CV method to the FIF Shares under s EX 44 and that choice is not limited by ss EX 46, EX 47, EX 47B, EX 48 or EX 62, in the income year of settlement.
- The "opening value" component of the formula in s EX 51 or s EX 52 is zero for the Siblings and the New Trusts in relation to the FIF Shares acquired by the Siblings and the New Trusts.
- Section BG 1 does not apply to the Arrangement.

Reasons for decisions | Pūnga o ngā whakatau

Issue 1 | Take tuatahi: Income

11. In this issue, TCO considered whether the disposal of the Shares by the Old Trusts, either by way of a realisation or on distribution to the Siblings, will give rise to income for the Old Trusts under the relevant provisions.

12. As a preliminary issue, TCO considered that the effect of s HG 2(1) is that a disposal of the NZ LP Interests is treated as being a disposal of the underlying partnership property, being shares. The Arrangement description also recorded that the limited partnerships of the NZ LP Interests hold the underlying property of the limited partnerships on capital account.

Section CB 1 - Business income

13. Under s CB 1(1), an amount derived from a business is income of a person. However, if the amount is of a capital nature it is excluded by s CB 1(2).

14. The essential question in determining whether an amount is income from a business is whether the amount was derived from the current operations of the business, and not merely connected to the fact that the business existed.[1]

15. Case law provides guidance for what factors are relevant to determining whether the activities of a taxpayer involved in share investment constitute a business.[2] These factors include:

[1] *CIR v City Motor Service Ltd; CIR v Napier* Motors *Ltd* [1969] NZLR 1010.

[2] *Grieve v CIR* [1984] 1 NZLR 101; (1984) 6 NZTC 61,682 (CA); *Calkin v CIR* (1984) 6 NZTC 61,781; *National Distributors Limited v CIR* (1987) 9 NZTC 6,135; *Estate of King v CIR* [2007] NZCA 474;

- profit making intention of the taxpayer;
- nature and pattern of the activity;
- period over which the activity is carried on;
- volume and frequency of transactions;
- the exercise of an activity in an organised and coherent way and one which is directed to an end result;
- whether sales are an integral part of an investment business or part of the taxpayer's normal operations in the course of making profits;
- whether there has been regular or continuous monitoring of the share portfolio by the taxpayer; and
- whether the activities are carried on in a similar manner to other similar businesses.

16. TCO considered two possible types of businesses that are relevant to the Old Trusts:
    - A share trading business. The Old Trusts would be carrying on a share trading business if they acquired shares with a purpose of disposing them at a profit such that the shares are trading stock of the business.
    - An investment business. If the Old Trusts were carrying on an investment business and held their shares as investments, amounts derived from the share disposals would be income if the disposals were not merely a realisation of an investment, but an act done in carrying on the business.[3] To determine whether this was the case, it was necessary to consider whether share disposals were an integral part of a business.[4]

17. TCO concluded that the Old Trusts acquired the Shares as long-term investments with a purpose of producing income and enhancing the capital value of the trust funds. The Shares were not acquired with a purpose of disposal at a profit, nor were the share disposals an integral part of a business. As such, the Shares are being held on capital account and amounts received from their disposal will be capital receipts and will not

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Rangatira Ltd v Commissioner of Inland Revenue (1994) NZTC 11,197 (HC), (1995) 17 NZTC 12,182 (CA), (1996) 17 NZTC 12,727 (PC); *FCT v Radnor Pty Limited* 91 ATC 4,689; *London Australia Investment Company Ltd v F C of T* (1974) 4 ALR 44 (HCA).

[3] *Californian Copper Syndicate (Limited and* Reduced*) v Harris (Surveyor of Taxes)* 5 TC 159.

[4] *London Australia.*

give rise to income of the Old Trusts under s CB 1. The matters that supported this conclusion were:

- The Old Trusts' asset portfolios are managed in accordance with long-term investment principles.
- The periods of time the Shares are held are consistent with long term investment.
- The low volume of share transactions does not suggest a trading activity being carried on or that share disposals are an integral part of a business.
- Some of the Shares are interests in managed funds. The nature of these interests is such that they are ordinarily held as long-term passive investments and not traded for profit.
- When shares are sold, the reasons for the sales indicate a change of investment rather than a profit-making operation.
- Each of the Old Trusts has one overall activity of owning and managing a range of investment types and the Shares are a part of that activity.
- The Old Trusts are family trusts concerned with the preservation and/or enhancement of the trust fund and the provision of income to beneficiaries on an inter-generational basis.
- The limited partnership interests are by their nature relatively illiquid as there is no significant secondary market for them, and they are not usually traded for profit.

Section CB 3 – profit-making undertaking or scheme

18. Section CB 3 provides that an amount that a person derives from carrying on or carrying out an undertaking or scheme entered into for the purpose of making a profit is income of the person.

19. For s CB 3 to apply, the acquisition and sale must exhibit features that give it the character of a business deal. If a receipt is capital in nature, it will not be income under s CB 3.[5]

20. As TCO had already concluded that the Old Trusts held the Shares on capital account, any amount derived from the disposal of the Shares will be a capital receipt and will not give rise to income under s CB 3.

[5] *Duff v Commissioner of Inland Revenue* (1982) 5 NZTC 61,131 (CA).

Section CB 4 – Acquired with a purpose of disposal

21. Section CB 4 provides that an amount that a person derives from disposing of personal property is income if they acquired the property for the purpose of disposing of it.

22. It was concluded earlier that the Old Trusts did not acquire the Shares with a purpose of resale but acquired them as long-term investments with a purpose of producing income and preserving or enhancing their capital.

23. Further, the Old Trusts' investment policies are such that sales may be contemplated at the time of acquisition, but there is nothing in the Old Trusts' policies or activities that indicate a clear purpose of disposal at that time.

24. Therefore, TCO concluded that the disposal of the Shares will not give rise to income under s CB 4.

Section CB 5 – Business of dealing in shares

25. Section CB 5 provides that an amount that a person derives from disposing of personal property is income of the person if their business is to deal in property of that kind.

26. TCO had already concluded that the Old Trusts were not carrying on a business of buying and selling shares for a profit for the purposes of s CB 1. However, the case *Piers & Ors v CIR (1995) 17 NZTC 12,283* suggests that a person who is not carrying on a business under s CB 1 may nevertheless be carrying on a dealing business under s CB 5.

27. TCO did not need to resolve the question of whether the principle in *Piers* applied, because even if s CB 5 could apply there were insufficient share transactions carried out by the Old Trusts to constitute a dealing business under s CB 5.

28. Therefore, the disposal of the Shares will not give rise to income under s CB 5.

Section CA 1(2) – Income under ordinary concepts

29. Section CA 1(2) provides that an amount is income of a person, if it is their income under ordinary concepts.

30. For an amount to be "income under ordinary concepts", the amount must be something that comes in to a person and is in money or money's worth.[6] However, receipts that are on capital account are not income according to ordinary concepts.[7]

31. Given TCO's previous conclusion that the Old Trusts held the Shares on capital account, any amount derived from the disposal of the Shares will be a capital receipt and will not give rise to income under s CA 1(2).

Issue 2 | Take tuarua: FIF income

32. This issue considered whether any income derived by the Old Trusts from the disposal of the FIF Shares will be excluded income under ss CX 57B and EX 59(2).

33. The relevant FIF rules are such that where a person is using one of the FIF calculation methods listed in s EX 59(1) for a FIF interest in a period, an actual amount derived by the person from that FIF interest (other than deemed FIF income) is excluded income under ss EX 59(2) and CX 57B. The listed methods include the FDR method and the CV method.

34. A person who has an attributing interest in a FIF has FIF income (s CQ 5). A direct income interest in a foreign company is an attributing interest, and a direct income interest includes shares in a foreign company (ss EX 29 and EX 30). Given the Old Trusts have an attributing interest in the FIF Shares, and that they calculate their FIF income or loss using the FDR or CV method in respect of the FIF Shares, TCO concluded that any income arising to the Old Trusts from the disposal of the FIF Shares will be excluded income under ss CX 57B and EX 59(2).

Issue 3 | Take tuatoru: Trust distribution

35. TCO considered whether, to the extent the distributions from the Old Trusts do not comprise a distribution of beneficiary income under s HC 6, the distributions will be exempt income for the Siblings under ss CW 53 and HC 20.

36. The effect of ss HC 20 and CW 53 is that to the extent a distribution from a complying trust (other than a community trust) is not beneficiary income, it is exempt income.

[6] *Tennant v Smith* [1892] AC 150, *CIR v Parson (No. 2)* [1968] NZLR 574

[7] *Case S86* (1996) 17 NZTC 7,538

37. Given the Old Trusts are complying Trusts other than community trusts, any distributions from the Old Trusts that are not beneficiary income will be exempt income to the Siblings.

Issue 4 | Take tuawhā: Deduction of cost of investments

38. TCO considered whether to the extent the Siblings derive income under s CB 4 from resettling the Shares from the Old Trusts on the New Trusts, they are allowed a deduction under s DB 23 for the cost of the Shares.

39. Under s DB 23, a person is allowed a deduction for expenditure they incur as the cost of revenue account property. Relevantly, "revenue account property" is defined in s YA 1 to include property that would produce income for the person if it was disposed of for valuable consideration.

40. To the extent the Siblings derive income under s CB 4 when they dispose of the Shares, such Shares will be revenue account property. It follows that s DB 23 applies to allow a deduction for any expenditure incurred as a cost of the Shares.

41. Even though the Siblings will not pay for the Shares, a distribution of property by a trustee to a beneficiary (s FC 1(1)(c)) is treated as a disposal of property at market value and an acquisition by the transferee at market value (s FC 2(1)). As such, the Siblings will have a cost of revenue account property equal to the market value of the Shares and will be entitled to deduct this amount under s DB 23.

Issue 5 | Take tuarima: Distribution of FIF Shares

42. This issue considered whether any income arising to the Siblings from the disposal of the FIF Shares to the New Trusts is excluded income under s CX 57B. This is relevant to the extent that the FIF Shares are distributed to the Siblings in specie by the Old Trusts.

43. Given the Siblings will have an attributing interest in the FIF Shares and the FIF income or loss will be calculated using the FDR or CV method, TCO concluded that any income arising to the Siblings from the disposal of the FIF Shares to the New Trusts will be excluded income under ss CX 457B and EX 59(2). This is based on the same reasoning as discussed in [33]-[34].

Issue 6 | Take tuaono: Choice of FIF method for New Trusts

44. In this issue, TCO considered whether the New Trusts can choose to apply either the FDR or CV method to the FIF Shares under s EX 44 in the income year of resettlement.

45. Under s EX 44, a person can choose one of the five FIF income or loss calculation methods, but the choice is limited by ss EX 46, EX 47, EX 47B, EX 48 and EX 62. TCO concluded that the New Trusts can choose to use the FDR or CV calculation method under s EX 44 because the choice is not limited by the above limitations.

Issue 7 | Take tuawhitu: Opening value of FIF interests

46. This issue considered whether the "opening value" component of the formula in s EX 51 or s EX 52 is zero for the Siblings and the New Trusts in relation to the FIF Shares acquired by the Siblings and the New Trusts.

47. The "opening value" component of the comparative value formula in s EX 51 (1) is defined in s EX 51(5). Under that definition, the opening value of a person's FIF interest for a particular income year is zero if the person did not hold the interest at the end of the previous income year. To the extent the distributions consist of FIF Shares, the Siblings and the New Trusts will not have held those shares at the end of the previous income year. Consequently, the "opening value" of their FIF interests for the purposes of the CV method will be zero.

48. The "opening value" component of the FDR formula in s EX 52(3) is defined in s EX 52(5). Under that definition, the opening value for a particular person and a particular income year is the total of the market values of the FDR interests held by the person at the start of the year, provided they are not direct income interests that meet the requirements of s EX 52(5)(a)-(c)) (which they are not). To the extent the distributions consist of FIF Shares, the Siblings and the New Trusts will not have held those shares at the start of the income year of resettlement. Consequently, the "opening value" of their FDR interests for the purposes of the FDR method will be zero.

Issue 8 | Take tuawaru: Section BG 1

49. Section BG 1(1) provides that a "tax avoidance arrangement" is void as against the Commissioner. Section GA 1 enables the Commissioner to make an adjustment to counteract a tax advantage obtained from or under a tax avoidance arrangement.

50. The Supreme Court in *Ben Nevis Forestry Ventures Ltd v CIR* [2008] NZSC 115, [2009] 2 NZLR 289 considered it desirable to settle the approach to applying s BG 1. This approach is referred to as the Parliamentary contemplation test, which is an intensely fact-based inquiry. *Ben Nevis* has been followed in subsequent judicial decisions.

51. TCO's approach in making this decision is consistent with Interpretation Statement: IS 23/01 Tax avoidance and the interpretation of the general anti-avoidance provisions

sections BG 1 and GA 1 of the Income Tax Act 2007 (3 February 2023) (IS 23/01). IS 23/01 will not be replicated in this TDS but in summary the steps are as follows:

- Understanding the legal form of the arrangement. This involves identifying and understanding the steps and transactions that make up the arrangement, the commercial or private purposes of the arrangement and the arrangement's tax effects.
- Determining whether the arrangement has a tax avoidance purpose or effect. This involves:
  - Identifying and understanding Parliament's purpose for the specific provisions that are used or circumvented by the arrangement.
  - Understanding the commercial and economic reality of the arrangement as a whole by using the factors identified by the courts. Artificiality and contrivance are significant factors.
  - Considering the implications of the preceding steps and answering the ultimate question under the Parliamentary contemplation test: Does the arrangement, when viewed in a commercially and economically realistic way, make use of or circumvent the specific provisions in a manner consistent with Parliament's purpose?
- If the arrangement has a tax avoidance purpose or effect that is not the sole purpose or effect of the arrangement, consider the merely incidental test. The merely incidental test considers many of the same matters that are considered under the Parliamentary contemplation test.

52. Taking into account all of the relevant facts and circumstances (noting that as this is a summary it may not contain all the facts or assumptions relevant to the decision and, therefore, cannot be relied on) TCO concluded as follows.

The Arrangement

53. The Arrangement for s BG 1 purposes includes the following steps and transactions:

- the disposal of assets of the Old Trusts;
- the distribution of assets (including cash and shares) from the Old Trusts to the Siblings;
- the settlement of assets (including cash and shares) by the Siblings on the New Trusts;

- the use of the FDR or CV method by the Siblings and the Old and New Trusts; and
- the New Trusts investing in PIEs using the settlement assets.

54. According to the Applicants, the commercial or private purposes of the Arrangement are:

    - Simplify the existing structure and to provide better financial security and certainty for the Siblings and their family members.
    - Protect assets against potential creditor and relationship property claims.
    - The New Trusts will have modern trust deeds consistent with current best practice.
    - Settlement will simplify investment thereby reducing administration and compliance costs.

55. The Arrangement will give rise to the following tax effects:

    - In relation to the realisation of assets in the Old Trusts for cash:
        - The realisation of NZ Shares and ASX Shares will result in capital receipts.
        - The disposal of any Debt Investments will result in all income and expenditure under the relevant instrument brought to tax under the financial arrangement rules.
        - Income from the FIF Shares will be returned under the FDR or CV method.
    - In relation to the distribution of assets by the Old Trusts to the Siblings:
        - The distribution of assets in specie will be deemed to take place at market value, with the same overall tax outcomes arising as for the assets that are realised.
        - The distribution of cash and assets in specie will constitute a capital distribution from the Old Trusts.
        - Any amounts allocated as beneficiary income will have tax paid at the Siblings' marginal tax rates.
    - In relation to the New Trusts:
        - The settlement of cash and assets on the New Trusts will be a deemed disposal by the Siblings at market value. To the extent the assets are viewed as having been acquired for the purposes of disposal they will be on revenue account. However, because the assets will be transferred to the

New Trusts immediately for the same value, no net income will arise for the Siblings.

- o The New Trusts will use the settlement assets to invest in PIEs, which will suffer tax at a PIR of 28% on the PIEs income. This will be a final tax so the New Trusts will not suffer tax at the top trustee tax rate of 39%.

- The use of the FDR or CV method by the Old Trusts, New Trusts and the Siblings mean that no other income arises to them outside of the FIF regime. Further, the FIF income will be limited to the lesser of the amount arising under the FDR or CV method.

Parliamentary contemplation

56. TCO considered the above tax effects do not give concerns from a s BG 1 perspective because the legislation is working as intended. In particular:

- The disposal of the Shares by the Old Trusts will not give rise to income of the Old Trusts because they are capital items. This is consistent with Parliament's purpose that capital receipts are not taxed.
- In terms of the trust rules in subpart HC, Parliament intends that the only distributions from a complying trust that are taxed are distributions of beneficiary income (s HC 5, s HC 6 and s CV 13(a)). Consequently, trust corpus, capital profits, and tax paid accumulated income may be distributed tax free (s HC 20 and s CW 53).
- In terms of the FIF rules, Parliament intends that if a person calculates their FIF income using the FDR method and derives another amount from the FIF during the income year, that amount is excluded under s EX 59. This is the same for the CV method. The exclusion of other amounts in s EX 59 shows Parliament intends that the calculation methods are a code for the calculation of FIF income. The effect of this is that the only income that is taxable is income determined under a calculation method and any dividends or gains from disposing of the person's FIF interest will be tax free.
- An aim of the PIE rules is for PIEs to be taxed on collective investment income on a similar basis to individual investors. Parliament contemplated that some investors could pay less tax if they invested through a PIE than if they invested personally.

Commercial and economic reality

57. TCO considered the relevant factors to determine the commercial and economic reality of the Arrangement and concluded the following:

    - The stated commercial or private purposes of the Arrangement made commercial and economic sense being directed toward better asset protection and succession planning outcomes.
    - The economic and commercial effects of the Arrangement are consistent with the legal form of the Arrangement. The Arrangement is carried out in such a way that there are effective transfers of the Old Trusts assets to the New Trusts, either in specie or in cash, and the New Trusts acquire new investments and hold and manage them on behalf of their beneficiaries. In addition, the Old Trusts will come to an end and the New Trusts will manage their assets under new trust deeds, the terms of which are drafted with a purpose of achieving the asset protection, succession planning and other outcomes desired under the Arrangement.

Conclusion

58. TCO concluded that the Arrangement, when viewed in a commercially and economically realistic way, makes use of the Act in a manner that is consistent with Parliament's purpose. This is because:

    - The Arrangement does not exhibit artificiality, contrivance, pretence or any of the indicators of tax avoidance.
    - The commercial and economic outcomes under the Arrangement are consistent with its commercial purposes and legal form.

59. Therefore, the Arrangement does not have a tax avoidance purpose or effect, and s BG 1 does not apply to the Arrangement.