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TAX INFORMATION Bulletin

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Inland Revenue
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YOUR OPPORTUNITY TO COMMENT

Inland Revenue regularly produces a number of statements and rulings aimed at explaining how taxation law affects taxpayers and their agents. Because we are keen to produce items that accurately and fairly reflect taxation legislation and are useful in practical situations, your input into the process, as a user of that legislation, is highly valued.

You can find a list of the items we are currently inviting submissions on as well as a list of expired items at **www.ird.govt.nz/public-consultation**

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Public Consultation
Office of the Chief Tax Counsel
Inland Revenue
PO Box 2198
Wellington 6140

You can also subscribe at **www.ird.govt.nz/public-consultation** to receive regular email updates when we publish new draft items for comment.

Ref	Draft type	Title	Comment deadline
PUB00171	Interpretation statement	Income tax – treatment of costs of resource consents	3 August 2018
IRRUIP11	Issues paper	Whether remuneration paid to an employee in cryptocurrency is subject to PAYE or FBT	3 August 2018

IN SUMMARY

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PUBLIC RULINGS

This section of the *TIB* contains binding rulings that the Commissioner of Inland Revenue has issued recently. The Commissioner can issue binding rulings in certain situations. Inland Revenue is bound to follow such a ruling if a taxpayer to whom the ruling applies calculates their tax liability based on it.

For full details of how binding rulings work, see *Binding rulings: How to get certainty on the tax position of your transaction (IR715)*. You can download this publication free from our website at **www.ird.govt.nz**

BR Pub 18/06: Goods and services tax - payments made by parents to state and state integrated schools

This Public Ruling, BR Pub 18/06, is a reissue of BR Pub 14/06. For more information about earlier publications of this Public Ruling see the Commentary to this Ruling.

This Ruling is substantially the same as the BR Pub 14/06, which expired on 20 June 2018. Some parts have been rewritten to improve readability, legislative changes have been included, and a new example (Example 5) has been added.

This is a public ruling made under s 91D of the Tax Administration Act 1994.

Taxation law

All legislative references are to the Goods and Services Tax Act 1985 unless otherwise stated.

This Ruling applies in respect of ss 8 and 10(2) and the definition of "consideration" in s 2.

The Arrangement to which this Ruling applies

The Arrangement is:

- the payment of amounts (whether described as "school fees", "donations", "voluntary contributions", "activity fees" or otherwise)
- to the board of trustees of a state or state integrated school
- by parents or guardians of students enrolled at such a school (who are not international students under the Education Act 1989).

How the taxation law applies to the Arrangement

The taxation law applies to the Arrangement as follows:

GST is not chargeable on payments made to the board of trustees of a state or state integrated school by parents or guardians of students enrolled at such a school (and who are not international students under the Education Act 1989), where the payments are made to assist the school with the cost of delivering the education services that the student has a statutory entitlement to receive free of charge.

GST is chargeable on payments made for supplies of other goods or services, not integral to the supply of education to which the student has a statutory entitlement, where that supply is conditional on the payment being made.

In this Ruling state non-integrated schools and partnership schools kura hourua, are referred to as "state schools". Any references to a state school's board of trustees should be read as also a reference to the sponsor of a partnership school kura hourua.

The period for which this Ruling applies

This Ruling will apply for the period beginning 21 June 2018 and ending on 20 June 2023.

This Ruling is signed by me on 21 June 2018.

Tania Sauvao
Manager, Public Rulings

Commentary on Public Ruling BR Pub 18/06

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Ruling BR Pub 18/06 ("the Ruling").

Legislative references are to the Goods and Services Tax Act 1985 (the GST Act) unless otherwise stated. Relevant legislative provisions are reproduced in the Appendix to this commentary.

Summary

1. In accordance with Ministry of Education guidance, boards of trustees of state and state integrated schools are permitted to ask parents or caregivers for voluntary contributions, including contributions towards the cost of delivering the school's curriculum. In addition, schools may offer for sale consumables, stationery, clothing and optional activities that do not form part of the delivery of the school's curriculum. Schools are permitted to charge for these additional things, but students are not obliged to buy them.
2. This Ruling addresses whether payments (however described) made by parents to state and state integrated schools are subject to GST. In this commentary, state non-integrated schools, including partnership schools kura hourua, are referred to as "state schools", and similarly any references to a state school's board of trustees should be read as a reference to the sponsor of a partnership school kura hourua. Further, the word "parents" includes guardians or caregivers of students who also make payments to state or state integrated schools.

Background

Application of this Ruling

3. This Ruling applies for the period from 21 June 2018 to 20 June 2023.
4. The subject matter covered in this Ruling was addressed in:
   - "Public Ruling BR Pub 14/06: Payments made by parents or guardians of students to state schools – GST treatment" *Tax Information Bulletin* Vol 26, No 9 (October 2014): 3 (expired);
   - "Public Ruling BR Pub 09/01: Payments made by parents or guardians of students to state schools – GST treatment" *Tax Information Bulletin* Vol 21, No 3 (May 2009): 4 (expired); and
   - "Public Ruling BR Pub 03/04" *Tax Information Bulletin* Vol 15, No 7 (July 2003): 6 (expired).
5. This Ruling also withdraws and replaces "Question 70" *Public Information Bulletin* No 158 (November 1986).

Ministry of Education guidance in Circular 2018/01

6. The Ministry of Education provides guidance to boards of trustees, proprietors, sponsors, parents and students in relation to requests for donations and other forms of payments to schools. This guidance is provided in *Circular 2018/01: Payments by parents of students in schools* (Ministry of Education, 2018). The circular explains the types of payments boards of trustees, proprietors and sponsors may seek from parents and students at state and state integrated schools.
7. The circular states that no payments sought by boards of trustees and proprietors from parents are compulsory except for the attendance dues payable to the proprietors of state integrated schools and charges by schools for voluntary purchases of goods and services where parents have agreed to the purchase. No charges, including "fees" or "levies" should be associated with the delivery of the curriculum.

Education framework

School governance

8. Every state and state integrated school must have a board of trustees: s 93 of the Education Act 1989. A board is responsible for the governance of a school, including setting the policies by which the school is to be controlled and managed. A board's primary objective in governing the school is that every student at the school is able to attain his or her highest possible standard in educational achievement. A board has complete discretion to perform its functions and exercise its powers as it thinks fit, subject to the Education Act and any other enactment and the general law of New Zealand: Schedule 6 to the Education Act. Grants are paid out of public money to boards for the purpose of administering their schools: s 79 of the Education Act.

9. State integrated schools were mostly private schools established to provide education with a special character that have become part of the state system of education. When a private school is integrated into the state system it must be controlled and managed and operate in all respects as if it were a state school: s 440 of the Education Act. Therefore, as with other state schools, a state integrated school's governing body is its board of trustees. State integrated schools also have a proprietor, who looks after the school's land and buildings and determines and supervises the school's special character.

10. Every board must have a written charter. The purpose of the charter is to establish the missions, aims, objectives, directions and targets of the school board. The charter gives effect to both the Government's goals, curriculum statements, performance measures and guidelines published under s 60A of the Education Act and the board's priorities: s 61 of the Education Act.

11. The effect of a school charter is that it is an undertaking by the board to the Minister of Education to take all reasonable steps to ensure the school is managed, organised and administered for the purposes set out in the school charter and that the school and its students and community will achieve the aims and objectives set out in the school charter: s 63 of the Education Act. A school charter will not take effect if the Secretary for Education determines it is inconsistent with the Education Act or the national administration guidelines: s 63A of the Education Act. (From 2019, school charters will be replaced by four-year strategic plans and annual implementation plans.)

Free education

12. Everyone who is not an international student (that is, generally, a New Zealand citizen or resident) is entitled to free enrolment and free education at any state school during the period beginning on their fifth birthday and ending on 1 January after their 19th birthday: s 3 of the Education Act.

13. Students enrolled at any state integrated school must be given free education on the same terms and conditions as students enrolled at other state schools: s 441 of the Education Act. However, the proprietor of a state integrated school may require payment of attendance dues as a condition of enrolment and attendance: s 447 of the Education Act. The money received from attendance dues may be used only for improvements to the school buildings and associated facilities as required by any integration agreement, for capital works required by the Minister of Education under s 456(2)(d) of the Education Act, and for meeting debts, mortgages, liens or other charges relating to the school premises. Attendance dues paid to the proprietors of state integrated schools are subject to GST, being payments to secure the enrolment of a student in a school for which the proprietors provide the buildings and ensure the special character: *Turakina Māori Girls College Board of Trustees v CIR* (1993) 15 NZTC 10,032 (CA).

14. Each year, parents or guardians of students enrolled at state and state integrated schools may be asked by their school's board to pay nominated amounts to assist the school with its costs, including the cost of delivering its curriculum. Schools may refer to these payments as "donations", "voluntary contributions" or the like. In the case of state integrated schools, such payments are in addition to attendance dues payable to the proprietor.

Application of the legislation

Scheme of the Goods and Services Tax Act 1985

15. GST is chargeable on a supply of goods and services by a registered person in the course or furtherance of a taxable activity carried on by that person by reference to the **value** of the supply: s 8(1). The value of the supply is the **consideration** provided for the supply (including both monetary and non-monetary consideration): s 10(2).

16. GST is chargeable on payments made to the board of trustees of a state school that is a registered person if such payments are "consideration", as defined in the Act. Any charitable trusts or parent–teacher associations for the same school should be considered separately when determining the school's GST registration. Generally, the board of a state or state integrated school will be a registered person, because the activities of a school board are taxable activities for GST purposes. This is on the basis that every board of trustees of a state or state integrated school is a Crown entity for the purposes of the Crown Entities Act 2004: s 7(1)(d). A Crown entity is a "public authority" (s 2) and, pursuant to s 6(1)(b), the term "taxable activity" includes the activities of any public authority. Section 5(6) deems that a school board (as a public authority) is supplying goods and services where it receives revenue from the Crown for the supply of outputs (in this case, the supply of education services). For example, a school board is deemed to be making a GST supply when it receives operational funding from the Crown for the supply of education services. The operational funding is the consideration for that supply.

17. GST is chargeable on that supply by the board of trustees of a state or state integrated school by reference to the "consideration" provided for the supply: s 8.

Definition of "consideration" for GST purposes

18. The statutory definition of "consideration" in the Act is wider than the contract law meaning of the term. In *Trustee, Executors and Agency Co NZ Ltd v CIR* (1997) 18 NZTC 13,076 (HC), Chisholm J commented in respect of the definition of "consideration" (at 13,085):

> In the context of this matter I am not persuaded that it is helpful or appropriate to reflect upon the ordinary meaning of the word. The statutory definition extends the ordinary meaning and it is the scope of the extended statutory definition which needs to be determined.

19. The following seven principles are drawn from the cases on the definition of "consideration" in the Act.

Whether the payment is voluntary is irrelevant

20. Under the first part of the definition of "consideration", it is irrelevant whether the payment is voluntary. No contract between the person making the supply and the person providing the consideration is necessary. The supply need not be made to the person who makes the payment: *Turakina*. In *Turakina*, McKay J, referring to the definition, said (at 10,036):

> It is clear from this definition that the supply of any service for consideration is part of a "taxable activity" under sec 6, even though it is to a person other than the person who provides the consideration. Likewise, the value of the supply is to be measured by the consideration, whether or not the consideration is provided by the person to whom the service is supplied. It is not necessary that there should be a contract between the supplier and the person providing the consideration, so long as the consideration is "in respect of, in response to or for the inducement of the supply.

Supply need not be made by the person who receives the payment

21. The supply also need not be made by the person who receives the payment. In *Trustee, Executors and Agency Co*, Chisholm J said (at 13,086):

> in my opinion the crucial factor is the strength of the connection between the payment and the supply. If there is sufficient proximity between the supply and payment to satisfy the requirement that the payment is "in respect of" (or "in response to, or for the inducement of") the supply of goods then the payment qualifies as "consideration" notwithstanding that the payment is made to a third party.

Not every payment received is "consideration"

22. Although the statutory definition of "consideration" is wider than the contract law meaning, not every payment a registered person receives is "consideration" for GST purposes. A distinction is drawn between a payment in respect of the payee's taxable activity and a payment that is consideration for a supply of goods and services: *Director-General of Social Welfare v De Morgan* (1996) 17 NZTC 12,636 (CA).

Payment and the supply must be connected

23. For a payment to be "consideration" within the first part of the definition, a sufficient relationship must exist between the making of the payment and the supply of goods or services: *CIR v NZ Refining Co Ltd* (1997) 18 NZTC 13,187 (CA); *Chatham Islands Enterprise Trust v CIR* (1999) 19 NZTC 15,075 (CA); *Taupo Ika Nui Body Corporate v CIR* (1997) 18 NZTC 13,147 (HC); *Trustee, Executors and Agency Co; Rotorua Regional Airport Ltd v CIR* (2010) 24 NZTC 23,979 (HC).

24. In *NZ Refining*, Blanchard J said (at 13,193):

> It is fundamental to the GST Act that the tax is levied on or in respect of supplies. It is not a tax on receipts or on turnover; it is a tax on transactions … It is therefore necessary, as Mr Green submitted, to distinguish between supplies and the taxable activity (as defined in s 6) in the course of which they are made. The definition in s 6 itself requires a nexus between a supply and consideration, as does s 10.
>
> The tax itself is levied by s 8 on a supply in the course or furtherance of a taxable activity and is "by reference to the value of that supply". Section 10 provides that the value of a supply is "to the extent of the consideration for the supply" the amount of the money involved or the non-monetary open market value of the consideration. Already, before turning to the definition of "consideration", it can be seen that, again, a linkage between supply and consideration is requisite to the imposition of the tax.
>
> **The definition of "consideration", though broad, cannot and does not dispense with that requirement. To constitute consideration for supply a payment must be made for that supply, though it need not be made to the supplier nor does the supply have to be made to the payer.**
>
> **There is a practical necessity for a sufficient connection between the payment and the supply.** The mechanics of the legislation will otherwise make it impossible to collect the GST. [Emphasis added]

Expectation of a supply of goods and services is not enough

25. An expectation that the payee will supply goods and services is not enough. It is not sufficient that the person who receives the payment carries out some activity that has the effect of benefiting either the person making the payment or some other person.

26. It is also not sufficient that the payment enables the payee to carry on its activity. Hence, a payment by the Crown to a charitable trust the Crown had established to promote the economic development and well-being of the Chatham Islands' inhabitants and the provision of services in the interests of the community was not consideration for GST purposes. The trustees were fulfilling their fiduciary duties under the trust, and the payment was not an inducement for the performance of services by the trustees: *Chatham Islands*.

Element of reciprocity must exist

27. The expression "in respect of, in response to, or for the inducement of" in the definition of "consideration" involves an element of reciprocity: *Taupo Ika Nui*; *Chatham Islands*; *Rotorua Regional Airport*.

What are the legal arrangements between the parties

28. It is necessary to consider the legal arrangements between the parties to determine whether a payment is consideration. In *Chatham Islands*, Blanchard J commented (at [17]):

> Although the linkage or nexus between a payment and the activity to which it gives rise may be very broad, it is still necessary to have regard to the legal form which is being employed:
>
> > … in taxation disputes the Court is concerned with the legal arrangements actually entered into … not with the economic or other consequences of the arrangements.
>
> (*C of IR v New Zealand Refining Co Ltd* (1997) 18 NZTC 13,187 at p 13,192 citing *Marac Life Assurance Ltd v C of IR* [1986] 1 NZLR 694 at p 706. The tax being one on transactions, it is necessary to pay close attention to the legal nature of what has been done.

Role and accountability of school boards

29. In *Maddever v Umawera School Board* [1993] 2 NZLR 478 (HC), Williams J discussed the role of school boards (at 505):

> The [Education Act 1989] was based on *Administering for Excellence: The Report of the Task Force to Review Education Administration* (the Picot report (1988)) which found that the existing administrative structure of the Education Act 1964 was over-centralised and overly complex. Its recommendations for change were largely implemented in the Education Act 1989, the title of which states that it is "An Act to reform the administration of education". The statute brought about a marked devolution of decision making away from the Minister of Education and the Department of Education so that schools became the basic unit of education administration. The primary mechanisms in the statute to achieve the legislative objectives were the novel concept of boards of Trustees who were given by s 75 broad powers to manage schools and the idea of the school charter.

30. Williams J then referred to the requirements relating to charters in s 61 of the Education Act and went on to say (at 505):

> It is thus clear that the [Education Act 1989] contemplates that the board, in consultation with the Minister, should have a significant role in determining the school's educational goals and a degree of independence in deciding how those goals should be achieved. While the Ministry of Education influences a school's broad objectives through the application of the national educational guidelines established under s 60A … and the Minister also has a power of approval of school charters, the guidance thus provided is in rather general terms. It is for the parents, staff and other persons to largely determine the distinctive character of the charter for a particular school.

31. Williams J noted that the accountability of school boards was achieved in several ways, including the requirement that boards must adhere to their charters.

32. The policy of the Education Act, therefore, is to decentralise the administration of education so boards of trustees are responsible for controlling and managing the schools. Although school boards have considerable power to manage schools, such powers are subject to any enactment and the law of New Zealand: Schedule 6 to the Education Act. The Education Act provides for several ways to achieve accountability by boards, including the obligation for boards to adhere to their school charters (which must incorporate guidelines specified by the Minister of Education for the education services to be provided).

Scope of free education

33. A student's statutory entitlement to free education is established in s 3 of the Education Act:

> **3 Right to free primary and secondary education**
>
> Except as provided in this Act, every person who is not an international student is entitled to free enrolment and free education at any State school or partnership school kura hourua during the period beginning on the person's fifth birthday and ending on 1 January after the person's 19th birthday.

34. "Education" is not defined in the Education Act. The term "education" is defined in the *Concise Oxford Dictionary* (12th ed, Oxford University Press, 2011) as:

> the process of educating or being educated. > the theory and practice of teaching. > information about or training in a particular subject.

35. It is possible to define the limits of the obligation of school boards to provide education services (and, therefore, the scope of a student's entitlement to free education). The national education guidelines issued by the Minister of Education specify the:
   - outcomes desired from the school system;
   - policy concerning teaching, learning, and assessment for the purposes of underpinning and giving direction to how curriculum and assessment responsibilities are to be managed; and
   - subjects in which education is to be provided (including areas and levels of knowledge).

36. The Minister of Education specifies through national education guidelines or by regulation, in broad terms, the type, level, and standard of instruction or education to be provided in state schools. The national education guidelines are all the national education goals, foundation curriculum policy statements, national curriculum statements, national standards, and national administration guidelines in force at the time under s 60A of the Education Act.

37. Every school must have a school charter. The purpose of the charter is to establish the missions, aims, objectives, directions and targets of the school board that will give effect to the Government's national education guidelines and the board's priorities: s 61 of the Education Act. Although the board has a significant role (through the preparation of the school's charter) in determining the school's aims and objectives and how these are to be achieved, the charter does not take effect if the Secretary for Education determines that it is inconsistent with the Education Act or the national administration guidelines: s 63A of the Education Act. The effect of a school charter is that it is an undertaking by the board to the Minister of Education to take all reasonable steps to ensure the school is managed, organised and administered for the purposes set out in the school charter and that the school and its students and community achieve the aims and objectives set out in the school charter: s 63 of the Education Act. (From 2019, school charters will be replaced by four-year strategic plans and annual implementation plans.)

38. Therefore, school boards have an obligation to provide education that complies with the requirements of the national education guidelines. New Zealand citizens and residents (and not international students under the Education Act) have a statutory right to free enrolment and free education at any state school: s 3 of the Education Act. The provision of free education in state schools is supported by a grant from the Crown: s 79 of the Education Act.

Ministry of Education Circular 2018/01

39. The Ministry of Education provides guidance to boards of trustees and principals of state and state integrated schools and the proprietors of state integrated schools, and the sponsors of partnership schools kura hourua on the rights of boards, proprietors, sponsors, parents, and students in relation to requests for donations and other forms of payments in schools. That guidance is in *Circular 2018/01*.

40. In the circular, the Ministry makes the following nine points.

Payments sought from parents are not compulsory except for attendance dues and charges for voluntary purchases

41. Payments sought from parents are not compulsory except for the attendance dues payable to the proprietors of integrated schools. Charges by schools for voluntary purchases of goods and services can be enforced, but only if the parent has agreed to make the purchase.

42. When communicating with parents, boards of trustees must clearly distinguish between requests for donations and for charges. The circular states:

> Requests for payment must make a clear distinction between attendance dues, charges, and donations - and between board of trustees' and proprietors' items.

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Ideally, invoices should specify attendance dues (for state-integrated schools) and charges for agreed optional goods or services only. Strictly speaking, schools cannot "invoice" donations as non-payment of donations does not give rise to a debt that is owed. On the other hand, it can make practical sense to list all requests for payments in a single document. In such cases, it must be made very clear which payments are voluntary and which are not. It is misleading to include a donation within a total which is described as 'Balance Due', or as being owed by a family.

Charges may not be imposed for materials used in delivering the curriculum

43. Charges may not be imposed for materials used in delivering the curriculum such as for using photocopiers, musical instruments or computer facilities. The most a school board can do is ask for a donation in the same way as it asks for a general donation. This is because the statutory right to free education implies there should be no charge for materials or equipment used in the delivery of the curriculum.

44. However, students may be charged for the hire of musical instruments owned by the school and used outside the delivery of the music curriculum. A charge may be made for costs involved in project work (such as the production of a T-shirt in a design class) but only if the student agrees to take ownership of the finished product. Schools cannot insist that students take finished products home.

Charges may not be imposed for attendance at a school camp as part of the curriculum

45. Charges may not be imposed for a student's attendance at a school camp that is part of the school's curriculum, including part of the content of a particular course at the school. The Ministry of Education considers it is reasonable for parents to be asked to contribute towards the cost of food and the cost of travelling. Such a request for a contribution is a request for a donation. Students may not be excluded from attending a camp that is part of curriculum delivery.

46. If students are given the choice of participating in a school camp that does not form part of the delivery of the curriculum, the school may impose a charge.

Students may not be excluded from attending a camp that is part of the curriculum because they cannot or will not pay a donation towards the cost

47. Students may not be excluded from attending a camp or going on a trip that is part of curriculum delivery (for example, field work in geography, biology and outdoor education programmes) because of an inability or unwillingness to pay a donation towards the activity's cost. It is reasonable for parents to be asked to contribute towards the cost of food and towards the costs which are involved in travel. Such a request for a contribution is a request for a donation.

Boards cannot require students to purchase a workbook that accompanies a course

48. Boards cannot require a student to purchase a workbook that accompanies a course and in which answers are written. Boards of trustees may sell workbooks, but purchase cannot be compelled.

49. Once a parent has opted to purchase the workbook, the cost becomes an enforceable charge. The circular states that if a workbook is made compulsory then a board of trustees may ask for only a donation towards the costs.

Charges may not be imposed for some special curriculum programmes

50. Charges may not be imposed for curriculum programmes such as Reading Recovery, English for Speakers of Other Languages, special education services (speech therapy, behaviour or learning difficulties) or music tuition from Itinerant Teachers of Music.

Charges may not be imposed where tertiary-level courses are purchased as part of a secondary school programme

51. Charges may not be imposed where secondary schools purchase tertiary-level courses that they offer to senior students as part of the school programme. However, where the school merely facilitates a student's enrolment in a tertiary course, meaning the student would be enrolled only part time at the school, the student is required to pay the fees associated with the tertiary course.

Charges may be imposed for in-school activities at which attendance is voluntary

52. A charge may be imposed for in-school activities at which attendance is voluntary and conditional on payment being made such as performances by visiting drama groups, lunchtime sport or education outside the classroom opportunities.

Boards may not withhold items such as leaving certificates to motivate parents to pay school donations

53. Boards must report on student progress and are subject to the Official Information Act 1982 and Privacy Act 1993. Therefore, boards are not entitled to withhold items such as students' reports or leaving certificates to encourage parents to pay school donations or resolve unpaid debts for goods or services the school has provided.

Commissioner accepts the views in Circular 2018/01

54. The Commissioner accepts the Ministry of Education's views as expressed in Circular 2018/01. The supply of services that are necessary to the supply of education services (in which a school board has an obligation under its charter to provide instruction and in which participation by students is compulsory) is within the scope of education services to which there is a statutory entitlement to receive free of charge.

55. Services that are necessary to the supply of education services include the:

- use of materials or goods necessary for delivering the curriculum (for example, the use of computers, of photocopiers for copying materials used in delivering the curriculum, and for materials for practical subjects);
- the right to participate in activities that are a compulsory part of the curriculum (for example, camps that are part of the curriculum or fieldwork in geography or biology); and
- the provision of programmes such as Reading Recovery, English for Speakers of Other Languages and special education services (for speech therapy or behavioural or learning difficulties).

56. A distinction exists between the supplies described above and supplies made in circumstances where the supply made is not necessary to the supply of education services, and students or their parents have a choice as to whether to receive the supply. Such supplies include:

- goods supplied with a clear take-home component (such as stationery or materials) where a student is entitled to ownership of a finished product from practical classes, although a school may not insist that the student take ownership of such products; and
- attendance at or participation in extra-curricular activities that are optional.

Supply of education services

57. Where a school board brings to charge as revenue amounts received from the Crown, such as operational grants for the supply of education services, the delivery of outputs by the grant recipient is deemed to be a supply for GST purposes: s 5(6). This means payments the Crown makes, such as operational grants, are consideration, being payments made for a school's supply of education services to students.

58. The Crown's grant is provided for the supply of education services in terms of the undertaking given by the board to the Minister of Education. A supply may be taxed only once, although GST may be chargeable on any separate supplies the board makes to parents: *Case R34* (1994) 16 NZTC 6,190 (TRA); *Suzuki NZ Ltd v CIR* (2001) 20 NZTC 17,096 (CA).

59. In *Suzuki*, the taxpayer was obligated to repair defective vehicles under a warranty the taxpayer gave to its customers. In turn, the taxpayer had a warranty from its parent company (from which the taxpayer had purchased the vehicles) and had received payments from the parent company for carrying out the obligations of the parent company under the parent company's warranty. There were two separate supplies: the supply of repair services under the warranty to customers and the supply of repair services to satisfy the obligations of the parent company under its warranty. As two separate supplies were made, the Court of Appeal did not accept that the Commissioner had sought to impose tax on the same supply (at [24]).

60. The Court of Appeal said at [23]:

> This is simply an instance of the common enough situation in which performance obligations under two separate contracts with different counter-parties overlap, so that performance of an obligation under one contract also happens to perform an obligation under another. In such case a supply can simultaneously occur for GST purposes under both contracts. There is a nexus in both cases between the performance and the consideration given by the other party.

61. *Suzuki* clarifies that sometimes simultaneous GST supplies might arise under arrangements with different parties, but for GST to be chargeable on those supplies a sufficient relationship must exist between each supply and the consideration given in return for that supply.

Link between payment and supply where a statutory right exists

62. In some circumstances an existing statutory obligation may mean the relationship between the payment and a supply is insufficient. Two GST cases have addressed the situation where the parties had statutory rights or obligations outside any contractual relationship that might have existed between the parties: *Television NZ Ltd v CIR* (1994) 16 NZTC 11,295 (HC); *Case U1* (1999) 19 NZTC 9,001 (TRA).

63. *Television NZ* concerned payments the Department of Maori Affairs made to the Broadcasting Council (the assets and liabilities of which were later vested in Television New Zealand). The payments were for a training scheme operated by the Broadcasting Council (and later Television New Zealand) for Māori trainees. Television New Zealand argued that a supply

had not been made for the payment because, in collaborating with the Department of Maori Affairs, the Broadcasting Council was merely discharging a statutory obligation to be a good employer. Being a good employer included operating a personnel policy that complied with the principle of being a good employer, including recognising the aims and aspirations of Māori, the employment requirements of Māori, and the need for greater involvement of Māori as employees of the Broadcasting Council.

64. Tompkins J held that the Broadcasting Council had made a supply of services, being the provision of the training programme. A contractual obligation existed to provide the services, and the fact the supply was in accordance with the statutory obligations of the Broadcasting Council did not affect the conclusion that a supply was made under the contract.

65. Under contract law, the performance of a statutory duty is not consideration, although the undertaking of something more than the bare discharge of the duty can be good consideration: *Ward v Byham* [1956] 2 All ER 318 (CA); *Williams v Williams* [1957] 1 All ER 305 (CA). The *Television NZ* case is consistent with that principle. Reciprocity existed between the Broadcasting Council and the Department of Maori Affairs. Payment would not have been made if the services had not been provided. The Broadcasting Council had discretion about how it would carry out its statutory obligation to be a good employer. The provision of training services under the agreement with the Department of Maori Affairs was in accordance with the Broadcasting Council's statutory obligations, but there was no direct and specific statutory obligation to provide the training.

66. In *Case U1*, the taxpayer had granted a lease under which the tenant had an obligation to pay rates (in addition to rental). The tenant was an "occupier" under the Rating Powers Act 1988 (being the lessee of a property under a lease for a term of not less than 12 months). Under the Rating Powers Act 1988, the occupier had primary liability to pay rates. The issue in *Case U1* was whether the payment of rates formed part of the consideration for the lease. (Hence, the issue considered in *Case U1* is slightly different from that considered in the *Television NZ* case.)

67. Judge Barber considered and rejected the argument that the payment of rates was consideration (because the obligation contained in the lease to pay rates was "in respect of" the lease). He also rejected the argument that the payment of rates by the lessee was part of the inducement to persuade the landlord to lease the farm at the rental figure agreed on and was part of the lessee's response to the granting of the lease. Judge Barber considered that the lease merely recorded the legal position and was not consideration, because the payment of rates by the lessee satisfied the lessee's own statutory obligation rather than an obligation of the lessor. (However, the payment of rates by a lessee under a lease would be part of the consideration for the lease, if the lessor were primarily liable for the payment of rates, and the lessee had accepted an obligation under the lease to meet the lessor's liability.)

68. In *Television NZ*, the statutory obligation was expressed in general terms. However, in *Case U1*, the lessee had a specific statutory obligation to pay rates.

Payments by parents and the statutory right to free education

69. Payments made by parents or guardians may supplement the Crown grant to the school. School boards have a considerable degree of autonomy as to how their funds are used. How the amounts paid are used is not the test of whether a supply is made for the payment: *Chatham Islands*.

70. *Turakina* also confirms that how payments are used does not determine the nature of the supply for the payments. In *Turakina*, the court (at 10,037) rejected the taxpayers' argument that because attendance dues were applied to meet mortgage obligations of the proprietors of the schools, the attendance dues were paid for exempt supplies (being the payment or collection of any amount of interest, principal or any other amount in respect of a debt security in terms of ss 14(1)(a) (previously ss 14(a)) and 3(1)(ka)).

71. An expectation exists that amounts paid by parents will be used for the purposes of the school. However, the Commissioner considers that, because the supply of education services is not conditional on payment being made by parents and because students have a statutory right to receive education services in a state or state integrated school free of charge (if they are not international students), the relationship is insufficient between the payments made by parents and the supply of education services to which a statutory entitlement exists. In addition, the Commissioner considers that when the payments made by parents are not made for any particular purpose and the school boards do not undertake any obligations in return for payment, this more strongly supports the conclusion that a sufficient relationship does not exist between the payment and any other supply: *Chatham Islands*.

72. Some school boards may attempt to collect amounts unpaid by withholding items (for example, school reports, leaving certificates or school magazines) until payment is made. It is possible to argue that, although school boards have an obligation to the Minister of Education to supply education services, if a threat is made to withhold education services

unless payment is made, a separate obligation exists to parents to supply education services under a separate transaction with the parents. On that basis, it could be argued that the payments are consideration, being a payment for the inducement of the supply of education services.

73. The relationship between students and the school board is based at least in part on the Education Act: *Grant v Victoria University of Wellington* [2003] NZAR 185 (HC); *A-G v Daniels* [2003] 2 NZLR 742 (CA). A statutory right exists to free education: s 3 of the Education Act. All children from the ages of 6 to 16 must be enrolled at a school: s 20 of the Education Act. This means school boards have a corresponding statutory obligation to provide education in state and state integrated schools free of charge. Although boards may represent that education services would not be supplied if payment is not made, the true legal nature of the transaction is that the board cannot require payment for the supply of education services as students have a statutory entitlement to receive education free of charge. This is clearly supported by Circular 2018/01.

74. In *Chatham Islands*, Tipping J commented at [25]:

> GST is payable on transactions. When deciding whether a particular transaction is of a kind which attracts GST, it is important to analyse carefully its legal characteristics.

No waiver of statutory right

75. A person may waive a statutory benefit conferred on that person under a statute if the waiver does not infringe some public right or public policy: *Bowmaker Ltd v Tabor* [1941] 2 All ER 72 (CA); *Reckitt & Colman (NZ) Ltd v Taxation Board of Review* [1966] NZLR 1,032 (CA). To determine whether a statutory right to free education can be waived, it is appropriate to consider whether the purpose of the legislation under which the right is conferred would be infringed by the waiver or contracting out: *Johnson v Moreton* [1978] 3 All ER 37 (HL); *Lieberman v Morris* (1944) 69 CLR 69 (HCA).

76. All New Zealand citizens and residents aged from 6 to 16 must be enrolled at a registered school and attend the school: ss 20 and 25 of the Education Act.

77. Parents can choose to have their children educated at non-state schools. It could be argued that in that sense the statutory entitlement to free education can be waived. However, the public policy objective expressed in the Education Act is that all children are to receive education of a minimum standard. The provision of public funding for education and the entitlement to free education are intended to ensure cost is not a barrier to access to education. That free education is provided for a public purpose is confirmed by the 1993 statement of national education goals (*New Zealand Gazette* No 58, 29 April 1993), which states:

> **Education is at the core of our nation's efforts to achieve economic and social progress. In recognition of the fundamental importance of education, the Government sets the following goals for the education system of New Zealand.**
>
> 1. The highest standards of achievement, through programmes which enable all students to realise their full potential as individuals, and to develop the values needed to become full members of New Zealand's society.
> 2. **Equality of educational opportunity for all New Zealanders, by identifying and removing barriers to achievement …**
>
> …
>
> 6. Excellence achieved through the establishment of clear learning objectives, monitoring student performance against those objectives, and programmes to meet individual need. [Emphasis added]

78. Therefore, the right to free education is not solely a private right. If boards were able to impose a requirement for the payment of "fees" and individual parents were able to waive the right to free education, the purpose of the legislation would be infringed.

79. Although school boards have wide discretion to manage and control schools, such powers cannot be exercised in a manner inconsistent with a statutory provision: Part 2 of Schedule 6 of the Education Act. The Commissioner's view is that school boards do not have the power to require payment as a condition of the provision of education or any other services or items that are properly regarded as being integral to the supply of education to which a statutory entitlement exists. This is confirmed in Circular 2018/01.

80. The Commissioner acknowledges that, given an illegal activity can be a taxable activity and given the definition of "consideration" does not require a contract to exist between the supplier and recipient for a payment to be consideration, payment need not be enforceable for the payment to be consideration. Therefore, the fact the transaction is invalid because the parties do not have the power to enter into a transaction, does not mean the transaction would not be recognised for GST purposes: *C & E Commrs v Oliver* [1980] 1 All ER 353 (QBD). However, the statutory entitlement to education cannot be altered by a representation that education services are conditional on the payment of "fees".

81. Therefore, contributions paid to the board of trustees of a state school, whether for general or specific purposes, are not consideration for the supply of education services, even if there were a representation that schools reports or other information relating to the assessment of students would be withheld unless payment was made (albeit contrary to the legal position). However, if school boards supplied other goods or services beyond the supply of education services on the basis that the supply was conditional on payment being made, the payment would be consideration for that supply.

82. If a contribution made includes a charge for an item that is beyond the supply of education services, such as a school magazine, a case may be made for apportionment of the payment. Section 10(18) states:

> Where a taxable supply is not the only matter to which a consideration relates, the supply shall be deemed to be for such part of the consideration as is properly attributable to it.

Conclusion

83. Amounts paid by parents are not consideration for the supply of education services to which there is a statutory entitlement. This is for the following six reasons.

84. The first reason is that the definition of consideration under the Act is not the same as the contract law definition. A contract is not required between parents and school boards for the payments to be consideration for GST purposes: *Turakina*. However, for the payments to be consideration for a supply, a sufficient relationship must exist between payments and a supply: *NZ Refining; Chatham Islands; Suzuki; Trustee, Executors and Agency Co.*

85. The second reason is that because free education is a statutory right, when an amount is not paid for any particular purpose or for the undertaking of any specific obligation, a sufficient connection does not exist between the payments and a supply. This is so even though an expectation exists that the payments will be used for the taxable activity: *Chatham Islands; NZ Refining*. The fact the amounts parents pay to boards may be used to meet the cost of things not covered by the Crown grant does not establish the necessary connection that the amounts are paid for services of a particular nature: *Turakina; Chatham Islands*.

86. The third reason is that GST consequences are determined on the basis of the legal character of the transaction: *Chatham Islands*. The relationship between parents and school boards is based on the Education Act, which requires boards of state and state integrated schools to provide education, entitles students at state schools to free enrolment and free education, and entitles students enrolled at state integrated schools to free education on the same terms and conditions as students in state schools. The true legal nature of the arrangement between parents and the school board is that school boards have a statutory obligation to provide free education and students have a right to free education. The supply of education services is not conditional on the payment being made, and payment is not required for the supply of education services.

87. The fourth reason is that it can be argued that where a representation is made that education services would be withheld if payment is not made, the payments would be made "in respect of, in response to or for the inducement of" the supply of education services. However, because a statutory entitlement to free education exists in State schools, the true legal position is that education services would be provided whether or not payment were made. Therefore, a sufficient connection would not exist between the payment of general or specific amounts and the supply of education services to which there is a statutory entitlement.

88. The fifth reason is that a statutory right conferred on a person may be waived only if the waiver does not infringe the purpose of the legislation: *Bowmaker Ltd; Reckitt & Colman; Johnson; Lieberman*. The purpose of the Education Act is that all children should receive education of a minimum standard, and there should be no barriers to access to such education. That purpose would be infringed by a waiver of the right to free education and an ability of school boards to require the payment of "fees" for education.

89. The sixth and final reason is that the scope of the obligation to provide education services is defined by the national education guidelines and by the school's charter (into which the guidelines are incorporated). The supply of reports and other information relating to the assessment of students is integral to the supply of education services, and such information must be supplied free. The amounts would not be consideration, even if there were a representation that the supply of such information would be withheld unless payment was made (albeit contrary to the legal position).

90. Therefore, GST is not payable on amounts paid by parents or guardians to school boards to assist the school with meeting the cost of delivering goods and activities that are an integral part of the curriculum that the school has a statutory obligation to provide and in which participation by pupils is compulsory. However, if other services not integral to the supply of those education services are supplied on the basis that the supply is conditional on payment being made, the payment will be consideration for that supply. If a separate charge is not made for such an item, apportionment may apply: s 10(18).

91. For payments made by parents or guardians to schools to be consideration, it must be possible to identify a supply of goods or services other than the supply of education services that the schools are obliged to supply in terms of their charters. The two issues that need to be considered are:

- whether what is provided to students is within the scope of the statutory entitlement to education services; and
- if the supply made is for goods or services outside the scope of the statutory entitlement, whether a sufficient relationship exists between the supply and the payment for the payment to be consideration for those goods or services.

Examples

92. The following eight examples explain the application of the law. The examples are consistent with the guidance in Circular 2018/01. None of the students in the examples are international students.

Example 1 – General donation

Each year the board of trustees of a state school asks the parents or guardians of students enrolled at the school to make a financial contribution to assist with meeting school costs.

The board is not required to use the contribution for any particular purpose. The contribution is paid for the general purposes of the school, such as the school library, swimming pool and shared computer facilities, all of which are facilities available to any student.

The payment is not consideration for the supply of education services because there is a statutory entitlement for students to receive education free of charge. Because the payment is received for the general purposes of the school and the board of trustees does not undertake any obligation to supply any goods or services in return for the payment, such payments are not consideration for any supply. Therefore, GST is not chargeable by the school board on the payments.

Example 2 – Payment for materials

Students at a state school are asked to contribute towards the cost of materials used in a clothing class. The students are not required to take ownership of the completed item and will be entitled to ownership only if payment is made.

A charge cannot be made for the use of materials necessary for the delivery of education services to which a statutory entitlement exists. However, a charge can be made for the right to ownership of an item constructed using such materials. The payment is not consideration for the use of the materials, because the use of such materials is necessary for the provision of instruction in the subject. However, if a student elects to take the completed item home, the payment is consideration for the right to ownership of the item, and the board is liable to account for GST on the payment.

Example–3 - Photocopying

In addition to a general school donation, parents of students at a state school are asked to pay photocopying charges for materials (such as articles, extracts from textbooks and homework exercises) used in teaching, even though such materials should be provided free of charge.

The payment is not consideration. It is implicit in the right to free education that there should be no charge for the cost of materials used in the delivery of the curriculum. The provision of photocopied materials necessary for teaching is integral to the supply of education services. GST is not chargeable on the payment.

However, if a student chooses to purchase their own copy of a photocopied school magazine produced by students, the payment made would be consideration for the supply of that item, and GST would be chargeable on the payment.

Example 4 – School camp

Students at a state integrated school are asked by the board for a donation towards the costs of a school camp (such as a year 12 outdoor education camp or a year 9 beginning of the year camp). Attendance at the camp is a compulsory part of the school's curriculum.

The donation amount is not subject to GST. This is because the payment is not consideration for the supply of education services as students have a statutory entitlement to receive education free of charge. The camp forms part of the supply of education services by the school. The student is entitled to attend the camp regardless of whether payment is made. Therefore, the payment does not have the requisite relationship to any supply for it to be consideration.

Example 5 – Ski trip

Each year, year 11 students have the option of going on a weekend ski trip to Mount Ruapehu. The trip is not compulsory and does not form part of the school's curriculum. Parents are asked to pay $200 to cover costs. Students whose parents do not pay in full are not entitled to attend the ski trip.

This payment is consideration for the right to participate in the ski trip. Therefore, GST is chargeable on the payment.

Example 6 – Stationery and workbooks

A state school charges students for stationery packs and optional workbooks that students are entitled to keep. Parents may choose whether to purchase the stationery packs or workbooks from the school. The payment is made for the supply of the stationery and the workbook, so is consideration. Therefore, GST is chargeable on the payment. (The school may occasionally waive a payment for stationery by some students but this does not mean the payments for stationery made by other students are not made for the supply of stationery.)

Example 7 – Visiting drama group

A drama group puts on a performance at a state school. Attendance by students is optional but if students choose to attend a charge is payable. The payment is consideration for the right to attend the performance, and GST is chargeable on the payment.

However, when students are required to attend a drama performance as a compulsory part of the curriculum, parents are not obligated to pay. Any payment by parents towards the cost of their child attending a compulsory performance will not be subject to GST.

Example 8 – Advance payment of charges

The board of trustees of a state integrated school asks parents or guardians of students enrolled at the school to make a single payment in advance, in return for future items to be supplied by the school, such as stationery and visiting drama groups, which the family has agreed to receive. The advance payment also includes an amount for a take-home item (such as a letterbox that will be made in workshop technology) that the student chooses to take home once they have built it.

These goods and activities are not integral to the supply of education that the school has a statutory obligation to provide. The payment is made for the right to participate in the activities to which the payment relates or for the right to ownership of an item. The entitlement of students to these rights is conditional on payment being made, and GST is chargeable on the payment.

References

Subject references

Education
GST
State integrated schools
State schools

Legislative references

Crown Entities Act 2004, s 7(1)(d)
Education Act 1989, ss 3, 20, 25, 60, 60A, 61, 63, 63A, 79, 93, 440, 441, 447, 456(2)(d), Schedule 6
Goods and Services Tax Act 1985, ss 2 ("consideration", "public authority"), 3(1)(ka), 5(6), 6(1)(b), 8, 10(2) and (18), 14(a), 14(1)(a)
Official Information Act 1982
Privacy Act 1993
Rating Powers Act 1988
Tax Administration Act 1994, s 91D

Case references

A-G v Daniels [2003] 2 NZLR 742 (CA)
Bowmaker Ltd v Tabor [1941] 2 All ER 72 (CA)
C & E Commrs v Oliver [1980] 1 All ER 353 (QBD)
Case R34 (1994) 16 NZTC 6,190 (TRA)
Case U1 (1999) 19 NZTC 9,001 (TRA)
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Grant v Victoria University of Wellington [2003] NZAR 185 (HC)
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"Public Ruling BR Pub 14/06: Payments made by parents or guardians of students to state schools – GST treatment" *Tax Information Bulletin* Vol 26, No 9 (October 2014): 3 (expires 20 June 2018)
"Public Ruling BR Pub 09/01: Payments made by parents or guardians of students to state schools – GST treatment" *Tax Information Bulletin* Vol 21, No 3 (May 2009): 4 (expired)
"Public Ruling BR Pub 03/04" *Tax Information Bulletin* Vol 15, No 7 (July 2003): 6 (expired)
"Statement of national education goals" New Zealand Gazette No 58, 29 April 1993
"Question 70" *Public Information Bulletin* No 158 (November 1986)

Appendix – legislation

Goods and Services Tax Act 1985

1. Section 8(1) provides:

8 Imposition of goods and services tax on supply

(1) Subject to this Act, a tax, to be known as goods and services tax, shall be charged in accordance with the provisions of this Act at the rate of 15% on the supply (but not including an exempt supply) in New Zealand of goods and services, on or after 1 October 1986, by a registered person in the course or furtherance of a taxable activity carried on by that person, by reference to the value of that supply.

2. The value of the supply is determined under s 10(2), which states:

(2) Subject to this section, the value of a supply of goods and services shall be such amount as, with the addition of the tax charged, is equal to the aggregate of,—

(a) to the extent that the consideration for the supply is consideration in money, the amount of the money:

(b) to the extent that the consideration for the supply is not consideration in money, —

(i) the open market value of that consideration, if subparagraph (ii) does not apply; or

(ii) the value of the consideration agreed by the supplier and the recipient, if subsection (2B) applies.

3. The definition of "consideration" in s 2 is:

consideration, in relation to the supply of goods and services to any person, includes any payment made or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods and services, whether by that person or by any other person; but does not include any payment made by any person as an unconditional gift to any non-profit body:

INTERPRETATION STATEMENTS

This section of the *TIB* contains interpretation statements issued by the Commissioner of Inland Revenue.

These statements set out the Commissioner's view on how the law applies to a particular set of circumstances when it is either not possible or not appropriate to issue a binding public ruling.

In most cases Inland Revenue will assess taxpayers in line with the following interpretation statements. However, our statutory duty is to make correct assessments, so we may not necessarily assess taxpayers on the basis of earlier advice if at the time of the assessment we consider that the earlier advice is not consistent with the law.

IS 18/01: Taxation of trusts – income tax

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

Part 1 Introduction

Content of this Interpretation Statement

1.1 This Interpretation Statement considers the taxation of trusts. This Interpretation Statement is intended to be a general guide as to how income derived by the trustees of a trust is taxed. It also provides an overview of the various compliance obligations imposed on settlors, trustees and beneficiaries of trusts under tax law.

Trusts generally

1.2 A trust is a creation of the law of equity. A trust is not a legal entity distinct from its trustee. Instead, a trust is a fiduciary relationship where a trustee holds property for the benefit of the beneficiaries of the trust or, where the trust is a charitable trust, for the specified charitable purposes. Although a trustee has legal ownership over the trust property, it holds the property subject to the beneficial interests of the beneficiaries and must act in the best interests of the beneficiaries of the trust. A trustee may be an individual (or natural person) or an entity such as a company (entity). There may also be multiple trustees, who can be removed and replaced from time to time.

1.3 A trust can be established by a natural person, who settles the trust property on the trust while they are alive (*inter vivos*) or by way of their will (a testamentary trust). A trust may also be settled by an entity. Alternatively, a trust may arise by operation of law (eg, a constructive trust). The property settled on the trust is known as the corpus of the trust. The trustees will often use the corpus to derive income and capital gains.

1.4 The operation of a trust and the specific duties imposed on trustees are governed by the law of equity relating to trusts and by the Trustee Act 1956. For each individual trust, the operation may also be governed by the trust deed (or functional equivalent document). The trust deed, or functional equivalent document, specifies the ability of a trustee to deal with trust property and the ability to make distributions to beneficiaries for each individual trust relationship. The trust rules in the ITA 2007 apply to determine the tax consequences that flow from the operation of the trust under trust law.

1.5 References in this Interpretation Statement to "a trust" or "the trust" are references to the trustee(s) of a particular trust, as appropriate.

Trust rules

1.6 The "trust rules" definition in the ITA 2007 sets out most of the rules for taxing income derived by trustees of a trust and the amounts distributed to beneficiaries of a trust. The trust rules also contain various rules relating to the compliance obligations of trustees, settlors and beneficiaries of trusts. Since the rewrite of the income tax legislation, the rules that relate to trusts are contained in different parts of the ITA 2007, but most of the rules are in subpart HC.

1.7 The "trust rules" are expressly defined in s YA 1 as meaning the rules contained in:

(a) ss DV 1 to DV 7 (which relate to superannuation funds);

(b) s DV 9 (which provides rules relating to how trusts can claim deductions);

(c) s GB 22 (which contains a specific anti-avoidance rule relating to beneficiary income);

(d) subpart HC (which contains the general rules relating to trusts);

(e) subpart HZ (Terminating provisions);

(f) ss LE 4, LE 5, LF 2, LF 3 and LO 2 (which relate to tax credits and minor beneficiaries); and

(g) ss 43B, 59 and 93B of the Tax Administration Act 1994 (TAA) (which relate to trustee filing and disclosure requirements).

1.8 Aside from the trust rules as defined the following sections are fundamental to the operation of the trust regime: ss BD 1(4)(c), CV 13, CW 53, CW 54 and CX 59. They set out the treatment of amounts derived from trusts as taxable, exempt or excluded income depending on their character.

1.9 The current trust regime was introduced in 1988 through an amendment to the Income Tax Act 1976 (ITA 1976) with application for income derived by a trustee of a trust in the income year beginning 1 April 1988 and in subsequent income years.

Rewrite of the income tax legislation

1.10 Since the introduction of the trust rules, the income tax legislation has been reordered, reformatted, and progressively reviewed and rewritten over several years on a part-by-part basis. This work resulted in the introduction of the Income Tax Act 1994 (ITA 1994), the Taxation (Core Provisions) Act 1996 (the Core Provisions Act), the Income Tax Act 2004 (ITA 2004) and the ITA 2007. The purpose of the rewrite project was to reorganise and consolidate the law relating to income tax and to rewrite the tax legislation in plain language.

1.11 The trust rules were rewritten in the ITA 2007 as part of the third phase of the rewrite project. While the project reorganised the provisions dealing with the taxation of trusts and changed the way the trust rules were written, no substantive changes to the law occurred. Any intended legislative changes are noted in sch 51 of the ITA 2007. However, additions have been made to the trust rules since the introduction of the regime in 1988, such as the introduction of the minor beneficiary rule, discussed in Part 6 of this Interpretation Statement.

Core provisions

1.12 The trust rules have been affected by the introduction of the Core Provisions Act that represented the first phase of the rewrite of the ITA 1994. The core provisions (in part B of the ITA 2007) set out the fundamental principles on which the rest of the income tax legislation is based, including the purposes of the ITA 2007, those to whom it applies, and the rules to be used in interpreting the ITA 2007.

1.13 The Core Provisions Act introduced a consistent "global/gross" approach to the calculation of income tax liabilities generally. This approach is consistent with the approach that has always been taken for the taxation of trusts, where trustees were assessed on gross income less deductions and income was distributed gross to beneficiaries with tax credits. From the perspective of the trust regime, the charging provisions were moved into part B of the ITA 2007 (Core provisions) and the trust rules were left to focus on defining the circumstances arising from a trust which give rise to income or exclusions from income. In particular the trust rules under the Core Provisions Act provided for:

(a) when settlors became agents;

(b) elections when the settlor's residence changed;

(c) marshalling rules for taxable distributions;

(d) certain administrative requirements and elections; and

(e) clarification of how the trust rules interface with the core provisions.

1.14 The structural change made by the Core Provisions Act for the taxation of trustees was that they became taxed under the core provisions under the same source and residence rules that apply to any "person" rather than under a charging regime contained within the trust rules. Then foreign-sourced amounts derived by trustees were treated under the core provisions as either:

(a) exempt income if the foreign sourced amounts were derived by a resident trustee (only one trustee need be resident to qualify) where no settlor was New Zealand resident during the income year; or

(b) assessable income where the settlor was a New Zealand resident at any time in the income year, whether the trustees are resident or non-resident.

1.15 As a consequence of the core provisions global/gross approach, two new provisions were also introduced (now s DV 9(1) and (2)) to clarify that the trustee, and not the beneficiary, is allowed deductions.

Overview of the operation of trust rules

1.16 A trust will usually have at least one settlor, trustee and beneficiary. The meaning of these terms for tax purposes is discussed in Part 2 and Part 3 of this Interpretation Statement.

1.17 Income derived by a trustee of a trust is taxed either as "beneficiary income" or "trustee income".

1.18 Beneficiary income is (s HC 6):

(a) income derived by the trustee of a trust that is vested absolutely in interest in a beneficiary in the income year when it was derived; or

(b) income derived by the trustee of a trust that is paid to a beneficiary during the income year or within the extended period allowed for in the ITA 2007.

1.19 Trustee income is (s HC 7):

(a) all the income derived by the trustee of a trust in an income year, other than income that is beneficiary income.

1.20 There are special rules for the taxation of foreign sourced amounts derived by a trustee or a beneficiary. Foreign-sourced amounts derived by a trustee that are trustee income are taxed based on the residence of the settlor. Where there is no resident settlor, foreign-sourced amounts derived by a trustee are generally not taxed in New Zealand (provided that, where the trust is a foreign trust, any New Zealand resident trustees comply with the registration requirements discussed in Part 13 of this Interpretation Statement). Foreign-sourced amounts distributed to non-resident beneficiaries as either beneficiary income or as taxable distributions are not subject to tax in New Zealand.

1.21 The rules for taxing foreign-sourced amounts derived by non-resident and resident trustees, in ss HC 25 and HC 26 respectively, interface with the core provisions (see s BD 1), but the resulting income amounts are provided for under part C of the ITA 2007 not by subpart HC where the trust rules are mainly set out. Subpart HC does not make an amount income under the ITA 2007.

1.22 These concepts, along with specific rules that apply where beneficiary income is paid to minors, are discussed in Part 4 (Income derived by trustees), Part 5 (Beneficiary income), Part 6 (Minor beneficiary rule) and Part 7 (Trustee income) of this Interpretation Statement.

1.23 The tax treatment of distributions to beneficiaries of amounts that are not beneficiary income depends on the classification of the trust. For tax purposes, trusts are classified as:

(a) **complying trusts** – essentially trusts where tax has always been paid in New Zealand on the worldwide income derived by the trust, whether by obligation or election, and the tax obligations relating to the trustees' income tax liability have been satisfied.

(b) **foreign trusts** – trusts that have not had a New Zealand resident settlor at any time since 17 December 1987; and

(c) **non-complying trusts** – trusts that are neither complying nor foreign trusts.

It is also possible for a trust to satisfy the requirements to be a complying trust, and to have only a non-resident settlor(s) so that it is also a foreign trust. These types of trusts are referred to in this Interpretation Statement as "dual status trusts".

1.24 These different types of trusts are discussed in Part 8 of this Interpretation Statement.

1.25 Distributions to beneficiaries of a trust, other than distributions that are beneficiary income, will be one of:

(a) exempt income, where the distribution is made by a complying trust or dual status trust;

(b) a taxable distribution, where the distribution consists of income, or capital gains derived through a transaction with an associated person distributed by a foreign trust, or income or capital gains distributed by a non-complying trust; or

(c) a non-taxable distribution, where the distribution consists of capital gains (other than capital gains derived through a transaction with an associated person) of a foreign trust, or corpus of a foreign or non-complying trust.

1.26 The tax treatment of distributions to beneficiaries of a trust is discussed in Part 8 of this Interpretation Statement.

1.27 The general tax treatment discussed above applies to most trusts, including the standard family or trading trust structures often used in New Zealand. However, in some situations different tax rules apply to specific types of trusts, including:

(a) charitable trusts;

(b) deceased estates;

(c) community trusts;

(d) superannuation funds;

(e) lines trusts;

(f) licensing trusts;

(g) bare trusts;

(h) unit trusts;

(i) Maori authorities;

(j) foreign investment funds; and

(k) foreign superannuation schemes.

1.28 The taxation of these entities is discussed briefly in Part 9 of this Interpretation Statement.

Residence

1.29 The trust rules are a settlor-based taxation regime. The trust rules interact with the core provisions to tax income derived by the trustees of a trust based on the residence of the settlors, rather than the residence of the trustees. All New Zealand sourced amounts are taxed in New Zealand regardless of the residence of the settlor. However, foreign-sourced amounts are generally taxable in New Zealand only where the settlor is resident in New Zealand. This is discussed in Part 7 (Trustee income) of this Interpretation Statement. For more information see "IS 16/03: Tax Residence", Part 3: Residence and trusts (*Tax Information Bulletin* Vol 28, No 10 (October 2016): 2).

1.30 The trust rules contain specific rules for trusts that change their status due to a change in the residency of their settlor or settlors. These rules are discussed in Part 10 and Part 11 of this Interpretation Statement.

1.31 The residence rules for financial institution trusts that must comply with the Foreign Account Tax Compliance Act (FATCA) or Common Reporting Standards (CRS) due diligence and reporting requirements in New Zealand are slightly different from the residency regime applied to the trust rules for income tax purposes. Guidance in other Inland Revenue publications on the FATCA and CRS requirements for trusts is referred to at [13.35] and [13.36].

1.32 The settlor-based taxation approach is a change from the rules that applied before 1 April 1988. Previously, foreign-sourced amounts derived by the trustees of a trust with New Zealand resident settlors were not subject to tax in New Zealand where the trustees were non-resident. The settlor-based taxation regime was chosen because it was considered too easy to avoid tax on foreign-sourced amounts under the old regime by appointing non-resident trustees. It was also considered that, in economic terms, the residence of the settlor provides a more appropriate basis for taxing foreign-sourced amounts derived by a trustee.

Associated persons

1.33 The associated persons rules as they apply to trusts are discussed in Part 12 of this Interpretation Statement. In particular, that part considers situations where settlors, trustees and beneficiaries will be associated for tax purposes.

Compliance obligations

1.34 The trust rules contain various rules relating to the compliance obligations of settlors, trustees and beneficiaries of trusts. These rules include:

(a) settlor disclosure obligations;

(b) trustee disclosure obligations;

(c) beneficiary disclosure obligations;

(d) records that must be kept by trustees of foreign trusts;

(e) sanctions for non-compliance;

(f) filing of tax returns;

(g) allocation of tax credits;

(h) withholding tax obligations; and

(i) agency obligations.

1.35 These compliance issues are considered in Part 13 of this Interpretation Statement.

Previous statements

1.36 This Interpretation Statement replaces "Appendix: Explanation of Taxation of Trusts", *Tax Information Bulletin* Vol 1, No 5 (November 1989) and "Withholding Tax and Payments to Overseas Beneficiaries", *Public Information Bulletin* No 29 (February 1966): 4.

1.37 The statement in "Consequential amendments to Part H – Treatment of net income of certain entities", *Tax Information Bulletin* Vol 8, No 9 (November 1996): 23 concerning amendments to the definition of "qualifying trust" that: "The amended definition is also intended to ensure that a foreign trust cannot be a qualifying trust under the global/gross approach" is also replaced by the discussion of dual status trusts in this Interpretation Statement.

Part 2 Settlors

Introduction to the term "settlor"

2.1 The term "settlor" is defined broadly in the ITA 2007. The core meaning of "settlor" is a person who transfers value to a trust. The definition also contains extensions, clarifications and exceptions to this core meaning.

2.2 The definition of "settlor" in the ITA 2007 is broad enough to include the common law meaning, but also extends beyond that meaning. At common law, a "settlor" is a person who "settles" property on a trust and this creates equitable obligations on a trustee in relation to the property.

Location of "settlor" definition

2.3 The definition of "settlor" is in ss YA 1 and HC 27. Section HC 27 contains a general definition, which applies for the purposes of the ITA 2007 as a whole unless otherwise stated.

2.4 Section YA 1 incorporates the s HC 27 definition and provides some qualifications to the s HC 27 definition for the purposes of particular sections (relating to minor beneficiaries and associated persons).

Significance of the term "settlor" in the ITA 2007

2.5 The definition of "settlor" is important in several respects, including:

(a) determining when foreign-sourced amounts derived by non-resident trustees will be assessable income (s HC 25);

(b) determining when foreign-sourced amounts derived by resident trustees will be exempt income (s HC 26);

(c) determining whether a trust is a foreign trust (s HC 11), which is relevant:

(i) in determining whether a distribution from the trust is a taxable distribution under s HC 15(4);

(ii) to the ordering rules for distributions from the trust (s HC 16);

(iii) in determining whether a trust is a non-complying trust, since a trust that is a foreign trust will not be a non-complying trust (s HC 12);

(d) determining whether a settlor may be liable for the income tax liability of a trustee (s HC 29);

(e) understanding the minor beneficiary rules (ss HC 36 and HC 37);

(f) understanding the associated person provisions relating to trusts (ss YB 7 to YB 9); and

(g) calculating income for social assistance purposes (eg, s MB 7 (Family scheme income of settlor of trust)).

2.6 The definition of "settlement" in s YA 1 is linked to the term "settlor". Essentially, a settlement is an act or a failure to act by a person, or a transaction or series of transactions entered into by a person, that has the effect of making the person a settlor. There cannot be a settlement without a person being, or being treated as being, a settlor.

2.7 Note that under trust law, each settlement is the creation of a new trust. However, for the purposes of the trust rules, if multiple settlements are made on the same terms, a trustee of the trust may treat all the settlements as one trust (s HC 3).

Comparison with definition of "settlor" in the ITA 2004

2.8 The current definition of "settlor" was introduced with the enactment of the ITA 2007. Although the definition was extensively rewritten, Parliament did not intend to change the meaning of settlor. There was only one identified legislative amendment in relation to the definition and even that was described as a clarification rather than a change. Schedule 51 of the ITA 2007 states:

> The definition of settlor is clarified so that any transfer to a trust that increases the net assets of the trust is a settlement on the trust and any deductible payments settled on a trust are included in trustee income.

2.9 The view that Parliament did not intend to widen the definition of settlor is also supported by *Officials' Report to the Finance and Expenditure Committee on Submissions on the Income Tax Bill* (30 April 2007). The New Zealand Institute of Chartered Accountants (as it was then) submitted that the transfer of value concept should be removed from the definition of "settlor" in the Income Tax Bill. In response, officials stated at 46:

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> The drafting style adopted is again the generalised approach with specific exclusions. If specific examples of transfers of property or services are identified, they will be incorporated as an exclusion from the rule.
>
> The definition of "settlor" in the 2004 Act is extensive and covers all dispositions by a person to or for the benefit of a trust (in terms of the trust) of property, making available of property at less than market value, services at less than market value. It also extends to a person who uses property or services of a trust for consideration greater than market value, and includes the abstaining of entering into transactions and also is extended further in specific situations set out in section HH 1.
>
> Neither the submission nor officials have been able to identify any particular situation that would fall outside the current definition that falls within the meaning of "transfer of value".

2.10 The new definition was also discussed in "Rewriting the Income Tax Act: Exposure Draft—Part H" (Policy Advice Division of the Inland Revenue Department, 4 March 2005). The Exposure Draft stated at 7:

> **Transfer of value and terms "distribution", "settlor" and "settlement"**
>
> The defined terms "distribution", "settlor" and "settlement" rely on the common law but also extend the common law concepts for certain classes of transaction or event. In reviewing the effect of these two terms, it seems that both a "distribution" and a "settlement" involve a transfer of value in a very similar way to the concept used in subpart CD of the [ITA 2004].
>
> In rewriting the dividend rules in subpart CD, a transfer of value is a transaction or event that leads to a value passing from one person to another for an unequal consideration (if any) in return.
>
> These two concepts have been re-drafted on the basis they are a transfer of value which is intended to simplify and harmonise concepts that have similar effect throughout the Act.

2.11 The Exposure Draft indicates that the transfer of value concept was adopted from the dividend rules. It states that both a "distribution" and a "settlement" involve a transfer of value in a very similar way to the concept used in subpart CD of the ITA 2004 (relating to dividends).

2.12 The Exposure Draft also indicates that the intention in adopting the transfer of value concept was to simplify and harmonise the concepts that have similar effect throughout the income tax legislation.

Features of the definition of "settlor"

2.13 The definition of "settlor" in s HC 27 has the following features:

(a) the core concept of a person who transfers value to a trust;

(b) a legislative response to the decision in *Re Marshall (Deceased), CIR v Public Trustee* [1965] NZLR 851 (CA) (*Re Marshall*) discussed below [2.57] to [2.59];

(c) rules that help in determining whether a transfer or provision has been made; and

(d) exceptions for:

(i) trusts for retirement benefits of employees;

(ii) employee share purchase agreements; and

(iii) contributions to foreign superannuation schemes.

2.14 A person can also be treated as a settlor under s HC 28. In particular:

(a) a person who has a control interest in a company that settles an amount on a trust is treated as a settlor of the trust;

(b) where a trustee settles an amount on a sub-trust, the settlor of the head trust will also be a settlor of the sub-trust;

(c) a person can be treated as a settlor of a trust, if they have control over a trustee or a settlor of the trust; and

(d) a person can be treated as a settlor, if s HC 28(2), an anti-avoidance provision, applies.

2.15 Although not part of the definition of "settlor", a person may be treated as a settlor under s YB 21, if someone else settles a trust as nominee for the person.

2.16 Finally, as previously noted, the definition of settlor is qualified for the purposes of the minor beneficiary rules and the associated person rules.

Person who transfers value to a trust

2.17 As noted above, the core meaning of "settlor" is a person who transfers value to a trust. In particular, a person will be a settlor of a trust under s HC 27(2)(a) if they transfer value:

(a) to the trust;

(b) for the benefit of the trust; or

(c) on the terms of the trust.

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2.18 For simplicity, this part of the Interpretation Statement will generally refer to transfers of value "to" a trust despite the definition also applying to transfers for the benefit of the trust or on the terms of the trust.

2.19 It is noted that a person will be a settlor, if they transfer value "at any time". This means a person will be a settlor of a trust if they have transferred value to the trust at any time in the past. To avoid any doubt, this includes transfers that occurred before and since the introduction of the 1988 amendments to the trust rules.

Definition of "transfer of value"

2.20 The definition of "settlor" uses the definition of "transfer of value" in s YA 1. The definition of "transfer of value" features:

(a) a general meaning;

(b) a specific inclusion relating to the release of an obligation to pay money;

(c) a reference to a specific definition in s CD 5, which applies to transfers made by companies; and

(d) confirmation that "transfers value", which is used in the settlor definition, has a corresponding meaning.

General meaning of "transfer of value"

2.21 Often a transfer of value from a person to a trust will simply involve the payment of an amount, or the transfer of property, by the person to the trust with the trust providing nothing in return. In such cases, a transfer of value equal to the market value of the property will be transferred.

2.22 However, a transfer of value to a trust can also occur where a transaction occurs between a person and a trust and the trust does provide something in return.

2.23 Essentially, under the general definition of "transfer of value", there is a transfer of value from one person (person A) to another person (person B) when person A provides money or money's worth to person B and receives in return money or money's worth that has a lower market value than what was provided (para (b) of the definition in s YA 1). In net terms, money or money's worth is being transferred from person A to person B.

2.24 "Money's worth" means something that is convertible into money (*Wilkins (Inspector of Taxes) v Rogerson* [1961] 1 All ER 358 (CA) at 361).

2.25 "Market value" is an important concept in the definition of "transfer of value" and is defined in s YA 1.

2.26 Note that s YA 1 provides two definitions of "market value" that apply to a share or option (depending on whether the share or option is quoted on the official list of a recognised exchange). These definitions apply for the purposes of the ITA 2007 as a whole unless otherwise stated. Therefore, these definitions may be relevant in the context of a transfer of value involving a share or option. The definition of "market value" in s YA 1 also provides meanings that apply for the purposes of specific provisions. However, the settlor definition is not one of the specific provisions.

2.27 Therefore, in many situations, the ordinary meaning of "market value" will apply. Generally, the market value of something is the price that would be agreed between a willing but not anxious seller and a willing but not anxious buyer. It is important to identify the relevant market for the property or service being provided. Also, in determining the market value, surrounding circumstances that might reasonably be expected to affect the price agreed on must be taken into account. The market value of property or services is determined objectively. The subjective value placed on property or services by the person transferring or receiving the property is not relevant (*Edge v CIR* [1958] NZLR 42 (CA); *Hatrick v CIR* [1963] NZLR 641 (CA) at 661; *R v Islam* [2009] UKHL 30 (HL)). Where the settlement is denominated in foreign currency, the market value will be the value in New Zealand dollars on the date of settlement.

2.28 In the case of a transaction between a person and a trust involving the provision of money's worth in exchange for money, a transfer of value to the trust could arise in two ways:

(a) Firstly, where a person is providing money's worth to a trust, a transfer of value could arise as a result of the trust paying a below market value consideration.

Example 1. Transfer of value – below market consideration

Sara sells her car to a family trust to be used in a business carried on by the trust. The sale price is $6,000, but the market value is $10,000. Sara has transferred value of $4,000 to the trust because she has sold her car to the trust for a discounted price.

(b) Secondly, where a trust is providing money's worth to a person, a transfer of value could arise as a result of the person paying an *above* market value consideration.

Example 2. Transfer of value – inflated consideration

Erica acquires management services from a trust. She pays $10,000 for the services, but the market value is only $1,000. Erica has transferred value of $9,000 to the trust because she has paid an inflated price to the trust for the management services.

These facts could also raise other issues (involving potential avoidance considerations and the amount of income derived by the trust). However, this example is intended merely to illustrate the operation of the settlor definition.

2.29 Generally, in an arms-length transaction, the Commissioner is likely to accept that the price paid for property is a market value consideration.

2.30 As noted above, in determining whether there has been a transfer of value, the Commissioner will take into account the surrounding circumstances of a transaction. For instance, the Commissioner acknowledges that in some situations a purchaser may pay a premium for property, for example because they are in a hurry to purchase. Similarly, in some situations a vendor may discount the sale of property because they urgently need funds. It is unlikely that Parliament would have intended such transactions, when entered into with trustees, to result in settlements. However, the onus will be on the taxpayer to show that there are special circumstances that have led to the premium or discount.

2.31 For simplicity, in discussing the transfer of value concept, this part of the Interpretation Statement generally assumes that a trust does not provide anything in return, and the part will generally refer to only what is provided by a person to a trust. This is despite the importance of considering both the value provided by the person to the trust and the value, if any, provided by the trust in return.

Specific inclusion relating to the release of an obligation to pay money

2.32 As well as the general definition above, a "transfer of value" also specifically includes the release of an obligation to pay money. The release may be by agreement or by operation of law.

Example 3. Settlement made by release of obligation

Dory sells her house to a family trust, which was settled by her parents. The purchase price is satisfied by a loan from Dory to the trust. Dory later forgives the loan owed by the trust. By forgiving the loan, Dory has transferred value to the trust equal to the loan balance. Therefore, Dory is a settlor of the trust.

2.33 There may be situations where the obligation to pay money will have no value (eg, because the trust and trustees are insolvent). Whether this is so will be a question of fact to be determined in each situation. If the obligation to pay money has no value, no settlement will result from the release of the obligation.

Transfers of value made by a company to a person

2.34 A special definition of "transfer of value" is also provided in s CD 5 for transfers of value made by a company to a person. The difference between the general definition and the definition in s CD 5 is that under the general definition the provision of services for less than market value is a transfer of value.

2.35 The definition in s CD 5 applies only for the purposes of the dividend rules in subpart CD. This is implicit from the legislative history of the definition (the term "transfer of value" was originally relevant to only the dividend rules) and the placement of s CD 5 in subpart CD.

2.36 For the purposes of the definition of "settlor", a company will transfer value to a trust if the requirements of paras (b) or (c) of the definition of "transfer of value" in s YA 1 are satisfied, even if the company would not be treated as transferring value under the definition in s CD 5. Therefore, for the purposes of the settlor definition, a company will transfer value to a trust if the company provides services to the trust for less than market value.

Situations included under the previous definition of "settlor"

2.37 The transfer of value concept in the current settlor definition is wide enough to include situations that were expressly included under the previous definition of "settlor" (in the ITA 2004 and previous Income Tax Acts). These situations are discussed below and include:

(a) making a "disposition of property" to a trust (from [2.39]);

(b) making property available to a trust (ie, where there is no disposal) (from [2.41]);

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(c) providing financial assistance to a trust (from [2.42]); and

(d) providing services to a trust (from [2.45]).

2.38 Again, for simplicity, in discussing the transfer of value from a person to a trust it is generally assumed in this part of the Interpretation Statement that something is being provided to the trust, but nothing is provided by the trust in return. This is so, even though a transfer of value could also occur if the trustee did provide something in return with a market value lower than that provided to the trust.

Disposition of property

2.39 The previous definition of "settlor" included a "disposition of property" made to a trust. The term "disposition of property" was defined for the purposes of the settlor definition. The transfer of value concept in the current settlor definition is wide enough to include the situations that were covered in the definition of "disposition of property". These situations include:

(a) Transferring property to a trust when it is first set up. A trust is created when property is transferred to a trustee to hold subject to the terms of the trust. If a person transfers property to a trustee to hold on trust (even a minor amount), and thereby creates a trust, the person will be a settlor of the trust.

(b) Transferring ownership of property to a trust.

(c) Providing a trust with the right to use property. This includes a lease or licence.

(d) Granting an interest in or over property in favour of a trust (eg, a mortgage or charge).

(e) Providing a loan to a trust at a less than market interest rate (*CIR v Dick* (2001) 20 NZTC 17,396 (HC) at 17,402; *Rossiter v CIR* [1977] 1 NZLR 195 (CA)).

(f) Issuing shares in a company to a trust.

(g) Where there is a release, discharge, surrender, forfeiture, or abandonment of any debt, contract, or thing in action, or of any right, power, estate, or interest in or over any property. A debt or any other right, estate or interest is deemed to be released when it becomes irrecoverable or unenforceable by action or for any reason ceases to exist.

(h) Where a person grants a power over any property to a trustee (eg, a power to dispose of the person's shares to anyone in a specified group of persons). Although the trustee does not have legal ownership of the property, the effect may be similar to a more standard trust relationship. A similar effect could be achieved by transferring property to the trustee on trust with discretions corresponding to the powers (eg, to distribute the property to beneficiaries in the specified group).

(i) The exercise by a person of a general power of appointment over property (ie, someone else's property) in favour of a trust. This applies only if the person has the ability to deal with the property for their own benefit. The exercise of such a power in favour of a trust would be equivalent to the person exercising it in their own favour to acquire the property and then disposing of the property to the trust.

2.40 The above transfers could also be made by will or by virtue of intestacy. However, where a person attempts to transfer an interest in property and the trustees disclaim that interest (ie, if the trustees reject their right to receive the property), then there will be no transfer of value.

Making property available to a trust

2.41 The previous definition of "settlor" also included any person who makes property available to a trust (eg, a lease of property). The transfer of value concept in the current definition of settlor is wide enough to cover this situation.

Providing financial assistance to a trust

2.42 The previous definition of "settlor" stated that making property available included the provision of financial assistance. Again, the transfer of value concept is wide enough to cover this situation. Financial assistance could be provided to a trust by, for instance:

(a) providing an interest-free loan or a loan with a below market interest rate;

(b) guaranteeing the repayment of an amount borrowed by a trust; and

(c) providing a trust with security for the purposes of borrowing.

2.43 If a person provides financial assistance to a trust, then there will be a transfer of value and the person will be a settlor. This can apply to a person who is a trustee of the trust, for example if a trustee provided their own personal property as security for money borrowed by the trust.

Example 4. Providing financial assistance

Solid Ltd guarantees a loan made by a bank to a trust carrying out a property investment business. Solid Ltd is not paid a guarantee fee. The market value for the provision of the guarantee would have been $10,000. In this situation, Solid Ltd will be a settlor because it has given a guarantee for no consideration.

2.44 A specific provision in the current definition of "settlor" (s HC 27(2)(b)) deals with the situation where a person provides financial assistance to a trust and has the right to demand payment from the trust, but the right to demand payment is not exercised or is deferred. This is discussed from [2.51].

Providing services to a trust

2.45 A transfer of value occurs if a person provides services to a trust for less than market value. This includes any investment advisory services, legal and accounting services, or services relating to any business carried on by the trustees of the trust.

2.46 If a trustee of a trust provides services that are incidental to the operation of the trust, there will be no transfer of value and, therefore, no settlement. However, there may be a transfer of value if services that are not incidental to the operation of the trust are provided.

2.47 The above is also true for people other than trustees who have rights and obligations in relation to a trust, for example a person with the power of appointment.

2.48 The Commissioner considers that Parliament would not have intended trustees (or other right holders) to be settlors merely by providing services that are incidental to the operation of the trust. This would cause a significant number of trustees (and other right holders) to be settlors. This would be an absurd result. Therefore, it is appropriate in this case to read down the definition of settlor so that trustees (and right holders) who provide services that are incidental to the operation of the trust are not treated as settlors.

2.49 Examples of services that are incidental to the operation of a trust include attending trust meetings and reviewing trust documents. An example of a service that is not incidental to the operation of a trust is the day to day management of a business carried on through a trust.

2.50 *The Commissioner's approach to the treatment of services that are incidental to the operation of a trust, that is excluding them from being settlements, is intended to be confirmed in a Taxation Amendment Bill (expected to be introduced in the near future). The same Bill proposes that a person who provides other services to a trust for less than market value will be a settlor to correct an unintended legislative change arising from the rewrite of the trust rules.*

Responding to the decision in *Re Marshall*

2.51 Under s HC 27(2)(b), a person will be a settlor if:

(a) they provide financial assistance (eg, a loan) that involves an obligation to pay on demand (eg, a loan that bears interest if demanded); and

(b) the right to demand is not exercised or is deferred.

2.52 "Financial assistance" is not defined. However, it is considered that it will include the provision of loans, guarantees, security, and other types of financial assistance.

2.53 In the case of loans, the amount payable on demand could be the interest or the principal or both. In the case of a guarantee or security, the amount payable on demand could be a fee for the guarantee or security.

2.54 In the case of a loan with interest and principal repayable on demand, s HC 27(2)(b) could apply even if the interest rate is set at a market rate.

2.55 Where a person is a settlor under s HC 27(2)(b) there will be a "settlement" for the purposes of the trust rules (see definition of "settlement" in s YA 1).

2.56 Where the right to demand payment of an amount is deferred, the value transferred will be the product of the amount that could be demanded, the length of the deferral, and an appropriate rate of return. The whole amount of the payment will only be transferred if the right to demand payment of the amount is surrendered or lost.

2.57 Section HC 27(2)(b) is the equivalent of s 226(2)(b) of the ITA 1976. The purpose of s 226(2)(b) was to respond to the decision of the Court of Appeal in *Re Marshall*. *Re Marshall* concerned a situation where a person had lent an amount to a trust with interest payable on demand. The question was whether the failure by the person to demand the interest was a "disposition of property" in terms of para (d) of the definition of "disposition of property" in s 2 of the Estate and Gift Duties Act 1968. The court held that the right to make a demand for interest was a thing in action. The failure to make a demand did not result in a release, a discharge, a surrender, an abandonment, or a forfeiture of the thing in action. The thing in action was just not exercised.

2.58 The result in *Re Marshall* was that the failure to demand interest did not amount to a disposition of property, so was not a gift under the Estate and Gift Duties Act 1968. Parliament was concerned that this decision would be applied in the context of the income tax legislation and that an easy avenue would be available for transferring value to a trust without being treated as a settlor. Therefore, Parliament introduced s 226(2)(b) of the ITA 1976.

2.59 It is noted that s HC 27(2)(b) does not cover the provision of financial assistance generally. The provision of financial assistance is covered under the general definition of "settlor" in s HC 27(2)(a), based on the transfer of value concept.

Determining whether a transfer or provision is made

2.60 The definition of "settlor" has two components in s HC 27(4) and (5) that help in determining whether a transfer or provision has been made.

2.61 Firstly, s HC 27(4) states that a person may make a transfer or provision directly or indirectly, by one transaction or a number of transactions, whether connected or otherwise.

2.62 For s HC 27(4) to apply to a person, the person must "make" the transfer or provision. This suggests that the person must have some influence or control over the transactions involved so that it can be said that the person causes the transfer or provision to occur. A conclusion that a person "makes" a transfer or provision indirectly or by a number of transactions is more likely to be reached where associated parties are involved.

Example 5. The person must "make" the transfer or provision

Peter makes an unconditional gift of $100 to Ed and Ed then gives the $100 to a trust. Peter does not have any control over what Ed does with the $100 and, therefore, does not cause the transfer to occur. Therefore, s HC 27(4) would not treat Peter as a settlor of the trust.

If Peter gave the $100 to Ed as part of a plan or understanding that Ed would settle the amount on the trust, then Peter could be said to have "made" the transfer (by a number of transactions) and, therefore, will be treated as a settlor. Ed might also be treated as making the settlement for Peter as a nominee under s YB 21 (discussed further below), in which case, Peter would be treated as making the settlement.

2.63 Note also that a person may be a settlor if they transfer property to an entity owned by a trust. Value is effectively transferred to the trust in these circumstances because the value of the trust's ownership of the entity will increase with the transfer of the property to the entity. This would be an indirect transfer of value. The trust receives a transfer of value indirectly through its ownership of the entity, rather than receiving a direct transfer of value (s HC 27(4)). The transfer would also be a transfer "for the benefit of the trust" in terms of s HC 27(2)(a)(ii).

2.64 Secondly, s HC 27(5) provides that the fact that a person is or will become a beneficiary of a trust does not mean that they have given or received any value.

2.65 Section HC 27(5) is intended to forestall an argument that might otherwise be made about whether a person transfers value to a trust when the person provides money or money's worth to a trustee. The argument being that the person, if they are or become a beneficiary of the trust, receives value by having a claim on the property that they settle on the trust; meaning that there is no transfer of value and, therefore, no settlement.

Exceptions

2.66 As noted above, the definition of "settlor" has two exceptions that apply to:

(a) trusts for retirement benefits of employees (s HC 27(3)); and

(b) contributions to foreign superannuation schemes (s HC 27(3C)).

Exception—trusts established to provide retirement benefits

2.67 Under s HC 27(3), a person will not be a settlor of a trust if:

(a) The person is a New Zealand resident; and

(b) The person makes a settlement on a trust as an employer for the benefit of one or more employees; and

(c) The trust is established or created mainly to provide retirement benefits to natural persons (which if satisfied would also make the trust a "superannuation scheme"); and

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(d) The trust is not a "foreign superannuation scheme" (which is a superannuation scheme constituted outside New Zealand); and

(e) The trust is not a "superannuation fund" (one of a number of registered schemes referred to in the Financial Markets Conduct Act 2013).

2.68 Further, under s HC 27(3C), a person will not be a settlor if they make a contribution to a trust that is a foreign superannuation scheme.

2.69 Therefore, s HC 27(3) applies to certain superannuation scheme trusts settled in New Zealand and s HC 27(3C) applies to contributions made to superannuation schemes settled outside New Zealand.

2.70 One situation in which s HC 27(3) will be relevant is where:

(a) there is an existing trust settlement which would have satisfied the requirements of the exclusion in s HC 27(3);

(b) no settlor or trustee of the trust is resident in New Zealand (ie, the settlor has left New Zealand since settling the trust and the trustee is also non-resident); and

(c) a New Zealand resident employer makes a further settlement on the trust as an employer for the benefit of one or more employees.

2.71 In this situation, the effect of the exclusion is that the New Zealand resident employer would not be treated as a settlor of the trust as a result of the settlement. This would help to ensure that the trustee would not lose its exemption from income tax under s HC 25 and that the New Zealand resident employer would not be liable for the income tax payable by the trustee.

Exception—contributions to foreign superannuation schemes

2.72 Under s HC 27(3C), a person who makes a contribution to a trust that is a foreign superannuation scheme is not a settlor of the trust.

2.73 As noted at [2.67](d), a "foreign superannuation scheme" means a superannuation scheme constituted outside New Zealand. These schemes are trusts in an offshore jurisdiction that are mainly for the purpose of providing retirement benefits to natural person members.

Treated as a settlor under s HC 28

2.74 In other situations, a person may be treated as a settlor of a trust under s HC 28:

(a) A person can be treated as a settlor of the trust, if they have a control interest in a company that settles an amount on a trust.

(b) A person can be treated as a settlor of a sub-trust if they are the settlor of a head trust and a trustee of the head trust settles an amount on the sub-trust.

(c) A person can be treated as a settlor of a trust if they have control over a trustee or a settlor of the trust.

(d) A person can be treated as a settlor of a trust if s HC 28(2), an anti-avoidance provision, applies.

2.75 These situations are discussed further below.

Person who has a control interest in a company that settles an amount on a trust

2.76 Under s HC 28(3), a person is treated as a settlor of a trust if:

(a) a controlled foreign company (CFC) settles an amount on the trust; and

(b) at the time of settlement the person has a control interest of 10% or more in the CFC.

2.77 If the person has a control interest of 10% or more in the CFC at any time in the CFC's accounting period, the person is treated as having a control interest of 10% or more for the whole of the CFC's accounting period (s EX 1(3)).

2.78 CFCs and control interests are defined in subpart EX. Briefly, a CFC must be a foreign company. This means it must not be resident in New Zealand or treated as not being resident under a double tax agreement. A CFC must also be controlled by New Zealand residents. The ITA 2007 contains rules relating to the type and extent of control required for a company to be a CFC. Rules also aggregate the control interests of associated persons.

2.79 Under s HC 28(4), the same treatment that applies under s HC 28(3) applies to a company that would have been a CFC at the date of settlement if it had been a foreign company at the time.

2.80 For ease of reference, in this part of the Interpretation Statement, a company described in either s HC 28(3) or (4) is referred to as a "controlled company".

2.81 The objective of s HC 28(3) and (4) is to ensure that the trust rules will apply where a person uses a controlled company to establish a trust and then winds up the controlled company. The provisions recognise that where a controlled company is used to settle a trust, the controlled company is being used as a vehicle for the settlement. Therefore, it is appropriate to look through the controlled company to the real settlor.

2.82 This rule may be significant in determining whether the trust has a New Zealand resident settlor. Having a New Zealand resident settlor is significant for several reasons, as discussed later in this Interpretation Statement. For example, having a New Zealand resident settlor is relevant in determining whether a trustee is liable for tax on their worldwide income.

2.83 It is possible that more than one person could be treated as a settlor of a trust as a result of a settlement by a controlled company. This is because more than one person may have a control interest of 10% or more in the controlled company.

2.84 In addition, this settlor treatment can apply through multiple layers of controlled companies. A "person" that has a control interest of 10% or more in a controlled company might, itself, be a controlled company. Further, a "control interest" of a person includes direct and indirect control interests as calculated in subpart EX.

Example 6. Settlor—multiple layers of controlled companies

Jack has a direct control interest of 15% in Holdings Ltd, which is a controlled company. Holdings Ltd has a direct control interest of 100% in Operations Ltd. Operations Ltd settles an amount on a trust. Jack is treated as a settlor of the trust for two reasons. Firstly, Jack has an indirect control interest in Operations Ltd (via Holdings Ltd) of 15%, which is more than the 10% required to be a settlor under s HC 28(3). Secondly, Jack has a control interest in Holdings Ltd of 10% or more and Holdings Ltd is treated as having settled the trust that was settled by Operations Ltd (because it has a control interest in Operations Ltd of 10% or more). Operations Ltd (who made the actual settlement) and Holdings Ltd (who has a control interest of 10% or more in Operations Ltd) would also be treated as settlors.

2.85 In addition, the controlled company provisions can work in tandem with other parts of the settlor definition. For example, a settlement may be made by a nominee of a company with the result that the company is treated as a settlor. And if a person has a control interest of 10% or more in that company, they may also be treated as a settlor.

Settlor of head-trust also settlor of sub-trust

2.86 Under s HC 28(5), a person is treated as a settlor of a trust (sub-trust) if:

(a) the person is a settlor of a trust (head-trust); and

(b) a trustee of the head-trust:

 (i) settles an amount on the sub-trust; or

 (ii) makes a distribution to or on the terms of the sub-trust.

2.87 Note that "sub-trust" is a term used in s HC 28(5) of the ITA 2007. For taxation purposes this is a wider term than for trust law purposes.

2.88 Where s HC 28(5) applies the settlor of the head-trust will be treated as the settlor of the sub-trust. The trustee of the head-trust will also be a settlor of the sub-trust under s HC 27(2) (as the person who made the settlement or distribution).

2.89 *A Taxation Amendment Bill (expected to be introduced in the near future) proposes an amendment to ensure a New Zealand resident trustee of a head trust is not treated as a settlor for a resettlement of an amount on, or a distribution to, a sub-trust if the head trust has no settlor resident in New Zealand at the time of settlement. The amendment is intended to have effect from Royal assent with a savings provision for positions already taken.*

2.90 The purpose of s HC 28(5) is to treat a person as settlor if they use one trust as a vehicle to settle, or to make distributions to, another trust. It means that the sub-trust will continue to have a settlor (the settlor of the head trust) in existence even if the head trust is wound up. This is particularly relevant to the potential liability of a settlor for income tax payable by a trustee under s HC 29.

2.91 "Distribution" is defined in s HC 14. Generally, a trustee of a trust makes a distribution when the trustee transfers value to a person because the person is a beneficiary of the trust.

2.92 Section HC 28(5) can apply through multiple layers of trusts. In other words, s HC 28(5) can apply to a settlor of a head-trust who is treated as settlor of the head-trust by virtue of an earlier application of s HC 28(5).

Example 7. Settlor–multiple layers of trusts

If Gene settles the Original Trust and the trustee of the Original Trust settles the Next Generation Trust and the trustee of the Next Generation Trust settles the Deep Space Trust, then Gene will be treated as settlor of all three trusts.

2.93 Section HC 28(5) applies only if the settlement or distribution made by the trustee of the head trust was made on or after 1 April 1988. However, s HC 28(5) can apply to a person who is a settlor of the head trust, regardless of when that person became a settlor of the head trust, ie before or after 1 April 1988.

Control over a trustee or a settlor

2.94 Under s HC 28(6), a person is treated as a settlor if:

(a) they acquire, directly or indirectly, rights or powers in relation to a trustee or a settlor of a trust; and

(b) the purpose or effect of that acquisition is to enable the person to require the trustee to treat the person, or a nominee, as a beneficiary of the trust.

2.95 The word "acquire" is not defined in the ITA 2007. It is defined in the *Concise Oxford English Dictionary* (12th ed, Oxford University Press, New York (2011)) as "come to possess (something)…". This ordinary meaning is wide and suggests that a person could acquire something actively or passively. In addition, the words "directly or indirectly" following "acquire" support a wide interpretation of "acquire".

2.96 A person could acquire rights or powers in relation to a trustee of a trust by obtaining ownership of a corporate trustee. This could allow the person to appoint themselves, or a person who will follow their instructions, as the sole director of the corporate trustee. A person could acquire rights or powers in relation to a settlor by acquiring the settlor (if it is a company, which could include the corporate trustee of another trust).

2.97 A person could also acquire rights or powers in relation to a trustee by being given the right to appoint and remove trustees. This is because the person could remove the trustees, appoint themselves (or an entity that they control) as trustee. If, as trustee, they had the power to appoint or remove beneficiaries, the effect of the acquisition would be to enable the person to require the trustee to treat the person, or a nominee, as a beneficiary of the trust.

2.98 A person could acquire rights or powers in relation to a trustee of a trust by being appointed as a protector of the trust. The powers that are conferred on a protector under the terms of a trust can vary from trust to trust. Whether those powers enable the person to require the trustee to treat the person, or a nominee, as a beneficiary of the trust will depend on the extent of the powers given to the person. Not all protectors will be affected. If, for example, the powers given to a protector are limited to approving major transactions then the appointment of the person as a protector would not result in the person being a settlor under s HC 28(6).

2.99 It is sufficient that the purpose or effect of the acquisition is to "enable" the person to require the trustee to treat the person, or a nominee, as a beneficiary of the trust. It is not necessary that the person uses the ability.

2.100 "Require" is defined in the *Concise Oxford English Dictionary* as "**v …2** instruct or expect (someone) to do something."

2.101 For s HC 28(6) to apply, the trustee referred to in para (b) would need to have or be given the discretion under the terms of the trust to treat a person as a beneficiary. If a person acquires rights or powers in relation to only one trustee and the approval of more than one trustee is necessary to treat a person as a beneficiary of the trust, then this requirement will not be met.

2.102 A person would be able to require a trustee to treat the person, or a nominee, as a beneficiary of the trust if they appointed themselves as the sole trustee, assuming that, as trustee, they had the required power.

2.103 Section HC 28(6) could apply to a person who is already a beneficiary. This is because the requirements of the section could be satisfied if the purpose or effect of that acquisition is to enable the person to require the trustee to treat a nominee as a beneficiary of the trust.

2.104 The use of the phrase "purpose or effect" in s HC 28(6)(b) suggests an objective test. It is not necessary to show that the person has a subjective purpose or intention. The phrase "purpose or effect" in this context also suggests that the provision has an anti-avoidance nature.

2.105 Taking into account the above, s HC 28(6) could, if interpreted literally, apply in situations in which Parliament would not have intended, for example, where a professional advisor is given the right to appoint or remove trustees on the death of the previous right holder. Given this, and the apparent anti-avoidance nature of the provision, the Commissioner will take a purposive interpretation of s HC 28(6) to ensure that the provision does not apply in situations in which Parliament would not have intended.

2.106 The Commissioner will take into account the purpose of the provision and the circumstances of the acquisition of the rights or powers.

2.107 The purpose of s HC 28(6) is to treat a person as a settlor if they acquire rights or powers in relation to an existing trust.

2.108 The Commissioner will take into account the circumstances surrounding the acquisition of the rights or powers, including:

(a) Any existing relationships between the person and the settlor, trustee, and beneficiaries of the trust. The absence of such relationships may support the application of the provision.

(b) Whether consideration was provided by the person for the rights or powers acquired.

(c) Whether the acquisition of the rights or powers by the person could have been expected as an ordinary incident of the administration of the trust.

(d) Whether the person is in the business of providing trust administration services. It might be that the appointment of such a person could be expected under the terms of the trust.

2.109 The 1989 Explanation stated that s HC 28(6) was intended to apply to situations where a person has "informal" rights or powers over a trustee or settlor of a trust. However, arguably this intention is not reflected in the wording of s HC 28(6). Nevertheless, even if s HC 28(6) does not apply in this situation, it may be that s HC 28(2) (an anti-avoidance provision, considered further below) will apply to treat the person as a settlor.

2.110 Note that the situation addressed by s HC 28(6) is different from the situation addressed in s YB 21 (the nominee settlor rule). A trust to which s HC 28(6) applies may have been settled on the original settlor's own initiative. Nevertheless, the person to whom s HC 28(6) applies is effectively in the same position as if they had settled the trust directly.

Example 8. Control over a trustee

A Hong Kong resident, Jenny, makes an initial settlement of $990,000 on the Dragon Trust, which is a discretionary trust. The trustee of the Dragon Trust, Dragon Co, is a company owned by Jenny. Dragon Co has the power to appoint and remove beneficiaries. Apart from the $990,000 of trust property, Dragon Co does not have any assets. A New Zealand resident, Steve, acquires Dragon Co for $1 million. Steve appoints himself as director of Dragon Co. There is no indication that Jenny settled the trust as a nominee for Steve.

By acquiring Dragon Co and appointing himself as director, Steve has acquired rights or powers over the trustee that enables him to require Dragon Co to treat Steve, or his nominee, as a beneficiary of the Dragon Trust. This is an "effect" of the acquisition of the rights or powers. In addition, the fact that Steve paid $1 million to acquire Dragon Co, a company that does not have any assets of its own, suggests that the purpose of the acquisition was to enable him to require Dragon Co to appoint Steve, or his nominee, as a beneficiary of the Dragon Trust.

In this example, Steve has not transferred any value to the Dragon Trust and in the absence of s HC 28(6) would not be treated as a settlor. Nevertheless, under s HC 28(6) Steve is treated as a settlor.

Example 9. Acquiring rights under the terms of the trust

The original settlor of the Mete Trust dies and triggers a provision in the trust deed passing on the power to appoint or remove trustees to Grace, the Trust's lawyer. Under the trust deed the power to appoint or remove beneficiaries passes to the trustees.

As a result, Grace has acquired rights or powers over the trustees of the Trust. The acquisition of these powers would enable Grace to remove the existing trustees and appoint herself as the sole trustee of the Trust. Grace could then appoint herself, or a nominee, as a beneficiary of the Trust. Grace may have no intention of doing this, but it is an effect of the acquisition that she could require the trustee to treat herself, or a nominee, as a beneficiary.

Therefore, it might appear at first that s HC 28(6) would apply to treat Grace as a settlor of the Trust. However, taking into account the purpose of the provision and the circumstances of Grace's acquisition of the right, it is considered that Parliament would not have intended s HC 28(6) to apply. Grace is in the business of providing trust administration services. The appointment of Grace could have been expected under the terms of the trust as an ordinary incident of the administration of the trust. The circumstances do not suggest that Grace was attempting to avoid settlor status by acquiring rights or powers in relation to an existing trust. Therefore, Grace would not be treated as a settlor in this situation.

Anti-avoidance provision

2.111 Under s HC 28(2), a person is treated as a settlor if, in relation to a trust:

(a) they act, refrain from acting, or enter into a transaction or series of transactions; and

(b) this has the effect of defeating the intent and application of the trust rules.

2.112 This provision is an anti-avoidance rule to reinforce the definition of "settlor".

2.113 Historically, the provision was intended to cover transactions of the type described in para (f) of the definition of "disposition of property" in the Estate and Gift Duties Act 1968. However, it was also intended to cover actions and transactions falling outside that definition as the definition of "disposition of property" in the Estate and Gift Duties Act 1968 was seen as being defective.

2.114 Section HC 28(2) may apply to a unilateral action (or inaction) of a person. No requirement exists for there to be a transaction (which generally implies the existence of two parties). The section may also apply where a person has entered into a transaction or a series of transactions.

2.115 The intention of the person who acts, refrains from acting, or enters into a transaction or transactions is not relevant. The focus is on the effect of the action, inaction, transaction or series of transactions.

2.116 For s HC 28(2) to apply, the action, inaction, transaction or series of transactions must have the effect of defeating the intent and application of the trust rules.

2.117 One of the intentions of the trust rules is to treat any person who transfers value to a trust as a settlor.

2.118 As discussed above, one situation in which s HC 28(2) could potentially apply is in a situation where a person is not caught by s HC 28(6) because their rights or powers are "informal".

Example 10. Avoidance arrangement

Ace Ltd is owned by Harriet and James, with each holding 100 shares. Harriet and James are also the directors of Ace Ltd. Harriet would like to transfer half of her ownership interest in Ace Ltd to Harry's Trust, a trust of which she and her family are beneficiaries. However, Harriet would prefer not to become a settlor of the trust.

At a shareholders meeting for Ace Ltd, Harriet proposes a resolution to issue 100 new shares to Harry's Trust and 100 new shares to Jimmy's Trust (a trust of which James and his family are beneficiaries), in each case for no consideration. James abstains from voting and the resolution is passed. James is indifferent to whether he or Jimmy's Trust owns shares in Ace Co.

After the issue of the new shares, Harriet and James' interest in the company is diluted by 50% and valuable shares are now owned by Harry's Trust and Jimmy's Trust.

This example is given to illustrate the application of s HC 28(2). It is difficult to imagine situations where s HC 28(2) would apply, where a person would not be treated as a settlor under a different part of the settlor definition. It is noted that Harriet and James would both be treated as settlors of the trusts under s HC 28(4) (shareholders in companies). Nevertheless, this example can be used to illustrate how s HC 28(2) would apply if not for s HC 28(4).

If not for s HC 28(4), s HC 28(2) would apply. This is because:

- Harriet has acted by proposing a resolution and voting in favour of it. James has refrained from acting by abstaining from the vote.
- What has been done (or not done) would (if not for s HC 28(4)) have had the effect of defeating the intent and application of the trust rules. One of the intentions of the trust rules is to treat a person who transfers value to a trust as a settlor. The commercial and economic reality of what has been done, or not done, is that Harriet and James have each transferred value to the two trusts.

In this example, Harriet arguably has a purpose of avoiding settlor status. James, on the other hand, may not be aware of the implications of the arrangement for the trust rules and may have no purpose of avoiding settlor status. Nevertheless, Harriet and James will both be treated as settlors of the trusts because s HC 28(2) involves an objective test that focuses on the purpose or effect of the action or inaction, not the subjective purpose of the party involved.

Nominee settlor

2.119 Although not located with the settlor definition, s YB 21 is relevant to the concept of settlor in the ITA 2007. Under s YB 21(1), if a person (person A) makes a settlement on a trust as a nominee for another person (person B), person B is treated as having made the settlement and person A is ignored. (However, as discussed from [2.126], person A may still have disclosure obligations in relation to the settlement.)

2.120 Person A settles an amount on a trust as a nominee for person B if person A does so "on behalf of" person B. However, if person A is a trustee, person A will be a nominee only if they are a bare trustee in relation to the amount (s YB 21(2)).

2.121 The nominee rule is extended to situations involving nominal (small) settlements. Under s YB 21(3), a person making a nominal settlement (eg, a settlement of $10) at the request of another person is treated for the purposes of the ITA 2007 as a nominee in relation to the settlement. The Commissioner is likely to regard a settlement worth less than $100 as a nominal settlement.

2.122 The objective of this provision is to ensure that persons acting as nominees are not treated as settlors. Often professional advisers or relatives will assist in establishing a trust by settling a nominal sum on trust on behalf of another person. In these circumstances it is not appropriate to expose the professional adviser or relative to a potential tax liability under s HC 29 (settlor liable for income tax liability of trustee). The professional adviser or relative is not the real settlor of the trust, but is in effect only an intermediary or facilitator. The real settlor is the person on whose behalf the professional adviser or relative acted in making the settlement. Therefore, s YB 21 treats the person for whom the nominee acted as the settlor rather than the nominee.

2.123 The nominal settlement rule applies only where the settlement was made at the request of another person. Therefore, if a person settles a nominal amount on trust on that person's own initiative, they will not be a nominee. This is also implicit in the nominee concept generally.

2.124 Note that a direction or request to settle an amount on trust could be made directly or indirectly.

Example 11. Settlement by a person's lawyer—delegated

A client of a law firm may ask their lawyer to establish a trust by making a settlement on their behalf. If the lawyer then delegated this request to a colleague, the colleague would be regarded as having settled the trust at the direction or request of the client.

2.125 Section YB 21 makes it clear that a person can be a settlor if they use nominees to establish trusts.

Disclosure obligations on nominee settlor

2.126 As noted above, if a person (person A) settles an amount on a trust as a nominee for another person (person B), person B is treated as having settled the amount and person A is ignored. However, person A may still have disclosure obligations in relation to the settlement under s 59(2) of the TAA. A disclosure obligation will arise for a nominee settlor if at the time of the settlement:

(a) they were resident in New Zealand; and

(b) no trustee of the trust was resident in New Zealand.

2.127 This will apply, for example, to a New Zealand resident advisor that settles a trust for a foreign client with a non-resident trustee.

2.128 If the obligation applies, the nominee settlor will be required to disclose:

(a) the fact of the settlement;

(b) the name and address of the person who is deemed to be the settlor of the trust under s YB 21; and

(c) such further details as the Commissioner may require and for which the Commissioner has created the form *Settlors of Trusts Disclosure (IR462)* (January 2008), which requires further details such as the trust's name, IRD number, and address, a full description of the nature and date of the settlement, and the names and addresses of the trustees and beneficiaries of the trust.

2.129 The disclosure must be made within 3 months of the date of each settlement.

Minor beneficiary rule

2.130 The definition of "settlor" in s YA 1 is narrowed for the purposes of the exclusions from the minor beneficiary rules. The effect of this is to make it easier to fall within the exclusions to the minor beneficiary rule. The minor beneficiary rule is discussed further in Part 6 of this Interpretation Statement.

Associated person rules

2.131 The definition of "settlor" in s YA 1 provides that for the purposes of ss YB 7 to YB 9 (which relate to associated persons), "settlor" has the meaning given to it in s HC 27 modified by s YB 10.

2.132 Section YB 10 provides that for the purposes of ss YB 7 to YB 9 a person will not become a settlor by providing services to a trust for less than market value. This is significant because it may mean the person is not associated with a trustee or a beneficiary of the trust under ss YB 7 to YB 9.

2.133 Section YB 10 applies to any person who provides services to a trust for less than market value. Notably, an example would be a professional advisor or trustee who provides services to a trust at no charge (or for less than market value).

Resettlements

2.134 A resettlement occurs when the trustee of one trust makes a settlement of the trust's property on a new trust.

2.135 A distinction should be made between the following two situations:

- A resettlement that is made on behalf of a beneficiary that coincides with the trustee transferring an absolute interest in the property to the beneficiary.
- A resettlement that does not coincide with the trustee transferring an absolute interest in the property to the beneficiary, but which may give a beneficiary an interest in the property as a beneficiary of the new trust.

2.136 The first situation involves:

- A "payment" made by the trustee to the beneficiary for the purposes of the definitions of "beneficiary income" and "distribution". There is a "payment" because the trustee has transferred an absolute interest in the property to the beneficiary by dealing with the amount in their interest or on their behalf (see the definition of "pay" in s YA 1).
- A settlement by the beneficiary on the new trust. Having transferred an absolute interest in the property to the beneficiary, the trustee is a bare trustee in relation to the property. This means that s YB 21 (transparency of nominees) can apply to the trustee. Because the trustee makes the settlement on behalf of and, therefore, as nominee for the beneficiary, the beneficiary is treated as the settlor of the trust under s YB 21(1).

2.137 Resettlements are discussed further in Part 8. This includes a discussion of the relationship between resettlements and corpus (and amounts excluded from corpus), trustee income, distributions, and the ordering rules. See also [2.86], which discusses s HC 28(5).

2.138 A resettlement of trust assets may constitute a disposal under s FC 1(1)(f) and, under s FC 2, these trust assets may be treated as being disposed of for market value. This may have implications for the settlor and the recipient trustees under other provisions in the legislation, for example, depreciation recovery income. These implications are outside the scope of this Interpretation Statement, but trustees should be aware of the potential implications.

Part 3 Trustees and beneficiaries

Trustees

3.1 A trust is not a legal person for income tax purposes. The trustee as the legal owner of the trust property derives the income and is liable for the tax obligations of the trust in most situations, including as agent for the beneficiary's tax obligations.

3.2 The ITA 2007 recognises that a trustee is a person with a capacity that is separate from the individual capacity of the person or entity that fills the role. "Trustee" is defined in s YA 1 to mean "the trustee only in the capacity as trustee of the trust" and includes all the persons who are trustees from time to time. If trustees change from time to time, the tax status of the trustee of that trust does not change. The same tax number is retained for each trust despite a change in trustees.

3.3 The Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters) Act 2018 introduced a general rule from 29 March 2018 (with some exceptions) distinguishing between a trustee's personal or body corporate capacity and their separate trustee capacity. This is reflected in the definitions of both "company" and "natural person" in s YA 1, which generally do not apply to trustees. However, the definitions of "company" and "natural person" remain relevant for the purposes of determining the residence of a company or natural person who is a trustee. In the TAA a "natural person" is defined in s 3 to not include a person in their capacity as a trustee (with some exceptions).

3.4 Under s HC 2 joint trustees are treated as a notional single person with each being jointly and severally liable for the tax obligations of the trustees to calculate and return income. Trustees are also jointly and severally liable for tax as agent on beneficiary income and taxable distributions. This liability will cease for a person from the date that the person ceases to be a trustee, eg if they resign (note that different rules apply for GST purposes under s 57(3B) of the Goods and Services Tax Act 1985). The Commissioner recommends that trustees advise of any retirements or resignations as soon as possible to make sure that Inland Revenue records are kept up to date.

3.5 Based on trust law a trustee is treated as liable up to the date of resignation. In practice, as endorsed in *Case 5/2013* [2013] NZTRA 05, (2013) 26 NZTC 2-004, the Commissioner will generally hold a trustee liable to the end of the tax period prior to resignation because that is the last period in which the trustee had any control over the tax position taken. This will be the case unless the features of a particular situation require an alternative approach.

3.6 The trustee definition also extends to the role of executors and administrators of deceased estates for tax administration purposes. While an estate is not a trust at common law, there are specific rules in subpart HC that apply to estates. For detail on deceased estates, see Part 9 of this Interpretation Statement.

3.7 A trustee's tax obligation is described in s HC 24 as being a requirement to satisfy the liability for taxable income "as if they were an individual beneficially entitled to the trustee income". As a consequence, it makes no difference to the tax treatment if a trustee is a company, another type of entity or an individual. The rate of tax on trustee income is the same and set at 33% for most trusts that are not in special categories.

3.8 Because s HC 24 treats a trustee as liable for tax like an individual, subpart CV (Income specific to certain entities) deals only with the income treatment of a trustee in a few special situations. There is now no specific charging provision for the New Zealand sourced and foreign-sourced income of trustees as there once was. In contrast, subpart CV specifically lists the amounts derived from a trust that will be included as income.

3.9 New Zealand-sourced income derived by a trustee is always subject to tax in New Zealand. However, there is special treatment for foreign-sourced amounts. The rules determining whether foreign-sourced amounts are taxable in New Zealand are complex, and depend on a number of factors. In summary, however:

(a) Foreign-sourced amounts derived by a non-resident trustee will generally be taxed in New Zealand if a settlor is resident in New Zealand (other than a transitional resident) at any time during that income year.

(b) Foreign sourced amounts derived by a resident trustee will generally not be taxed in New Zealand if no settlor is resident in New Zealand (other than a transitional resident) at any time during the income year in which that amount was derived.

For detail on trustee income, see Part 7 of this Interpretation Statement.

3.10 With regard to passive income, for example, interest and dividends that have a New Zealand source, taxation is based on the residence of the trustee (based on a notional single person). If the trustee is non-resident, and so derives non-resident passive income as defined in s RF 2, non-resident withholding tax (NRWT) will be payable on the amount. In contrast, unless an exemption certificate is held, resident withholding tax (RWT) is deducted from passive income paid to resident trustees.

3.11 New Zealand does not determine the tax residency of a trust based on the tax residence of its trustees as some countries do such as the United Kingdom. However, as discussed above, the residence of the trustee is relevant in a number of situations, in particular for compliance and enforcement. The residence of the trustee is determined under the rule in s YD 1 for natural persons and under s YD 2 for companies. When a trust has co-trustees, the trustees are treated as a notional single person under s HC 2. Where one of the trustees is resident, then all of the co-trustees as the notional single person under s HC 2 are resident in that capacity. If all of the co-trustees (or a single trustee if there is only one) are non-resident, then the notional single person under s HC 2 will be non-resident.

3.12 These results are supported by the definition of "non-resident" in s YA 1 which means a person who is not a New Zealand resident. This means that if one or more of the trustees is a resident the 'non-resident' test is failed. The corollary is that if all of the trustees (or the single trustee if there is only one) are non-resident then the test is satisfied. Some support for this approach to determining the residency of the notional single person is also obtained from the joint and several liability of trustees. A resident trustee whose co-trustees are non-resident will be severally liable for the tax obligations of the notional single person. That is consistent with the liability of the notional single person having a link to the New Zealand residency of any of the trustees for enforcement purposes.

3.13 In a practical sense, if trustees have mixed residency, the filing and return obligations will typically fall on the resident trustee(s). If all the trustees are non-resident, a tax agent in New Zealand would usually attend to the obligations for a complying trust.

3.14 Trustees are included in the parties treated as associated persons in several relationships under subpart YB. Other provisions in the ITA 2007 can then treat such associated persons as aggregated parties or as having common interests to prevent possible manipulation of taxing transactions between or using related parties. More details on associated person rules and their impact on trusts are in Part 12 of this Interpretation Statement.

Beneficiaries

3.15 Beneficiaries are the objects of a trust. The trust property is held for the benefit of the beneficiaries. The term "beneficiary" is not defined in the ITA 2007 except for the purposes of s DX 1, which deals with only testamentary annuities. However, s YA 1 defines "beneficial interest" for tax purposes and this "includes an interest that is contingent, discretionary or unvested". Section YA 1 also defines "beneficiary income", which simply refers to the relevant provision s HC 6. This is discussed in Part 5 of this Interpretation Statement.

3.16 The entitlements of beneficiaries stem from the terms of the trust deed, or functional equivalent document, and the exercise of discretions by the trustees. As a result, the nature of a beneficiary's interest in trust property varies accordingly.

3.17 The trust rules impact on a person who is a beneficiary when they derive beneficiary income or receive a distribution from a trust. Beneficiary income is defined in s YA 1 by reference to its meaning in s HC 6 and then classified as income of the beneficiary under s CV 13(a). Distributions to beneficiaries may be taxable depending on the category of trust they are received from and the makeup of the distribution. The tax impact on beneficiaries is discussed in Part 5, Part 6 and Part 8 of this Interpretation Statement.

3.18 Beneficiaries are treated as associated persons of trustees and settlors if they have benefited or are eligible to benefit under a trust. This includes any person named as a beneficiary as well as discretionary beneficiaries both named and within a class. A person who could become a beneficiary by the exercise of a power of appointment is not treated as one until the power is exercised. For the detail on how a beneficiary is treated under the associated person rules, see Part 12 of this Interpretation Statement.

Part 4 Income derived by trustees

Introduction

4.1 The trust rules are largely concerned with the taxation of "income" derived by trustees. They determine whether the income is "trustee income" or "beneficiary income" for the purposes of determining tax liabilities.

4.2 The concepts of "beneficiary income" and "trustee income" are discussed in Part 5 and Part 7 of this Interpretation Statement respectively.

4.3 However, generally, before an amount can be beneficiary income or trustee income, it must first be "income derived by a trustee". This part makes several preliminary points about the requirement for there to be "income derived by a trustee".

"Income derived by a trustee" compared with "trustee income"

4.4 It is important to remember that the concept of "income derived by a trustee" is not the same as the concept of "trustee income" used in the trust rules. Generally, "trustee income" is income derived by a trustee that is not beneficiary income.

"Income" is a gross concept

4.5 "Income" means an amount that is income under a provision in part C (see the definition of "income" in ss YA 1 and BD 1(1)). Being defined as "income under a provision in part C" means "income" is a gross concept and does not take into account any deductions that may be claimed in the calculation of "net income". The ability to claim deductions is discussed further in Part 7, which discusses "trustee income".

Income includes deemed income

4.6 Income also includes amounts that are treated as income under a provision in part C, whether or not the amounts are treated as income under trust law (sometimes referred to as "deemed income"). For a fuller explanation of deemed income, see "IS 12/02: Income Tax – Whether Income Deemed to Arise Under Tax Law, But Not Trust Law, Can Give Rise to Beneficiary Income", *Tax Information Bulletin* Vol 24, No 7 (August 2012): 49.

Dual derivation

4.7 In a sense, an amount of income derived by a trustee that is vested in or paid to a beneficiary as beneficiary income is derived twice: firstly, by the trustee, and secondly, by the beneficiary. However, the income is taxed only once (ie, to the beneficiary). "Beneficiary income" is included in the beneficiary's "income" for the purposes of calculating their net income (s CV 13(a)). The income derived by the trustee that is beneficiary income is not included in the trustee's "income" for the purposes of calculating the trustee's net income. Only income that is "trustee income" is included for this purpose.

4.8 In contrast, where a foreign trust or non-complying trust makes a taxable distribution to a beneficiary (eg, a distribution of prior years' income), this income may be taxed twice, once to the trustee and then again to the beneficiary.

Part 5 Beneficiary income

Introduction

5.1 As noted above, income derived by a trustee is either "beneficiary income" or "trustee income".

5.2 Income derived by a trustee is "beneficiary income" if the requirements in s HC 6 (Beneficiary income) are satisfied; otherwise, the income will be "trustee income".

5.3 Beneficiary income is included in the income of the beneficiary and, if assessable, will be subject to tax at the beneficiary's marginal tax rate. An exception to this is beneficiary income to which the minor beneficiary rule applies. Income subject to the minor beneficiary rule is treated as trustee income for the purposes of determining the rate of tax that applies. The trustee income tax rate is set out in sch 1 of the ITA 2007 and is currently 33%. The minor beneficiary rule is discussed in Part 6 of this Interpretation Statement.

5.4 Generally, the obligation to satisfy the income tax liability on beneficiary income is on the trustee acting as agent for the beneficiary (see from [13.69]).

Definition of "beneficiary income"

5.5 "Beneficiary income" is defined in s HC 6 as "income" derived in an income year by a trustee to the extent to which it:

(a) "vests absolutely in interest" in a beneficiary of the trust in the income year; or

(b) is "paid" to a beneficiary in the income year or within the extended time period described in s HC 6(1B).

5.6 "Beneficiary income" also includes an RWT substitution payment made under s RE 2(7) (discussed further from [13.48]).

5.7 However, "beneficiary income" does not include:

(a) income derived by a trustee of a trust that is a superannuation fund; or

(b) income derived by a trustee to which ss CC 3(2) and EW 50 apply (these sections relate to income that may arise under the financial arrangement rules where debt owed by a trustee of a trust is forgiven).

These amounts are treated as trustee income.

5.8 Also, an amount treated as trustee income under s HC 7(3) cannot be treated as beneficiary income, despite being income of the trustee under s CV 13(b) (see [7.5] and [7.6] for further explanation of this rule).

5.9 The following topics and elements of the definition of "beneficiary income" are discussed further below:

(a) the need for there to be income derived by a trustee first for there to be beneficiary income (from [5.11]);

(b) general comments on vesting and paying amounts (from [5.15]);

(c) what "vesting absolutely in interest" means (from [5.20]);

(d) what "paid to" a beneficiary means (from [5.28]); and

(e) the extended time period for payment in s HC 6(1B) (from [5.47]).

5.10 This is followed (from [5.53]) by a brief discussion of s GB 22, an anti-avoidance provision that deals with situations where a trustee enters into an arrangement to defeat the intent and application of the rules relating to beneficiary income and taxable distributions.

Income derived by a trustee

5.11 For there to be "beneficiary income" there must first be an amount of "income" derived by a trustee. "Income" means an amount that is income under a provision in part C (see the definition of "income" in ss YA 1 and BD 1(1)). Therefore, if a trustee derives an amount from the sale of a rental property, for example, and the amount is not income under part C, then the amount cannot be beneficiary income if vested in or paid to a beneficiary.

5.12 As noted above at [4.5], income is a gross concept. When a trustee distributes income to a beneficiary they are distributing gross income derived by the trustee. With some trusts, the amount of income that can be distributed by a trustee is limited by the terms of the trust to an amount equal to the net income (income less expenditure) of the trust. However, if it is permitted by the terms of a trust, a trustee could distribute all of the income (gross income) derived by the trustee to a beneficiary. This would mean that, if the trustee incurred any expenditure, the trustee would have to pay for the expenditure out of previous years' income, capital funds or corpus. It could also lead to the trustee making a net loss for the income year (see [7.21] for further discussion on losses).

5.13 If an amount of income derived by a trustee is of a particular character in the hands of the trustee (eg, interest income), the income will retain this character in the hands of the beneficiary when the amount becomes beneficiary income. The character of the income could be significant in some situations. For example, if a trustee pays interest income to a non-resident beneficiary, the payment will be characterised as a payment of interest, and the trustee may be required to withhold NRWT from the payment (see [13.56] for more information on the NRWT withholding obligations of trustees).

5.14 Similarly, if an amount of income derived by a trustee has a source in New Zealand, the income will have the same source in the hands of the beneficiary when the amount becomes beneficiary income (s YD 4(13)). This may determine whether the beneficiary income will be assessable income for the beneficiary.

General comments on vesting and paying amounts

5.15 In order to be a valid distribution, an amount must be vested or paid in accordance with the terms of the trust. The terms of the trust will dictate what can be distributed to each beneficiary. Subject to this, the following principles need to be taken into account.

5.16 The amount that is vested in or paid to the beneficiary can take the form of money or money's worth. For example, a trustee could derive income in the form of cash sales, but vest or pay that income in or to the beneficiary by transferring assets of an equivalent value to the beneficiary (provided it is clear that the distribution is of the income derived by the trust). However, the distribution of the assets might give rise to further income tax consequences for the trustee (eg, income on the disposal of revenue account property).

5.17 The exact amount that is vested in or paid to a person does not need to be specified at the time of vesting or payment, as long as the amount can be calculated when the assessment of income is made for the income year. For example, the trust deed, or a resolution by the trustee during an income year, may state that two-thirds of the income derived by the trustee in the income year is allocated to a particular beneficiary. When the income derived by the trustee for the year is known it will be possible to calculate the amount and make an assessment of the trustee and beneficiary income for the income year (*Davidson v CIR* [1976] 2 NZLR 705 (SC) at 713).

5.18 Where an amount is future property or an expectancy, the vesting or payment of the amount will not be effective until the amount is received or receivable (*Hadlee and Sydney Bridge Nominees Ltd v CIR* (1989) 11 NZTC 6,155 (HC)).

5.19 The language used to vest or pay an amount varies. An amount could be "vested in" or "paid to" a beneficiary without using those words. What is important is that the words used have the effect of vesting or paying. For example, a trustee resolution could vest an amount in a beneficiary by resolving that income derived by the trustee is allocated to the beneficiary.

Vesting absolutely in interest

5.20 As noted above, income derived by a trustee in an income year will be beneficiary income to the extent to which it "vests absolutely in interest" in a beneficiary of the trust in the income year.

5.21 An amount may vest in a beneficiary as a result of a clause in a trust deed or as a result of the exercise of a discretion given to a trustee to allocate an amount to a beneficiary.

5.22 An amount will vest in a beneficiary for the purposes of the "beneficiary income" definition only if the beneficiary is given an indefeasible right to the amount (*CT v Johnson and Maeder* [1946] NZLR 446 (SC)). Vesting an amount in a beneficiary means the trustee cannot later change their mind and decide not to give the amount to the beneficiary. On vesting, the beneficiary obtains an absolute interest in the amount.

5.23 Vesting "in interest" means that the right given to the beneficiary can be a right to present or future possession of the amount. In other words, an amount can be vested in interest even if the beneficiary is not entitled to possession of the amount until a future date.

5.24 Even if there is a right to present possession, the trustee may hold the amount until the beneficiary demands it. There is no longer any requirement for the amount to be placed beyond the possession and control of the trustee. See the 1989 Explanation at Part 5, for more historical detail on changes in this area when the current regime was introduced.

5.25 The vesting cannot be subject to a condition being met or to an event occurring.

Example 12. Vesting in interest—not conditional

A trustee might allocate an amount of income to an 8 year old beneficiary with a right to possess the amount in 10 years, when the beneficiary would be aged 18. The amount would be vested in interest as the beneficiary has immediately received an indefeasible right to the amount, despite not having a right to possess the amount. After making the allocation, the trustee could not change their mind about giving the income to the beneficiary. If the beneficiary died before reaching 18, the income would become part of the beneficiary's estate and would not revert to the trust.

Example 13. No vesting—conditional allocation

A resolution by a trustee that an amount of income will be allocated to a beneficiary **if** they reach the age of 18 will not vest that amount of income in the beneficiary unless and until that condition is satisfied. The resolution, as worded, is conditional on the beneficiary reaching the age of 18. If the beneficiary died before reaching the age of 18, the condition in the resolution would not be met and the amount would remain trust property. In that case, the income will be trustee income in the year it is derived.

Example 12 differs from this example in that the allocation of the income to the beneficiary is not conditional on the beneficiary reaching the age of 18. If the beneficiary referred to in Example 12 died before reaching 18, the income would become part of the beneficiary's estate and would not revert to the trust.

5.26 The word "absolutely" reinforces the indefeasible nature of the vesting and the fact that the vesting results in the beneficiary receiving the beneficial ownership of the amount.

5.27 The phrase "vests absolutely in interest" is discussed in more detail in "IS 12/02: Income Tax — Whether Income Deemed to Arise Under Tax Law, But Not Trust Law, Can Give Rise to Beneficiary Income", *Tax Information Bulletin* Vol 24, No 7 (August 2012): 49.

Paid to a beneficiary

5.28 The definition of "beneficiary income" was rewritten with the introduction of the ITA 2007. The rewrite particularly affected the payment paragraph in the definition.

5.29 Prior to the introduction of the ITA 2007, the definition of "beneficiary income" referred to income derived by a trustee to the extent to which the trustee "pays or applies" the income to or "for the benefit of" the beneficiary. Also, the earlier legislation did not define "pay" for the purposes of the definition of "beneficiary income".

5.30 The definition of "beneficiary income" in the ITA 2007 now refers to income derived by a trustee during an income year to the extent that it is "paid to" a beneficiary. Also, the definition of "pay" in the ITA 2007 has been extended to apply for the purposes of the definition of "beneficiary income" (it now applies for the purposes of the IA 2007 generally). The definition of "pay" states that, for an amount and a person, to "pay" includes to:

(a) distribute the amount to the person;

(b) credit the person for the amount; or

(c) deal with the amount in the person's interest or on their behalf in some other way.

5.31 The definition of "pay" in the ITA 2007 includes grammatically associated terms such as "pays", "paid" and "payment". The definition expands the ordinary meaning to include situations where amounts are distributed, credited or dealt with in some way.

5.32 This rewording of the definition of "beneficiary income" was not intended to change the meaning of "beneficiary income"; rather, the change was intended to simplify the definition by relying on the definition of "pay" in s YA 1.

5.33 Because there was no intended change in the meaning of beneficiary income, cases dealing with the previous definition are still relevant.

5.34 Although the definition of "beneficiary income" suggests that the income must be paid "to" the beneficiary, the extended definition of "pay" means that the test is satisfied if the income is dealt with in the beneficiary's interest or on their behalf in some other way. Although this is largely dependent on the facts of each case, in general terms a transaction will be in the interest of a beneficiary if it improves the material situation of the beneficiary (*Re Pilkington's Will Trusts* [1964] AC 612 (HL); *CIR v Simpson* (1989) 11 NZTC 6,140 (CA) at 6,144).

5.35 An amount is dealt with in a minor beneficiary's interest and, therefore, "paid" to the beneficiary, if it is transferred to the beneficiary's parents or guardians for expenditure on behalf of the beneficiary. This will be a distribution to the beneficiary, and not to the parent or guardian. Receipt of the income by the parent or guardian is sufficient to discharge the trustee's obligations, and the trustee does not have to ensure the parent or guardian pays the income to the beneficiary or uses it to maintain and support them. However, distributions to minors may be subject to the minor beneficiary rule, in which case they will be taxed at the trustee tax rate.

5.36 An amount is dealt with on the beneficiary's behalf, and, therefore, "paid" to the beneficiary, if the trustee makes a payment of income to a person other than the beneficiary that discharges the beneficiary's obligation. In *Re Clore's Settlement Trusts* [1966] 2 All ER 272 (Ch), the court rejected a submission that a payment to a person other than the beneficiary was for the benefit of the beneficiary only if there was a direct benefit to the beneficiary. Instead, the court held (at 274) that there was a benefit to the beneficiary if the payment resulted in "the discharge … of certain moral, or social, obligations on the part of the beneficiary, for example towards dependants". Therefore, in some situations, a payment by a trustee to a dependant of a beneficiary that discharges an obligation of the beneficiary to the dependant may be treated as a payment to the beneficiary.

5.37 A payment of an amount of income does not require possession of the amount to be transferred to the beneficiary. The trustee can "pay" an amount to a beneficiary by giving the beneficiary an absolute indefeasible interest in the amount, even if the trustee retains possession of the amount. In this regard, the definition of "pay" and "vest absolutely in interest" overlap significantly.

5.38 In *CIR v Ward* [1970] NZLR 1, the Court of Appeal considered s 155 of the Land and Income Tax Act 1954. This provision was a forerunner of various trust taxation provisions in the ITA 2007, including s HC 6. It dealt with the taxation of trustee income that was also income derived by a beneficiary entitled in possession to the receipt of the income. The question in *Ward* was whether a resolution by a trustee that a certain amount of income be held for the credit of particular beneficiaries was a "payment or an application" of the income to or for the benefit of the beneficiaries in terms of s 155 of the Land and Income Tax Act 1954.

5.39 Under the trust deed the trustee held the trust property, including any income arising from it, on trust for the children of Mr and Mrs Ward. A child would become entitled to a share of the trust property provided that they reached the age of 21 years. The trust deed provided that if any such child dies before the trust property is distributed and the child leaves behind children of their own those children would take the interests that their parent would have taken. The trust deed also allowed the trustee to make a payment of the trust property to any of the children entitled under the trust notwithstanding that the children may not have reached the age of 21 years. The resolution in question was consistent with this later ability.

5.40 The court held that the resolution was an effective application of the income because it resulted in the income becoming the absolute property of the children. Having the absolute property meant that if one of the children had died, the income distributed to the child would have become part of the child's estate, even if they died before reaching the age of 21 years. That is, the children's interests in the income was no longer contingent on them reaching the age of 21 years.

5.41 *Ward* demonstrates that a resolution by a trustee that results in the income becoming the absolute property of a beneficiary is sufficient for the income to be "applied" to the beneficiary. It is not necessary for the resolution to be reflected in the books of the trust in the relevant time period, nor is it necessary for possession of the amount to be immediately transferred to the beneficiary. Also, it is not necessary that the income be separated from the trust fund (eg, be paid into a separate bank account).

5.42 The making of a loan to a beneficiary will not constitute a payment for the purposes of the beneficiary income definition. This is because the beneficiary has an obligation to repay the loan amount. This is the case even if the loan is repayable on demand. Although a loan itself will not give rise to "beneficiary income", consideration should be given to whether the financial arrangements rules apply to the loan.

5.43 The court in *Ward* focused on the word "applied" rather than "paid". However, in *CIR v Albany Food Warehouse* (2009) 24 NZTC 23,532 (HC) a decision similar to that in *Ward* was reached on the word "paid". In that case, the High Court held that a resolution by the directors of a company declaring a dividend was sufficient to result in a dividend being "paid" within the extended definition of "paid" (being essentially the same as the definition of "pay" that applies for the purposes of s HC 6).

5.44 The decision in *Albany Food Warehouse* on the meaning of "paid" suggests that the decision in *Ward*, which focused on the word "applied", is still good authority. This is despite the removal of the word "applied" from the phrase "paid or applied" in the definition of "beneficiary income".

5.45 Where a beneficiary has a discretionary interest in income, and not a vested or fixed interest, it is necessary for the trustee to pass a resolution that initiates the making of a payment of income to that beneficiary. In *Montgomerie v Commissioner of Inland Revenue* [1965] NZLR 951 the Supreme Court (now the High Court) found income was not applied where there was merely an entry in the trust account crediting amounts to beneficiaries and no resolution. The Court in *Ward* confirmed that it is the resolution which is the trigger for application of income not the book entries as these merely record earlier decisions of the trustees.

5.46 A record of a trustee resolution can be prepared after trustees have made a decision. However, such a record cannot be used as a means of backdating such a decision. See for example *Re Samarang Developments Limited (in liquidation); alt cit Walker v Campbell* (unreported HC, Christchurch, CIV 2003-409-2094, 30 September 2004, John Hansen J) where the court would not give effect to attempts to back date dividend resolutions and confirmed that any dividend would not arise until the actual date of the resolution.

The extended time period for payment in s HC 6(1B)

5.47 Income derived by a trustee during an income year will be taxed as beneficiary income if it is paid to the beneficiary within the extended time period described in s HC 6(1B) (if the trust deed permits).

5.48 The extended time period is the later of:

(a) 6 months following the end of the income year in which the trustee derived the income (s HC 6(1B)(a)); and

(b) the earlier of:

(i) the date on which the trustee files the return of income for the income year (s HC 6(1B)(b)(i)); and

(ii) the date by which the trustee is required to file a return of income for the income year under s 37 of the TAA (s HC 6(1B)(b)(ii)).

5.49 The date by which the trustee is required to file a return may vary. Most trustees with tax agents have a return filing extension until 31 March in the following year. Trustees who do not have tax agents may also apply for an extension of time. For trustees without an extension, the extended time period will likely be 6 months following the end of the income year because the standard time for filing returns is shorter (just over 3 months).

5.50 This extended time period enables the trustee to calculate the income derived by the trustee for the relevant year before paying any income to a beneficiary. This is especially relevant for trustees who receive farming income or are trading trusts that may be unable to calculate the amount of income available for distribution to the beneficiaries until after the end of the income year.

5.51 Beneficiary income that is paid to a beneficiary within the extended time period is treated as being derived by the beneficiary in the same tax year as that corresponding to the trustee's income year. This may be a different income year than the income year in which the beneficiary is paid the amount.

5.52 It is the Commissioner's view that a beneficiary paid in the extended period must exist as a beneficiary in the income year preceding the extended period. The purpose of the extended period is to provide trustees with additional time to finalise the trust's financial statements for an income year before making payments of income to the beneficiaries.

Section GB 22—anti-avoidance

5.53 A specific anti-avoidance provision is included in s GB 22 to deal with situations where a trustee enters into an arrangement to defeat the intent and application of the rules relating to beneficiary income and taxable distributions. Section GB 22 applies where:

(a) an arrangement exists that involves a trustee transferring property or providing services or other benefits to a person other than a beneficiary of the trust;

(b) the arrangement has the effect of defeating the intent and application of ss HC 17 to HC 23 (which deal with the tax consequences arising from a receipt of beneficiary income or taxable distributions by a beneficiary); and

(c) the trust is not a Maori authority.

5.54 If s GB 22 applies, the beneficiary of the trust is treated as receiving the property or enjoying the services or benefits provided to the other person for the purposes of ss HC 17 to HC 23 and will be taxed accordingly.

5.55 Section GB 22 is intended to limit opportunities for distributions to be made tax-free to a person who is not a beneficiary of the trust where a beneficiary of the trust benefits from the distribution. In many cases, these types of transactions will be treated as beneficiary income or a distribution to the beneficiary anyway. This is because of the broad definition of "pay", which includes dealing with an amount in a person's interests or on their behalf. Therefore, s GB 22 effectively operates to buttress the "beneficiary income" and "distribution" definitions in situations where a transaction may not technically be a "transfer of value" or a "payment" to the beneficiary, but where the beneficiary still benefits from the transaction.

5.56 Section GB 22 is also relevant to taxable distributions (discussed from [8.62]).

Part 6 Minor beneficiary rule

Source of content for this part

6.1 The minor beneficiary rule was discussed when it was enacted in "Taxing Beneficiary Income of Minors at 33% – the 'Minor Beneficiary Rule'", *Tax Information Bulletin* Vol 13, No 5 (May 2001): 28. This part of this Interpretation Statement draws from that commentary and also includes additional analysis and clarification.

Purpose

6.2 The purpose of the minor beneficiary rule is to limit the tax benefits that could otherwise be achieved by distributing the income of a trust to a minor beneficiary. This tax benefit could arise because of the different tax rates that may apply to trustee income, minor beneficiaries and other beneficiaries. The trustee tax rate is 33%. A minor beneficiary is likely to be on the lowest marginal tax rate of 10.5%. Other natural person beneficiaries may be on marginal tax rates of up to 33%.

6.3 The rule addresses the concern that a family with a trust could gain a tax advantage over a family without a trust by using the income of a trust to meet the family expenses.

Beneficiary income of a minor is treated as excluded income of the minor

6.4 Where the minor beneficiary rule applies, beneficiary income derived by a minor is treated as excluded income of the minor under s CX 58. This means that no income tax liability will arise in the minor's name.

Treated as trustee income

6.5 Instead, the trustee will be liable to pay the tax at the trustee tax rate (33%). The trustee will also be liable to include the beneficiary income in their income tax return. This is achieved in s HC 35(2)(b) by treating the beneficiary income derived by a minor beneficiary as if it were trustee income for the purposes of:

(a) determining the tax rate that will apply (ie, the trustee tax rate of 33%);

(b) paying the tax; and

(c) providing returns of income.

6.6 This means the income must be included in the trustee's income for provisional tax purposes along with other trustee income. Also, use of money interest may apply on underpayments by a trustee. Penalties may also apply (eg, late payment penalties).

6.7 For the purposes of debiting and crediting a beneficiary's account with a trust, a trustee may treat income tax paid by the trustee as paid on behalf of the beneficiary. That the trustee has to return and pay the tax does not change the fact the tax is on the beneficiary income derived by the beneficiary.

> **Example 14. Tax treated as paid on behalf of beneficiary**
>
> A trustee distributes $2,000 to a minor beneficiary and pays tax of $660 on that distribution as if it were trustee income. The beneficiary would have a credit of $1,340 in their account with the trust. The beneficiary could not demand payment of the whole $2,000 on the basis that the liability to pay tax was on the trustee.

6.8 If a trustee of a foreign trust distributes foreign-sourced amounts to a minor (defined as, a New Zealand resident) as beneficiary income and the minor beneficiary rule applies, the beneficiary income will be treated as if it were trustee income only for the purposes of determining the tax rate, paying the tax, and providing returns. These purposes do not include characterising income as non-residents' foreign-sourced amounts under s BD 1 or exempt income under s CW 54. The income is still income (albeit excluded income) of a New Zealand resident minor and is taxable in New Zealand. Therefore, a trustee of a foreign trust will be liable to pay tax on the beneficiary income.

Imputation credits and foreign dividend payment credits

6.9 As noted above, an amount of beneficiary income to which the minor beneficiary rule applies is treated as if it was trustee income for the purposes of paying tax on that income. This means, in the case of dividend income distributed by a trustee to a beneficiary, the dividend will be included in the trustee's assessable income. The trustee will then be able to use any imputation credits that are attached to the dividend (ss LE 1 and LE 4).

6.10 The trustee is also treated as deriving the minor's beneficiary income as a beneficiary to the extent that s HC 7(2) applies (s LE 4). This is important for the calculation under s LE 5 of the imputation credits of beneficiaries of the trust.

6.11 Similar rules apply in relation to foreign dividend payment credits under ss LF 1 to LF 3.

Definition of "minor"

6.12 The minor beneficiary rule applies where a person who is a "minor" derives an amount of beneficiary income from a trust. A "minor" is defined in s HC 35(3) as a person who is:

- (a) a natural person; and
- (b) on the trust's balance date for the income year, is;
  - (i) a New Zealand resident; and
  - (ii) under the age of 16.

6.13 If the person does not possess all three of the above characteristics, the minor beneficiary rule will not apply.

Exclusions

6.14 There are three types of exclusion to the minor beneficiary rule:

- (a) a $1,000 *de minimis* exclusion in s HC 35(4)(a);
- (b) exclusions relating to income derived from particular sources (s HC 35(4)(b)(iii) to (v)); and
- (c) exclusions based on settlements on a trust (ss HC 36 and HC 37).

A $1,000 or less de minimis exclusion

6.15 A *de minimis* rule is provided in s HC 35(4)(a). This section provides that the minor beneficiary rule does not apply to an amount of beneficiary income derived by a minor from a trust in an income year if the total amount of beneficiary income derived by the minor from the trust in the income year is $1,000 or less. The minor's marginal tax rate will apply instead.

6.16 If the total is more than $1,000, no amount of beneficiary income is excluded under the *de minimis* rule. In other words, the rule does not provide an exclusion for the first $1,000 derived by the beneficiary.

6.17 This exclusion applies on a per trust basis. This means the exception may still apply to a distribution if the beneficiary derives beneficiary income from multiple trusts that in total exceed $1,000 in the income year. There is no express limit on the number of trusts that can make distributions of $1,000 or less to the same minor beneficiary and still benefit from the s HC 35(4)(a) exclusion. However, where the use of multiple trusts has the effect of producing a greater than $1,000 exemption for a minor beneficiary, the Commissioner might consider the application of the general anti-avoidance rule in s BG 1.

Income derived from particular sources

6.18 The minor beneficiary rule does not apply to an amount of beneficiary income derived from a Māori authority or directly derived from a group investment fund. The minor beneficiary rule also does not apply if the minor is in receipt of a child disability allowance under the Social Security Act 1964 (s HC 35(4)(b)).

6.19 The exclusion from the minor beneficiary rule for beneficiary income derived from a Māori authority is now redundant as the trust rules (and, therefore, the minor beneficiary rule) do not apply to distributions from Māori authorities (s HC 1(2)(c)). From 2003, a distribution from a trust that is a Māori authority is taxed at a special Māori authority tax rate (17.5%).

6.20 The minor beneficiary rule will not apply to beneficiary income directly derived by a minor from a group investment fund. This is targeted at group investment funds that are structured in the form of a trust. The income must be directly derived by the minor from the fund. If income from the group investment fund is first derived by another trust (which is not a group investment fund) and is then distributed to the minor, the minor beneficiary rule may apply.

6.21 The minor beneficiary rule will not apply to beneficiary income derived by a minor who is in receipt of a child disability allowance under the Social Security Act 1964. This means any beneficiary income derived by such a minor will be taxed at the minor's marginal income tax rates. The exemption for a minor in receipt of such a child disability allowance is intended to exempt trusts set up for children with severe disabilities. The receipt of a child disability allowance is intended to provide an objective basis for determining whether a child has a severe disability.

Exclusions based on settlements on a trust

6.22 Sections HC 36 and HC 37 provide exclusions from the minor beneficiary rule based on the source and nature of settlements that have been made on the trust.

6.23 These exclusions are discussed in more detail below. However, two points are worth noting first:

(a) A trustee may treat multiple settlements made on the same terms as one trust.

(b) The meaning of "settlement" is narrowed for the purposes of these exclusions.

Trustee may treat multiple settlements made on the same terms as one trust

6.24 Sections HC 36(1) and HC 37(1) impose requirements that must be met in relation to "all settlements on the trust".

6.25 The reference to "all settlements on the trust" may at first appear inconsistent with trust law. This is because under trust law, each settlement may create a separate trust, even if each settlement is made on the same trustee and on the same terms.

6.26 However, under s HC 3 a trustee may treat multiple settlements made on the same terms as one trust.

6.27 Section HC 3 is consistent with the common practice in trust administration of treating multiple settlements on the same terms as one trust.

6.28 The imposition of requirements in relation to "all settlements on the trust" in ss HC 36 and HC 37 takes into account the possibility that the trustee of the trust may have treated multiple settlements made on the same terms as one trust, as allowed under s HC 3. Interpreted in this way, the reference to "all settlements on the trust" is not inconsistent with trust law.

Meaning of "settlement" is narrowed

6.29 The meaning of "settlement" for the purposes of the exclusions from the minor beneficiary rule in ss HC 36 and HC 37 is narrower than the general meaning under the ITA 2007. The effect of this narrower meaning is to make it easier to meet the requirements of ss HC 36(1) and HC 37(1), which must be satisfied for "all settlements on the trust".

6.30 The modification is actually made to the term "settlor" ("settlement" is defined in relation to the term "settlor"). "Settlor" is defined in s YA 1. Section YA 1 refers to s HC 27 for the general definition, which defines "settlor" as a person who, among other things, transfers value to, for the benefit of, or on the terms of a trust. This general definition of "settlor" is modified (in s YA 1) for the purposes of the exclusions to the minor beneficiary rule in ss HC 36 and HC 37. The definition is modified by providing that there will be no transfer of value and, therefore, no settlement, if the transfer of value in s HC 27(2) is:

(a) The provision of financial assistance by way of a loan for less than market value, and either of the following is true:

(i) The loan ceased to exist before 1 April 2002; or

(ii) If the loan existed on or after 1 April 2002, in each tax year of the trust's existence, interest has been paid at a rate that is equal to or greater than the interest rate prescribed under the Income Tax (Fringe Benefit Tax, Interest on Loans) Regulations 1995 on 31 March of the previous tax year. (Although this interest rate is generally regarded as high, it may be lower than the market interest rate that would apply to certain high risk loans.)

(b) The provision of financial assistance by way of guarantee and the guarantee has not been called on.

(c) The provision of security and the security has not been called on.

(d) The provision of services that are incidental to the operation of the trust (eg, bookkeeping services, accounting services, or services as a trustee).

6.31 These excluded settlements are, therefore, ignored when determining whether "all the settlements on the trust" meet the requirements of ss HC 36(1) and HC 37(1). See Example 18.

Settlements made by a relative, a guardian, or their associate (s HC 36)

6.32 Generally, the minor beneficiary rule is intended to apply only to trusts on which a settlement has been made by a relative or guardian of the minor or by a person associated with a relative or guardian of the minor (referred to below as a "relative, guardian, or their associate"). If no such settlements have been made, then the minor beneficiary rule will not apply. This means the rule applies only in those situations where families can potentially gain a tax advantage from using a trust.

6.33 Therefore, an exclusion from the minor beneficiary rule is provided if no settlements have been made on the trust by a person who is a relative, guardian, or their associate (s HC 36(1)(a)).

6.34 For these purposes, a "relative" means a person connected with another person by being:

(a) within the second degree of blood relationship with the other (eg, a grandfather and granddaughter or a sister and brother);

(b) in a marriage, civil union or de facto relationship with the other;

(c) in a marriage, civil union or de facto relationship with a person who is within the second degree of blood relationship with the other (ie, a person can be related to their de facto partner's grandfather under this test);

(d) adopted as a child of the other or as a child of a person who is within the first degree of relationship to the other (eg, a person will be associated with a child who is adopted by their daughter – essentially, a grandparent through adoption);

(e) in a marriage, civil union or de facto relationship with a person who is connected with another person through adoption as described in (d) (ie, a person will be related with a child who is adopted by their civil union partner's daughter – essentially, a grandparent through civil union and adoption); or

(f) the trustee of a trust under which a relative has benefited or is eligible to benefit.

6.35 "Guardian" has the meaning set out in s 15 of the Care of Children Act 2004, but does not include certain "guardians" appointed under various statutes (ie, the chief executive of the Ministry of Social Development, a court or an agent of a court, or the Public Trustee). Essentially, a guardian of a child is a person who has all the duties, powers, rights and responsibilities that a parent of the child has in relation to the upbringing of the child.

6.36 Further, for the purposes of s HC 36, an associated person does not include a person associated under only ss YB 4 or YB 5. These provisions relate to relatives who are treated as associated persons.

6.37 Some types of settlement can be made by the relative, guardian, or their associate that will not disqualify the trust from the exclusion. The exclusion from the minor beneficiary rule will still apply in the following situations (s HC 36(1)(b)):

(a) The relative, guardian, or their associate is acting as an agent of the minor and has received the property from a person other than a relative, guardian, or their associate. This exception would apply, for example, if accident compensation were paid on behalf of a disabled child to the child's parent, who settles the money on a trust.

(b) The settlement is of an amount of damages or compensation that a court order required the relative, guardian, or their associate to pay to the minor.

(c) The minor is a protected person (as defined in s 2 of the Domestic Violence Act 1995), in relation to a protection order, and the settlement is made before the protection order is made or during the time the protection order is in force. A settlement made after the protection order is removed will not qualify. Settlements made before the protection order is removed will continue to satisfy the requirements of the exclusion after the protection order is removed. A settlement that is made jointly by two persons (eg, both parents) will satisfy the requirements of the exclusion even if the protection order is in force against only one of the settlors.

6.38 Further, if a settlement does not meet the requirements of s HC 36(1)(a) or (b), the exclusion from the minor beneficiary rule may still apply if the mixed trust rule in s HC 36(3) applies. This is discussed at [6.44].

Settlement made on the death of a settlor (s HC 37)

6.39 Section HC 37 deals with settlements made under a will, a codicil (an amendment to a will), an intestacy or a court variation. The purpose of this is to exclude beneficiary income derived by a minor from a trust where the trust was settled on the settlor's death to provide for the minor. For this exclusion to apply, the minor must be alive within 12 months after the settlor's death. The exclusion will also apply to beneficiary income derived by a minor who has a sibling who was alive within 12 months after the settlor's death.

6.40 This exclusion allows for children who were alive at the time of the settlor's death and any children whose birth may have been contemplated on the settlor's death. The exclusion was extended to beneficiary income derived by other siblings because it was considered unfair if two siblings in a family received different treatment merely because of when they were born.

Example 15. Extension to siblings

Richard Stark dies on 1 January 2000. In his will, he directs that the Winterfell farm be settled on the Grey Wolf Trust. Richard's grandson, Rob, is born in the same year, on 5 December 2000. Rob's brother, Brandon Stark, is born 5 years later. In 2017, the current trustee makes a distribution of beneficiary income to Brandon, who is now 12 years old. The only settlement that has ever been made on the trust is the transfer by Richard Stark of the Winterfell farm under the will.

The minor beneficiary rule will not apply to the beneficiary income derived by Brandon in 2017. This is because all settlements (there was only one) were made under a will and Brandon has a brother (Rob) who was alive within 12 months after the settlor's death.

6.41 If there is a settlement that does not meet the requirements of s HC 37(1), the exclusion from the minor beneficiary rule can still apply if the mixed trust rule in s HC 36(3) applies.

The relationship between ss HC 36 and HC 37

6.42 Sections HC 36 and HC 37, as currently drafted, both require that all settlements on the trust meet their respective requirements. However, the Commissioner accepts that this is an unintended legislative change arising in the rewrite of the provision. The corresponding provision in the ITA 2004 (s HH 3C(1)) shows that it was intended that a trust could be excluded from the minor beneficiary rules if some of the settlements were excluded under s HC 36 and the other settlements were excluded under s HC 37.

6.43 *A Taxation Amendment Bill (expected to be introduced in the near future) is intended to address this.*

Mixed trust rule (s HC 36(3) and (4))

6.44 Generally, the mixed trust rule allows the exclusions from the minor beneficiary rule in ss HC 36 and HC 37 to still apply if some settlements do not meet the requirements of those sections, but at least one does (and the settlements are treated by the trustee as being one trust). For this rule to apply, the settlements that do not meet the requirements must be of a relatively small value.

6.45 If there is more than one settlement on a trust and one or more, but not all, of the settlements fail to meet the requirements of ss HC 36(1) or HC 37(1), the exclusions from the minor beneficiary rule under those provisions may still apply. They may still apply if all of the settlements that failed to meet the requirements of s HC 36(1) or s HC 37(1) meet the requirements of s HC 36(3) and (4). Section HC 36(3) and (4) require:

(a) The settlements were made through either:

 (i) the disposal of property for less than market value, where the total value of settlements made in this way (in the current and in previous income years) is $5,000 or less at the end of the trust's income year (value of each settlement is to be determined as at the date of settlement) (s HC 36(3)(a)); or

 (ii) providing financial assistance for less than market value in the form of a loan if the total amount loaned is not greater than $1,000 on any day in the trust's income year (s HC 36(3)(b)).

(b) No services are provided to the trust by a relative, guardian, or their associate. This requirement applies whether or not the trust pays for the services. For the purposes of this requirement, services do not include services that are incidental to the operation of the trust, for example, bookkeeping, accounting, or trustee services (s HC 36(4)). The purpose of this is to exclude trading trusts from the mixed trust rule. Trading trusts are intended to be subject to the minor beneficiary rule if any settlement on the trust fails to satisfy the requirements of ss HC 36(1) or HC 37(1).

Example 16. Mixed trust rule requires at least one qualifying settlement

A minor derives beneficiary income of $1,500 from a trust in an income year. There have been two settlements on the trust:

(a) a settlement of $5,000 by a parent of the minor; and

(b) the parent loans the trust $800 interest free in the income year.

Neither settlement would meet the requirements of ss HC 36(1) or HC 37(1). The mixed trust rule requires at least one settlement that meets the requirement of those provisions. Therefore, the minor beneficiary rule will apply.

However, if there had been a third settlement that did satisfy the requirements of ss HC 36(1) or HC 37(1), then the two settlements above would not prevent the exclusion from applying. The mixed trust rule would apply. The first settlement above would meet the requirement of s HC 36(3)(a) as it is a disposal for less than market value of property (money) and the total value of settlements on the trust of this nature is not more than $5,000. The second settlement would meet the requirements of s HC 36(3)(b) because the loan was not more than $1,000 on any day in the income year.

Example 17. Settlor provides services to trust

A minor derives beneficiary income of $1,500 from a trust in an income year. There have been two settlements on the trust:

(a) An initial settlement of $100 by a parent of the minor (being a disposal of property for less than market value under s HC 36(3)(a)).

(b) A second settlement was made by the grandmother of the minor. This settlement was made under the terms of the grandmother's will. The child was alive when the grandmother died.

The parent is also a full-time employee of the trust and is paid a market salary. Because the parent is paid market value, the provision of employee services by the parent is not a settlement on the trust.

The first settlement fails the requirements of s HC 36(1) because it is a settlement by a relative. The second settlement meets the requirements of s HC 37. Therefore, this is a mixed trust situation. The minor beneficiary rule will apply unless the mixed trust rule applies. The settlement by the parent will satisfy s HC 36(3)(a) because the total value of settlements made by disposal for less than market value of property is no more than $5,000. However, the mixed trust rule will not apply because the parent provides services to the trust that are not incidental to the operation of the trust. It does not matter that the parent is paid a market value salary. Therefore, the minor beneficiary rule will apply to the beneficiary income derived by the minor.

Example 18. Some settlements can be disregarded

A minor derives beneficiary income of $1,500 from a trust in an income year. There have been three settlements on the trust:

(a) On 4 May 2000, a parent of the minor provided a $2,000 interest-free loan to the trust. The trust repaid this loan on 31 March 2002.

(b) The parent made a further $1,000 interest-free loan to the trust, which is still outstanding.

(c) A third settlement was made by the grandmother of the minor. This settlement was made under the terms of the grandmother's will. The child was alive when the grandmother died.

The first settlement does not come within the definition of "settlement" for the purposes of ss HC 36 and HC 37. The settlement is the provision of financial assistance by way of loan for less than market value and the loan ceased to exist before 1 April 2002 (para (b)(i) of the definition of "settlor" in s YA 1). Therefore, this settlement can be disregarded.

The second settlement does not meet the requirements of s HC 36(1) because it is a settlement by a relative. The third settlement meets the requirements of s HC 37(1). Overall, one settlement meets the requirements of ss HC 36(1) or HC 37(1) and one does not. Therefore, this is a mixed trust. Because the interest-free loan is for no more than $1,000 the mixed trust rule will apply and the minor beneficiary rule will not apply to the beneficiary income derived by the minor.

Part 7 Trustee income

Definition of "trustee income"

7.1 "Trustee income" is defined in s HC 7 as an amount of income derived by the trustee of a trust, to the extent to which it is not "beneficiary income". New Zealand-sourced amounts that are trustee income are always taxed in New Zealand. Foreign-sourced amounts that are trustee income are generally taxed based on the residence of the settlors of the trust, rather than the residence of the trustees.

Income

7.2 Income derived by the trustees of a trust is determined according to the general rules contained in part C (s BD 1). As discussed above, "trustee income" is the portion of the total income derived by the trustees that is not "beneficiary income" (s HC 7).

7.3 New Zealand sourced income derived by a trustee of a trust is generally assessable income (where it is not exempt or excluded income) regardless of the residence of the trustee or settlor (s BD 1). Sections YD 4 (Classes of income treated as having a New Zealand source) and YZ 1 (Source rules for interest) apply to determine whether income has a New Zealand source.

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7.4 However, the trust rules contain specific provisions dealing with the tax treatment of foreign-sourced amounts derived by trustees. The general rule is that foreign sourced amounts will be assessable as trustee income when the settlor is resident in New Zealand. Section HC 25 deals with situations where the trustee is not resident in New Zealand. Section HC 26 deals with situations where the trustee is resident in New Zealand.

7.5 Section HC 7(3) extends "trustee income" to include the market value of any property settlement a trust receives that is excluded from "corpus" under s HC 4(3) to (5). Section CV 13(b) includes such amounts in the income of the trustee. As noted above, an amount included under s HC 7(3) is income that cannot be treated as "beneficiary income".

7.6 The original provision corresponding with s HC 7(3), s 226(9A) of the ITA 1976, was introduced in 1991 and, therefore, is not discussed in the 1989 Explanation. The purpose of ss HC 7(3) and CV 13(b) is to ensure that settlements subject to the provision are taxed to the recipient trustee (ie, at the trustee tax rate) in the income year that the property is settled. In the absence of s HC 7(3), the settlement could be beneficiary income if distributed to a beneficiary in the income year of settlement or within the extended time period specified in s HC 6(1B).

Foreign-sourced amounts – non-resident trustees

7.7 Where the trustees of the trust are non-resident, foreign-sourced amounts are assessable as trustee income (subject to the exceptions discussed at [7.10]) if, at any time in the income year (s HC 25(2)):

(a) a settlor of the trust is a New Zealand resident who is not a transitional resident; or

(b) the trust is a superannuation fund; or

(c) the trust is a testamentary trust or an *inter vivos* trust, of which any trustee is resident in New Zealand and a settlor died resident in New Zealand (whether or not they died in the income year).

7.8 Section HC 25(2) applies so that foreign-sourced amounts are assessable if any one of the settlors of the trust (if there is more than one settlor) is resident in New Zealand at any time during an income year. An entire year of residency is not required.

7.9 Where there is a testamentary trust or an *inter vivos* trust, and a settlor died resident in New Zealand, foreign-sourced amounts derived by non-resident trustees are assessable income in New Zealand only for income years where any trustee of the trust is resident in New Zealand (s HC 25(2)(c)). For example, if a New Zealand resident settlor of a trust that had non-resident trustees died in New Zealand in 2016, and any one of those trustees became resident in New Zealand for any part of the 2018 income year, any foreign-sourced amounts derived during the 2018 income year would be assessable income in New Zealand.

7.10 Even if a settlor of a trust is a New Zealand resident who is not a transitional resident, foreign-sourced amounts derived by a non-resident trustee are not assessable as trustee income if the trustee is resident outside New Zealand at all times in the income year, and:

(a) no settlement has been made on the trust since 17 December 1987 and an election has not been made by the trustee under s HZ 2 for the trust to pay tax on all income so that it will be treated as a complying trust (s HC 25(3)); or

(b) if a settlement were made on the trust after 17 December 1987, it was made by a settlor who was not resident in New Zealand at the date of the settlement and at any time between 17 December 1987 and the date of the settlement (s HC 25(4)).

7.11 Although s HC 25(3) and (4) means certain non-resident trustees are not required to pay tax on foreign-sourced amounts, the application of those provisions does not affect the settlor's income tax liability under the trust rules (s HC 25(5)). Therefore, a New Zealand resident settlor may still be liable as agent of the non-resident trustee for income tax payable by the trustee under s HC 29, subject to the exceptions in s HC 29(5) (discussed below from [13.81]), or under other provisions in the trust rules, such as s HC 33.

7.12 Section HC 25(3) and (4) also has no effect when determining whether a trust has met the requirements to be a complying trust under s HC 10(1)(a)(ii) (s HC 25(5)). To maintain complying trust status, it is still necessary for the trustee to pay tax on the trustee's world-wide income. A trustee, settlor or beneficiary of a trust can elect, under s HC 33, to satisfy the income tax liability on the world-wide income of a trust in order to satisfy the requirements to maintain complying trust status (this is discussed further in Part 10 of this Interpretation Statement).

7.13 Where the trustees of the trust are non-resident and foreign-sourced amounts are assessable as trustee income under s HC 25(2), s HC 25(6) confirms that, for the purposes of calculating the taxable income of the trustee, the non-resident trustee will be treated as resident in New Zealand for the purposes of:

(a) ss EW 9 and EW 11 (which state the situations where the financial arrangements rules will or will not apply);

(b) s LJ 2 (which states when a person can claim a tax credit for foreign income tax paid);

(c) s OE 1 (which states when a person can choose to be a branch equivalent tax account (BETA) person); and

(d) the international tax rules (which are defined in s YA 1 as including the rules relating to controlled foreign companies, foreign investment funds and foreign tax credits).

7.14 New Zealand does not determine the tax residency of a trust based on the tax residence of its trustees as some countries do. Under s HC 2, joint trustees are treated as a notional single person with each being jointly and severally liable for the tax obligations of trustees to calculate and return income. As a result of this approach, if one trustee is based in New Zealand with others offshore, the resident trustee will still be responsible for return obligations. Where all the trustees are not New Zealand resident a tax agent in New Zealand would usually attend to the obligations for a complying trust.

Foreign-sourced amounts – resident trustees

7.15 Foreign-sourced amounts derived by trustees resident in New Zealand are exempt income under ss HC 26 and CW 54, if:

(a) at all times in the income year no settlor of the trust is a New Zealand resident who is not a transitional resident; and

(b) the trust is not a superannuation fund, a testamentary trust or an *inter vivos* trust where the settlor died resident in New Zealand (whether or not they died in the income year); and

(c) where the trust is a foreign trust:

(i) the trust has a trust deed; and

(ii) the trust is a registered foreign trust under s 59B of the TAA at the beginning of the income year, and when the foreign-sourced amounts are derived; and

(iii) the New Zealand resident trustee complies with the foreign trust disclosure requirements in ss 22, 59B, 59C and 59D of the TAA (discussed in Part 13 of this Interpretation Statement) during the income year.

7.16 For foreign trusts that are not registered foreign trusts at the beginning of an income year, transitional rules apply. The New Zealand resident trustee will qualify for the exemption in ss HC 26 and CW 54 for all foreign-sourced amounts derived if:

- the New Zealand resident trustee applies to have the trust registered within the application period described in s 59C of the TAA (generally 30 days from the date the trust first had a resident foreign trustee); and
- the trust is not de-registered before the foreign-sourced amount is derived.

7.17 If the New Zealand resident trustee does not apply to have the trust registered within the application period described in s 59C of the TAA, the trust will not qualify for the exemption under ss HC 26 and CW 54 until the first full income year after the trust is formally registered.

Deductions

7.18 Section DV 9(2) applies for the purposes of calculating the trustees' deductions from trustee income (s HC 24(4)).

7.19 Section DV 9(2) states that, for the purposes of determining the deductions that the trustees are allowed in an income year, beneficiary income in the income year is treated as trustee income. This provision supplements the general permission in s DA 1, but the general limitations in s DA 2 still apply. By treating the beneficiary income as trustee income, s DV 9(2) makes it possible for a trustee to establish the required nexus for expenditure incurred in deriving this income.

7.20 Under s DV 9(1), a person who derives beneficiary income is denied a deduction for expenditure or loss that a trustee incurs in deriving the income. Instead, any deductions relating to this income are deducted from trustee income.

Losses

7.21 Where a trustee's annual total deductions are more than their annual gross income in an income year, the difference is their net loss for the income year (s BC 4(3)). This net loss can be carried forward to be subtracted from the net trustee income (being the portion of the total income that has not been distributed as beneficiary income, less the annual total deductions) for a future year in accordance with the provisions in part I (s BC 4(4)). A trustee cannot distribute net losses to beneficiaries.

Example 19. Calculation of trustee income

The trustees of the Dublin Trust derive $5,000 of rental income, $500 of dividend income and $200 of interest income in the 2017 tax year (total income $5,700). The trust deed requires that $1,000 must be distributed to each of the four beneficiaries of the trust as beneficiary income each year. In the current year, this leaves the trustees with trustee income of $1,700.

The trustees incur expenditure in the 2017 tax year of $800 in rates and $1,000 of interest (total expenditure $1,800). All of the expenditure must be deducted from the trustee income, leaving a loss to carry forward for the Dublin Trust of $100.

Tax liability of trustee

7.22 The trustee of a trust is liable to satisfy the income tax liability on trustee income as if they were an individual beneficially entitled to it (s HC 24(1)). While this may indicate that the trustee must return trustee income in their individual return, a trustee is defined in s YA 1 as being the trustee "only in the capacity of trustee of the trust" and "includes all trustees, for the time being, of the trust". Therefore, the trustee, which is deemed to include all trustees of the trust at any given time, derives the trustee income in a separate capacity, so must return the taxable income separately. Trustee income is taxed at a flat rate of 33% (sch 1, part A, cl 3).

7.23 In calculating a trustee's tax liability, the trustee is not entitled to have a tax credit under subparts LC and LD (which relate to tax credits for natural persons and for certain gifts) (s HC 24(2)).

7.24 Under s HC 29, the settlor is liable as agent of the trustee for income tax payable by the trustee, with some exceptions. This is discussed further from [13.77].

7.25 Under s HC 35, beneficiary income derived by a minor is treated as if it were trustee income for the purposes of determining the tax rate (being the trustee tax rate of 33%), paying tax on the income, and providing returns of income. This is discussed further in Part 6 of this Interpretation Statement.

Part 8 Distributions from complying, foreign and non-complying trusts

Introduction

8.1 The income tax treatment of amounts that are beneficiary income is discussed in Part 5 of this Interpretation Statement. This part discusses the income tax treatment of distributions generally, including the different categories of trust for distribution purposes, taxable distributions, and the application of the ordering rules.

8.2 In determining the tax treatment of distributions made by trustees to beneficiaries, trusts are classified into three main categories:

(a) complying trusts;

(b) foreign trusts; and

(c) non-complying trusts.

8.3 A distribution from a complying trust of an amount that is not beneficiary income is exempt income of the beneficiary. However, this may not apply if the trust is a community trust (community trusts are discussed in Part 9 of this Interpretation Statement).

8.4 Certain distributions from foreign and non-complying trusts may be "taxable distributions" and taxed to the beneficiary. The definition of "taxable distribution" in relation to foreign and non-complying trusts is discussed in detail below. Other distributions are not taxable (eg, a distribution of the corpus of a trust).

8.5 This part discusses:

(a) the definition of "distribution" (from [8.6]);

(b) the three categories of trust (ie, complying, foreign and non-complying trusts, and also dual status trusts) (from [8.14]);

(c) taxable distributions (from [8.62]);

(d) the ordering rules (from [8.108]); and

(e) resettlements (from [8.158]).

Definition of "distribution"

8.6 It is noted that the definition of "distribution" was re-written with the introduction of the ITA 2007. As discussed at [2.20], the transfer of value concept was adopted to simplify the definitions of "settlor" and "distribution" and to harmonise concepts that have similar effect throughout the legislation. The change to the definition of distribution was not intended to change the meaning of "distribution".

8.7 A trustee makes a "distribution" when the trustee "transfers value" to a person because the person is a beneficiary of the trust (s HC 14).

8.8 "Transfers value" is defined in s YA 1. It is a net concept in the sense that it takes into account the market value of what is provided by, in this context, the trustee and the market value of what (if anything) is provided in return by the beneficiary. The definition is discussed in detail from [2.20] in the context of the definition of "settlor".

8.9 A "distribution" can include a settlement by the trustee of a trust on another trust (resettlement) for the benefit of a beneficiary of the first trust, but only if:

(a) the amount or the property being settled would have been beneficiary income or a taxable distribution for a beneficiary had it been distributed at the time to a beneficiary resident in New Zealand; or

(b) s EW 50 or s EZ 39 (which relate to forgiveness of debt) apply, and the property settled is an amount forgiven and treated as paid under ss EW 44(1) or (2) or EZ 39(1).

8.10 Resettlements are discussed further at [8.158] below.

8.11 A distribution is made to a person when what is transferred vests absolutely in interest in the person or is paid to the person (see [5.20] to [5.46] for further discussion on these concepts). A distribution may be made directly or indirectly, or by one transaction or a number of transactions, whether related, connected or otherwise.

8.12 Under s HC 14(5), in determining whether there is a transfer of value, the fact a person is, or will become, a beneficiary of a trust does not constitute the giving or receiving of value. This is intended to forestall an argument that might otherwise be made about whether a trustee transfers value to a beneficiary when the trustee vests or pays an amount to the beneficiary. The argument being that a beneficiary's existing claim on the trust property is of value and this is given up as consideration when a trustee vests or pays the property to the beneficiary; meaning that there is no transfer of value and, therefore, no distribution.

8.13 An example of a distribution occurring is when a trustee permits beneficiaries to reside in a property owned by a trust without paying market value rent. For a complying trust such a distribution will be exempt income under s HC 20 but for a foreign trust or a non-complying trust the distribution may be treated as a taxable distribution with the tax status determined by ss HC 18 and HC 19 respectively.

Categories of trust

8.14 As noted above, in determining the tax treatment of distributions made by trustees to beneficiaries, trusts are classified into three main categories: complying, foreign and non-complying trusts. There is also a type of trust that is referred to in this Interpretation Statement as a dual status trust. These categories are discussed below.

Complying trusts

8.15 Complying trusts are essentially trusts where tax has always been paid in New Zealand on the worldwide income derived by the trust, whether by obligation or election, and the tax obligations relating to the trustees' tax liability have been satisfied.

Significance

8.16 Distributions from complying trusts of amounts other than amounts of beneficiary income are exempt income of beneficiaries (s HC 20). This contrasts with foreign trusts and non-complying trusts where distributions of amounts other than beneficiary income may be taxable. The reason for this different treatment is that trustee income of complying trusts has already been liable to New Zealand income tax. In contrast, income derived by trustees of foreign trusts and non-complying trusts may not have been liable to New Zealand income tax. Consequently, income accumulated by such trustees is taxed when it is distributed to a resident beneficiary.

Requirements

8.17 A trust will be treated as a complying trust for a distribution if:

(a) over the life of the trust until the time of the distribution:

(i) the trustee income does not include any non-resident passive income, non-residents' foreign-sourced income, or exempt income under s CW 54 and s HC 26 (discussed further from [8.20]); and

(ii) the tax obligations relating to the trustee's income tax liability have been satisfied for every tax year (discussed further from [8.31]) (s HC 10(1)(a)); or

(b) a person makes an election under s HC 33, and for the life of the trust up to the time of distribution, the tax obligations relating to the trustee's income tax liability for the trustee income are satisfied for each tax year (discussed further from [8.28]) (s HC 10(1)(ab)); or

(c) the trust is a superannuation fund (for more details on superannuation funds see Part 9 of this Interpretation Statement) (s HC 10(1)(b)).

8.18 Most trusts established by resident settlors with trustees who are resident in New Zealand will satisfy the requirements of (a) above. For example, if a resident individual settles funds or income-producing property on the terms of a trust and resident trustees are appointed, the trust will most likely be a complying trust. This is because the trustee income will have been liable to tax from the date on which the settlement was first made. Consequently, for such trusts distributions of amounts that are not beneficiary income will be exempt income and, therefore, not assessable (s HC 20).

8.19 The requirements of (b) above allow trusts that have non-resident trustees and/or settlors to elect to be a complying trust. Rules exist that allow a foreign trust of an immigrating settlor to become a complying trust, and a complying trust with an emigrating settlor to retain its complying trust status. For more details, see Part 10 and Part 11 of this Interpretation Statement.

No non-resident passive income, non-residents' foreign-sourced income or exempt income under s CW 54

8.20 For a trust to be a complying trust under s HC 10(1)(a), it is a requirement that, over the life of the trust until the time of distribution, "trustee income" must not have included:

(a) non-resident passive income (defined in s RF 2); or

(b) non-residents' foreign-sourced income (defined in s BD 1(4)); or

(c) exempt income under ss CW 54 and HC 26, which is foreign-sourced income derived by a New Zealand resident trustee of a trust that:

(i) has no New Zealand resident settlors; and

(ii) is not a superannuation fund or a trust (whether testamentary or *inter vivos*) of which a settlor died tax resident in New Zealand; and

(iii) if it is a foreign trust, is a registered foreign trust and complies with the foreign trust disclosure rules (discussed in Part 13 of this Interpretation Statement).

8.21 In other words, the trustee's income must have always been liable to New Zealand income tax in the same manner as a New Zealand resident individual beneficially entitled to the income would have been.

8.22 This requirement applies to "trustee income". That is, income derived by the trustee that is not "beneficiary income". (For a discussion of "beneficiary income" and "trustee income", see Part 5 and Part 7 of this Interpretation Statement.) If a trustee of a complying trust derives income that is non-resident passive income, non-residents' foreign-sourced income, or exempt income under s CW 54, then to retain complying trust status under s HC 10(1)(a) the trustee must ensure the income is distributed as beneficiary income so that the amount does not become trustee income. Alternatively, a person may be able to make an election under s HC 33 (discussed from [8.28]).

8.23 Trustee income is a gross concept. This means that a trustee will have trustee income even if available deductions exceed the trustee's income for the income year or the trustee has losses available to offset their net income.

8.24 The fact that a trustee may have no trustee income (whether this is because the trustee derives no income or because all income is distributed as beneficiary income) in an income year will not prevent the trust from being a complying trust.

8.25 The fact that a trustee may have trustee income that is exempt income will not prevent the trust from being a complying trust.

8.26 The requirement applies over the life of the trust. Where relevant, this includes income years falling before the 1989 income year when the present trust regime began.

8.27 The New Zealand income tax liability of trustees is determined under subpart BC, and ss HC 7 and HC 24. For the treatment of trustee income before 1 April 1988, when the current regime was introduced, see the 1989 Explanation at [4.77].

Election under s HC 33

8.28 Where a trust does not satisfy the requirements of s HC 10(1)(a)(i) because it derives non-resident passive income, non-residents' foreign-sourced income or exempt income under s CW 54, a trustee, settlor or beneficiary of the trust may be able to make an election under s HC 33, so that the trust can be a complying trust under s HC 10(1)(ab).

8.29 Under s HC 33, a trustee, settlor or beneficiary of a trust can elect to satisfy the income tax liability of the trustee of the trust by notifying the Commissioner within the time allowed for filing a tax return for the relevant income year. Alternatively, a trustee will be treated as having made an election if the trust has previously been a complying trust, ceases to be a complying trust because they cease to satisfy the requirements of s HC 10(1)(a)(i), and the trustee continues to indicate that the trust is a complying trust in its tax returns.

8.30 If a person makes an election under s HC 33, the person must satisfy the income tax liability that the trustee would have as if the trust had a New Zealand resident as settlor and the trustee were a New Zealand resident at all times. The person is not required to satisfy the income tax liability of any beneficiaries, however, the trustee will still have a liability as agent for the beneficiaries under s HC 32 (discussed from [13.62]).

Tax obligations relating to the trustee's income tax liability must have been satisfied for every tax year

8.31 For a trust to be a complying trust, it is also a requirement that, over the life of the trust until the time of distribution, the tax obligations relating to the trustee's income tax liability have been satisfied for every tax year.

8.32 This requires the satisfaction of the trustee's obligations, but not necessarily the actual payment of all income tax for which the trustee is liable. This ensures that a trust may still be a complying trust where the trustees have entered into deferred payment arrangements with the Commissioner.

8.33 If all of the trustee income has been liable to New Zealand income tax but the trustee's obligations have not been satisfied it is possible to convert the trust into a complying trust by satisfying the trustee's obligations retrospectively (taking into account the application of the time bar in s 108 of the TAA, if applicable). For example, if the trustees had failed to declare income from a particular source for several years, the trust would still be a complying trust if the Commissioner accepted a request by the trustees under s 113 of the TAA to have the earlier assessments amended, and the trustees satisfied their resulting obligations (see "Qualifying Trust Status", *Tax Information Bulletin* Vol 16, No 1 (February 2004): 85).

8.34 Section HC 32 requires that, in their capacity as agent, the trustee must satisfy the income tax liability of the beneficiary for their beneficiary income and taxable distributions derived. If the tax paid by the trustee fell short of the amount actually payable by the beneficiary, the beneficiary must file a return and pay the shortfall. If the beneficiary did not pay the shortfall, the trustee would be liable for this jointly and severally. A trust would retain its complying trust status in these circumstances under s HC 10 regardless of whether the shortfall was paid. This is because the tax obligation of the trustee as agent for the beneficiary's income tax liability is not an obligation relating to the trustee's income tax liability.

8.35 As noted above, to be a complying trust, a trust must satisfy the requirements of s HC 10 "for the life of the trust" until the time of distribution. This includes income years before the present trust rules were introduced.

8.36 Nevertheless, trusts with non-resident trustees that were settled before the trust rules were introduced that had foreign-sourced income or non-resident passive income sourced in New Zealand in the 1988 and earlier income years, were able to become complying trusts. This required an election under s 228(7) of the ITA 1976 to be liable for income tax on trustee income for the 1989 and subsequent income years. The election had to be made on or before 31 May 1989 by a settlor, trustee, or beneficiary of the trust.

8.37 A trust for which an election was made in accordance with s 228(7) is effectively treated as satisfying the requirements of s HC 10(1)(a)(i) and (ii) for the income years prior to the introduction of the trust rules (s HZ 2).

8.38 In addition, a trust where the settlor has migrated to New Zealand can elect to become a complying trust under s HC 30 (discussed further from [10.8]).

Foreign trusts

8.39 Foreign trusts are trusts that have not had a New Zealand resident settlor at any time since 17 December 1987.

Significance

8.40 A distribution of accumulated income (ie, income that is not beneficiary income) by a trustee of a foreign trust to a beneficiary is a taxable distribution and is included in the beneficiary's income. However, distributions of capital gains (unless made with parties associated with the trustee) and corpus are not. The terms "capital gain" and "corpus" are discussed in more detail below from [8.73] when discussing the term "taxable distribution". Current year income distributed to a beneficiary is taxed as beneficiary income.

Requirements

8.41 A trust is a foreign trust under s HC 11 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 at the moment in time at which it is necessary to determine if the trust is a foreign trust.

8.42 Prior to 21 February 2017 a foreign trust only existed when a distribution was made, but the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 amended s HC 11 to clarify that the definition of foreign trust applies to all trusts with only foreign settlors at a point in time regardless of whether a distribution has been made.

8.43 A trust settled by a New Zealand resident before 17 December 1987 may be a foreign trust, but only if the settlor (and any other settlors) were not resident in New Zealand at any time from 17 December 1987.

8.44 A trust may be a foreign trust if a settlor was resident in New Zealand after the later of 17 December 1987 or the date of first settlement of the trust, but the settlor was not a settlor of the trust while resident in New Zealand.

Example 20. Not a settlor while resident

Maria, a non-resident, settles a trust on 1 June 2014 with a resident trustee while Joseph is resident in New Zealand. Joseph, after ceasing to be resident in New Zealand and moving offshore, settles property on the same trust on 1 October 2015. In this example, the trust will be a foreign trust because Joseph was not a settlor of the trust while Joseph was resident in New Zealand.

8.45 Where a non-resident settlor of a trust becomes a transitional resident, the trust will remain a foreign trust under s HC 30 for distributions made of income derived prior to the earlier of the date an election is made to convert that trust into a complying trust and the expiry of that option. That is, one year after the settlor ceases to be a transitional resident. This is despite the transitional resident being tax resident in New Zealand throughout that period.

8.46 Where a trust was first settled before 17 December 1987 and the settlor died resident in New Zealand before 17 December 1987 the trust will technically be a foreign trust, but for so long as it satisfies the definition of complying trust it will be treated as one.

Dual status trusts

8.47 For the purposes of this Interpretation Statement, dual status trusts are trusts that satisfy the requirements to be a complying trust from inception and have only a non-resident settlor(s) so that they are also foreign trusts. Typically such trusts hold New Zealand property, have at least one New Zealand trustee, and only derive New Zealand-sourced trustee income.

Significance

8.48 A dual status trust is effectively treated like a complying trust in relation to the income tax treatment of distributions. A distribution of other than beneficiary income from a dual status trust is not assessable income.

8.49 A taxable distribution from a foreign trust that has a dual status is not assessable income under s BD 1(5) because its character as exempt income from a complying trust is retained despite it also having a status as income from a foreign trust.

8.50 Where a dual status trust makes a distribution sourced from capital gains or corpus these are excluded from being taxable distributions from a foreign trust under s HC 15(4) and are not income for a beneficiary of a foreign trust. The same distribution is exempt income for a beneficiary of a complying trust. As a consequence, a beneficiary of a dual status trust need not include such a distribution in their assessable income.

Requirements

8.51 A complying trust may also have a dual status as a foreign trust where it has only a non-resident settlor(s). All trustee income of a dual status trust is taxable at 33% and the tax obligations relating to the trustees' income tax liability must have been satisfied since the trust's inception.

Non-complying trusts

8.52 Non-complying trusts are trusts that are neither complying nor foreign trusts.

Significance

8.53 Distributions from a trustee of a non-complying trust to a beneficiary of accumulated income (amounts other than beneficiary income) and capital gains, but not corpus, are taxable distributions. The terms "capital gain" and "corpus" are discussed in more detail below from [8.73] when discussing the term "taxable distribution". These taxable distributions are taxable to the beneficiary. As with other categories of trust, current year income derived by the trustee that is beneficiary income is also included in the beneficiary's income and is taxed at the beneficiary's marginal rates (unless the minor beneficiary rule applies, in which case it is treated as if it was trustee income and taxed at the 33% trustee rate). Taxable distributions from non-complying trusts are taxed at a rate of 45% (ss HC 19, HC 34 and BF 1(b)). This penal rate, and the inclusion of capital gains in taxable distributions for non-complying trusts, reflects that New Zealand income tax may have been deferred through the use of this type of trust.

Requirements

8.54 Non-complying trusts are all trusts other than complying trusts and foreign trusts.

8.55 Non-complying trusts are those where there has been a settlor (or settlors) resident in New Zealand since the later of 17 December 1987 or the date of first settlement of the trust and:

(a) any of the trustee income from the income year in which the trust was first settled up to the income year in which the relevant distribution is made has included non-resident passive income or non-resident's foreign-sourced income or exempt income under s CW 54, unless the trustee, settlor or beneficiary has made an election under s HC 33; and/or

(b) the tax obligations relating to the trustees' income tax liability have not been satisfied for every tax year.

8.56 A non-complying trust can also arise where no election is made before the election expiry date under s HC 30(5). This arises for the pre-migration trust of a settlor who has become a New Zealand resident that has been treated as if it was a foreign trust for a period (until the exercise or expiry of that option), in respect of distributions made of income derived prior to that time.

8.57 As noted above at [8.19], rules exist that allow a foreign trust to become a complying trust and a complying trust with an emigrating settlor to retain complying trust status. These rules require a trustee, beneficiary or settlor of the foreign trust to make an election. A foreign trust or a complying trust, as the case may be, will become a non-complying trust if an election is not made within the required timeframe. For more details, see Part 10 and Part 11 of this Interpretation Statement.

Streaming

8.58 General trust law, not tax law, determines the powers of a trustee to decide which beneficiaries of a discretionary trust are entitled to receive a distribution and the amount and source of such a distribution. Trustees may prefer some beneficiaries over others. Trustees have a fiduciary obligation to consider what is in the best interests of beneficiaries before exercising any discretion and the tax position of each beneficiary is a relevant consideration.

8.59 Once a distribution is made subpart HC, and where relevant part B (Core provisions), will mainly govern the tax consequences for the beneficiary. These tax consequences arise in the context of the core provisions from which income tax obligations and entitlements are determined, taking into account such things as tax rates, credits and deductions.

8.60 Distributions made by a discretionary complying trust are not subject to the same constraints under subpart HC as distributions from foreign and non-complying trusts. The ordering rules override a trustee's resolution when determining the components of distributions from foreign and non-complying trusts. Furthermore s HC 16(5) has specific income and capital gain anti-streaming rules for both foreign and non-complying trusts and s GB 22 is a specific anti avoidance provision that applies to beneficiary income where property or services are provided to a third party.

8.61 Refer to QB 15/11 "Income Tax–Scenarios on Tax Avoidance-2015" *Tax Information Bulletin* Vol 27, No 10 (November 2015): 27, "Scenario 3-Use of a Discretionary Trust" for an analysis considering if certain distributions of beneficiary income from a discretionary complying trust, would result in s BG 1 applying.

Taxable distributions

Introduction

8.62 Essentially, a "taxable distribution" is a distribution from a foreign or non-complying trust to a beneficiary that is included in the beneficiary's income. The taxable distribution concept is relevant to the taxation of amounts that are not "beneficiary income" under s HC 6.

8.63 The concept of a "taxable distribution" applies only in relation to foreign and non-complying trusts. It is not relevant to distributions from complying trusts. A distribution from a complying trust is taxable to a beneficiary only if it is a distribution of beneficiary income. All other distributions from a complying trust to a beneficiary are exempt (with the exception of distributions from community trusts).

Definition of "taxable distribution"

8.64 A "taxable distribution", for a foreign trust and a non-complying trust, is defined in s HC 15. The definition is wider for a non-complying trust. The wider definition for a non-complying trust reflects the risk that New Zealand income tax may have been avoided or deferred by having income accumulated in such a trust.

8.65 In relation to a foreign trust, a distribution is a taxable distribution to the extent to which it is not a distribution of:

(a) an amount that is beneficiary income;

(b) a part of the corpus of the trust;

(c) a profit from the realisation of a capital asset or another capital gain (other than a capital gain or other capital profit made with an associated person);

(d) a foreign superannuation withdrawal; or

(e) a payment or transaction that represents a distribution of either the corpus of the trust or a capital gain.

8.66 In relation to a non-complying trust, a distribution is a taxable distribution to the extent to which it is not a distribution of:

(a) an amount that is beneficiary income;

(b) a part of the corpus of the trust; or

(c) a payment or transaction that represents a distribution of the corpus of the trust.

8.67 A taxable distribution will generally be made up of accumulated income or capital gain amounts. As can be seen from the above discussion, distributions of amounts that are beneficiary income and corpus from non-complying and foreign trusts, and distributions of capital gains in the case of foreign trusts, are not taxable distributions.

8.68 A trustee of a foreign or non-complying trust has limited control over whether a distribution is of income, a capital gain, corpus or otherwise. The nature of the distribution can depend on several factors, including the timing of the distribution and the ordering rules discussed from [8.108]. Therefore, the definition of "taxable distribution" in s HC 15 must be interpreted together with the ordering rules in s HC 16.

8.69 A distribution may also be a taxable distribution to the extent to which:

(a) the distribution is made by a foreign or non-complying trust by disposing of property at less than market value or providing services at less than market value (s HC 15(6)); or

(b) inadequate records are kept by the trustee (see the discussion from [8.155]).

8.70 The reference to a disposal of property at less than market value implies that the provision is aimed at property other than money. A distribution made by disposing of property at less than market value will occur, for example, where a trust asset is sold or leased to a beneficiary at a discounted price.

8.71 A distribution will not be a taxable distribution if it is a distribution of income or a capital gain from a trust (other than a unit trust, a group investment fund, or a superannuation scheme) that was derived in the 1988 or earlier tax years (ss HZ 1 and HC 1(2)(d)).

8.72 The discussion above on "taxable distributions" refers to "capital gains" and "corpus". These concepts are discussed next.

Capital gains

8.73 In determining whether a distribution from a foreign trust is a taxable distribution, it is important to understand what is included in the concept of "capital gain" for the purpose of the definition of "taxable distribution".

8.74 Despite referring to a specific type of capital gain (a "profit" that the trustee derives in the income year from "the realisation of a capital asset" of the trust), the definition of taxable distribution takes into account all types of capital gain. This is clear from the words "or another capital gain" in s HC 15(4)(c) and the reference to capital gain in s HC 15(4)(d).

8.75 The determination of a capital gain for the purposes of the definition of "taxable distribution" is modified under s HC 15(5). Firstly, for these purposes, a capital gain does not include a gain that is required to be taken into account for the purpose of calculating a person's income. For example, s CB 6 provides that an amount that a person derives from disposing of land is income of the person if they acquired the land for a purpose of disposing of it. In the absence of s CB 6, such an amount might be regarded as a capital amount. However, it is included in the person's income under s CB 6, so cannot give rise to a capital gain for the purposes of the definition of "taxable distribution".

8.76 In addition, a capital gain for the purposes of the definition of taxable distribution does not include a gain that a trustee derives through a transaction (or series of transactions) between the trustee and a person associated with the trustee. For example, if a trustee sells a capital asset of the trust to a beneficiary and realises a capital gain on the sale, this capital gain will not be a "capital gain" for the purposes of the definition of "taxable distribution". This is because a trustee of a trust is associated with a beneficiary of the trust (s YB 6).

8.77 *A Taxation Amendment Bill (expected to be introduced in the near future) proposes an amendment to limit most of the associated party capital gains made by a trustee of a foreign trust, which would be included under the ordering rules as taxable distributions, to situations where a CFC is a settlor of that trust. Gains in excess of market value made by a trustee of a foreign trust in transactions with associated parties who are not natural persons or corporate trustees will also be treated as tainted capital gains included as taxable distributions under the ordering rules. Such tainted gains will then be treated as income under the ordering rules restoring their treatment prior to the rewrite. The amendment is expected to apply from Royal assent but with a savings provision for tax positions taken that are consistent with the changes.*

8.78 *The Taxation Amendment Bill also proposes an amendment to s FC 2 to confirm that the market value treatment under this provision does not apply for the purpose of determining whether a transfer of property is a distribution under s HC 14. This will clarify that once a distribution of property has been made to a beneficiary only then is it treated as made in a market value exchange between the trustee and the beneficiary recipient under ss FC 1 and FC 2.*

8.79 Another point to note about the determination of a "capital gain" for the purposes of the definition of "taxable distribution" is that the amount of the capital gain is reduced by any capital loss that the trustee incurs in the income year in which the capital gain was derived. Therefore, if in an income year a trustee makes a $100 capital gain on one transaction and a $100 capital loss on another transaction, there is no capital gain to take into account for the year.

8.80 Finally, the capital gains taken into account are those that have been "realised". A capital gain is realised when it has been converted into money or money's worth. A capital gain that has accrued, but that has not been converted into money or money's worth, will not be realised. As noted above, capital gains are reduced by capital losses "incurred" during the income year in which the distribution was made. In this context, a loss that has accrued, but has not been realised, will not be "incurred".

Corpus

8.81 In determining whether a distribution is a taxable distribution it is also important to understand the meaning of "corpus". A distribution will not be a taxable distribution to the extent that it is a distribution of corpus.

8.82 "Corpus" is defined in s HC 4. Subject to the exclusions discussed below, "corpus" means an amount that is equal to the market value of a settlement of property on the trust. Generally, the market value of something is the price that would be agreed between a willing but not anxious seller and a willing but not anxious buyer (see [2.27]). The market value is measured at the date of the settlement. Where the settlement is denominated in foreign currency, the market value will be the value in New Zealand dollars on the date of settlement. Therefore, a change in the value of property settled on a trust will not change the value of the corpus of the trust.

8.83 Corpus requires a "settlement of property". A "settlement of property" is not the same as a "transfer of value". Some "transfers of value" do not result in the trust receiving "property". One example is the provision of services. Although there is a transfer of value and, therefore, a settlement on the trust, there is not necessarily any property created by the provision of the services. Another example is the provision of an interest-free loan to a trust. Again, although there is a "transfer of value" and, therefore, a "settlement", there is arguably no "property" settled on the trust. Although the trust as borrower enjoys an economic benefit from being able to enjoy the use of the loan principal for the term of the loan, this is arguably not a form of property in itself. This differs from the position that was accepted in argument by the Commissioner in *Case Y25* (2008) 23 NZTC 13,270.

8.84 Whether a settlement will give rise to corpus has implications for the value of corpus held by a trust, which is relevant in determining whether a distribution from a foreign or non-complying trust will be a taxable distribution.

8.85 The three exclusions from the general definition above are discussed next.

Property settlement by another trust

8.86 Firstly, corpus does not include a property settlement by a trustee of another trust to the extent to which, if the property were distributed to a beneficiary of the other trust and the beneficiary were resident in New Zealand, the distribution would be beneficiary income or a taxable distribution to that beneficiary.

8.87 The purpose of this exclusion is to prevent the creation of corpus by resettling amounts of income or capital gains accumulated in one trust on the terms of another trust. Without this exclusion it would be possible to avoid tax on distributions of amounts accumulated in foreign and non-complying trusts simply by settling those amounts on other trusts and then distributing them from those other trusts as tax-free corpus.

8.88 The exclusion applies only to the extent that the property settled would have been income (beneficiary income or a taxable distribution) to a resident beneficiary if distributed to such a beneficiary at the time of settlement. Therefore, the exclusion will not apply if the distribution from the other trust was of an amount of corpus of the other trust or, if the other trust was a foreign trust, a capital gain. In determining whether this exclusion applies, the ordering rules (discussed below) apply to determine the character of the amount distributed (ie, whether it is a distribution of income, a capital gain, or corpus).

8.89 There does not have to be a resident beneficiary for the exclusion to apply. The reference to a resident beneficiary is to a hypothetical person.

Property settlement for which the settlor is allowed a deduction

8.90 Secondly, property settled on trust is not corpus when the settlor is allowed a deduction for the settlement for New Zealand tax purposes. This might arise, for example, where a person pays an above market price for goods or services acquired from a trust. The difference between the market value of the goods and the price paid will be a transfer of value and, therefore, a settlement.

8.91 The purpose of this exclusion is to ensure that where a deduction is claimed for property settled on a trust a further benefit cannot be obtained in the form of a tax-free distribution of corpus.

Property settlement that would otherwise have been income to the settlor

8.92 Thirdly, s HC 4(5) states that a property settlement is excluded from corpus if, but for the fact of the settlement, it would be income of the settlor (or would be income if the settlor were resident in New Zealand at the time of settlement).

8.93 This exclusion will have limited application. If an amount is income of a person, the settlement of that amount on a trust will not prevent that amount from being their income. A person cannot avoid assessment of income that they derive by assigning that income to another person (*Hadlee and Sydney Bridge Nominees Ltd v CIR* (1989) 11 NZTC 6,155 (HC)). The same would apply to a settlement of that income.

Property settlement excluded from corpus treated as "trustee income" and a "distribution"

8.94 As noted at [7.5], a property settlement a trust receives that is excluded from "corpus" under s HC 4(3) to (5) is treated as "trustee income" under s HC 7(3). And, as noted at [8.9], the settlement will also be a "distribution" as defined in s HC 14.

8.95 The exclusion from the definition of "corpus" in s HC 4(3) is discussed further from [8.158] below when discussing resettlements.

Taxation of taxable distributions

8.96 Taxable distributions from a non-complying trust have a special tax treatment outside the usual tax treatment where income is included in assessable income.

8.97 Section HC 19 provides that such a taxable distribution:

(a) is excluded income under s CX 59; and

(b) may be reduced by tax losses calculated under s HC 22; and

(c) will be taxed at the rate set out in s HC 34(1) under s BF 1(b) (presently at 45%).

8.98 If the distribution is a foreign-sourced amount which is derived by a non resident beneficiary then s BD 1(3) in the core provisions removes that non residents' foreign-sourced income (as defined in s BD 1(4)) from having the status as excluded income.

8.99 Section BD 1(5) then removes non-residents' foreign-sourced income from being treated as assessable income.

8.100 Only taxable distributions that are excluded income are taxed under s BF 1(b) at the rate of 45%. Section CA 2(3) confirms that excluded income under s CX 59 does not include non-resident's foreign-sourced income. Consequently only taxable distributions that remain as excluded income after consideration of source and residency are taxable under s BF 1(b) at the current rate of 45%.

8.101 The end result is that all taxable distributions from non-complying trusts are taxed at 45% to New Zealand resident beneficiaries but only New Zealand sourced taxable distributions from non-complying trusts are taxed at 45% to non-resident beneficiaries.

8.102 If a CFC derives a taxable distribution from a non-complying trust then under s EX 19 the income is excluded from the CFC's income and is attributed instead to those persons with an income interest in the CFC at the 45% tax rate.

8.103 A different approach is adopted for taxable distributions from foreign trusts as these distributions are included in assessable income in the ordinary way. A taxable distribution to which s HC 18 applies is income of the beneficiary recipient under s CV 13. However, s BD 1(5)(c) operates to remove from assessable income any taxable distributions derived by non-resident beneficiaries that are "foreign-sourced amounts" under s BD 1(4).

8.104 A foreign-sourced amount is defined in s YA 1 as meaning an amount of income that is not treated as having a New Zealand source under ss YD 4 and YZ 1 (Section YZ 1 is a terminating provision dealing with source rules for interest). Section YD 4(13) directs that income derived by a beneficiary from a trust fund has a New Zealand source to the same extent as the income of the trust fund has. Section YD 4(13) will apply to the extent that a taxable distribution is treated

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under the ordering rules as income accumulated by the trustee in a prior year. Where the taxable distribution consists under the ordering rules of a capital gain amount (associated party gains of the trustee only for foreign trusts) then s YD 4(18) applies. The gain will be treated as having a New Zealand source under s YD 4(18) by reference to the source of the actual gain being distributed, rather than by reference to the proportion of all capital gains made by the trust that are New Zealand sourced.

8.105 If a New Zealand resident beneficiary (in their capacity as a beneficiary) derives a taxable distribution, they may be allowed a tax credit for any foreign tax paid on the amount under s LJ 6. To qualify for the tax credit the foreign tax must be of substantially the same nature as NRWT (ie, a withholding tax on a distribution to a non-resident). It therefore will not extend to underlying tax paid by a trustee on accumulated foreign-sourced amounts subsequently distributed.

Section GB 22—anti-avoidance

8.106 Section GB 22 contains a specific anti-avoidance provision to deal with situations where a trustee enters into an arrangement to defeat the intent and application of the rules relating to beneficiary income and taxable distributions. This provision is discussed from [5.53].

8.107 The Commissioner may also consider the application of s BG 1 to arrangements that have a more than merely incidental purpose or effect of tax avoidance. For example, s BG 1 might apply to an arrangement that involves a loan to a beneficiary of an amount that would, if the amount had been distributed to the beneficiary, have resulted in a taxable distribution taxed at 45%. Section BG 1 would not apply to all such arrangements. In determining whether s BG 1 applies, relevant factors would include (but are not limited to) the relationship between the trustee and the beneficiary, the term of the loan, the interest and repayment terms, the history of payments made on the loan, and the commercial reality of the beneficiary making payments.

Ordering rules

Introduction

8.108 Because some distributions will be taxable and some not, opportunities could arise for avoiding or deferring tax on income accumulated in trusts by distributing 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 opportunities for manipulating distributions from foreign and non-complying trusts in this manner. This is achieved by providing a series of ordering rules that determine the order in which amounts are treated as having been distributed from such trusts.

8.109 These ordering 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, and so determine whether a distribution will be a taxable distribution or not. Therefore, as noted earlier, it is necessary to interpret the definition of taxable distribution and the ordering rules together.

8.110 The ordering rules in s HC 16 apply when a trustee of a foreign or non-complying trust makes a distribution to a beneficiary. The four exceptions to the ordering rules are discussed from [8.143].

8.111 Where they apply, the ordering rules treat a distribution as being made up of the following elements in the following order:

(a) income derived by the trustee in the current income year;

(b) income derived by the trustee in an earlier income year;

(c) a capital gain derived by the trustee in the current income year;

(d) a capital gain derived by the trustee in an earlier income year; and

(e) the corpus of the trust.

8.112 The ordering rules apply on an end of year basis. That is, a distribution is not characterised at the time at which 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 derived in that income year (and previous income years). When the ordering rules are applied, they are applied individually to each distribution made by the trustee in the order in which the distributions are made (subject to potential reordering under s HC 16(5), as discussed from [8.129]).

8.113 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. This means that the order in which the distributions are made can be significant.

8.114 For each distribution, the elements must be applied in the order above. 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.

8.115 The ordering rules apply to distributions made in the income year. However, a distribution made in the income year can be treated as if it was made in the previous income year if it is a payment of income derived by the trustee in the previous income year that is paid within the extended time period allowed under s HC 6(1B). This approach allows the distribution to be treated as consisting of the income derived by the trustee in the previous income year and, therefore, allows the income to be treated as beneficiary income. Otherwise, the ordering rules would potentially treat the distribution as consisting firstly of income derived in the current income year under s HC 16(1)(a). This approach is appropriate as it resolves the potential conflict between s HC 6(1B) and the ordering rules, gives effect to the extension of time contemplated in s HC 6(1B), and is not inconsistent with the purpose of the ordering rules.

Distribution firstly treated as being made up of income derived by the trustee in the current income year

8.116 The first element that a distribution is treated as being made up of is an amount of income derived by the trustee in the income year in which the distribution is made (s HC 16(2)(a)).

8.117 An amount must not be treated as included in the distribution if the amount has been treated under s HC 16 as being included in an earlier distribution (ie, earlier in the year) or a distribution made at the same time.

8.118 An amount of "income" derived by a trustee in an income year, referred to in s HC 16(2)(a) and (b), is determined after subtracting any deduction that is taken into account in the calculation of net or taxable income for the corresponding income year.

8.119 "Income" otherwise has its normal meaning, being income of the trustee under a provision in part C. It means income under New Zealand income tax law, not the law under any other jurisdiction where for instance the amount may or may not be liable to tax. Income under part C may in fact be exempt to the trustee, for example FIF income derived by a resident trustee of a foreign trust treated as exempt under ss HC 26 and CW 54. If subsequently distributed to a resident beneficiary it would comprise a taxable distribution under the ordering rules.

8.120 Section HC 16(2)(a) does not make any distinction between trustee income and beneficiary income. This is because the ordering rules may cause a distribution that would otherwise be a distribution of beneficiary income to not be a distribution of beneficiary income. This is caused by the combination of the way the ordering rules work, the definition of beneficiary income, and the timing of distributions a trustee makes.

Example 21. Change to beneficiary income

During an income year the trustee of a non-complying trust derives $100 of income and a $100 capital gain. The trustee has discretion under the terms of the trust to distribute income or capital to any of the beneficiaries of the trust. The trustee makes two distributions. In the first distribution, on 1 February, the trustee pays the $100 capital gain to a non-resident beneficiary. In the second distribution, on 1 March, the trustee pays the $100 of income to a resident beneficiary. In the absence of the ordering rules, the $100 of income will be beneficiary income to the resident beneficiary because it is income that is paid to a beneficiary. The $100 capital gain could not be beneficiary income because it is not "income" derived by the trustee.

However, applying the ordering rules, and remembering that the trustee pays the $100 capital gain first and the $100 of income second, the result is different. Applying the ordering rules, when the trustee makes the first payment, the distribution is treated as consisting of the $100 of income derived by the trustee (because income comes before a capital gain in the ordering rules). And because the payment is treated as consisting of the trustee's current year income and is paid to a beneficiary, it will be beneficiary income under s HC 6. This means that when the trustee pays the second $100 to the resident beneficiary, the only available element left is the $100 capital gain. As a result, the ordering rules have changed which beneficiary has derived beneficiary income.

8.121 In the case of contemporaneous distributions, the trustee can generally decide how current year income will be apportioned between distributions. However, the total current year income treated as being included in the distributions cannot exceed the current year's income.

Example 22. Contemporaneous distributions

A trustee of a non-complying trust wishes to distribute $60 each to beneficiary A and beneficiary B on 24 December. The trustee has derived only $100 of income in the current income year. However, the trustee derived $20 of income 2 years earlier that has not yet been treated under s HC 16 as being included in a distribution. Given that the distributions are contemporaneous, the trustee can effectively decide how the current year income will be divided between the beneficiaries. The trustee can treat the distribution to beneficiary A as including $60 of current year income and the distribution to beneficiary B as including $40 of current year income and $20 of previous year income. As a result, beneficiary A will have beneficiary income of $60 and beneficiary B will have beneficiary income of $40 and a taxable distribution of $20. The $20 will be a taxable distribution and not beneficiary income because, by definition, beneficiary income must be distributed in the income year it is derived by the trustee (or by the date after the end of the income year referred to in s HC 6(1B)). The beneficiary income will be taxed at the beneficiaries' marginal tax rates, and the taxable distribution will be taxed at the 45% non-complying trust distribution rate.

Distribution secondly treated as being made up of income derived by the trustee in an earlier income year

8.122 The second element that a distribution is treated as being made up of is an amount of income, other than beneficiary income, that the trustee has derived in an earlier income year (s HC 16(2)(b)).

8.123 Again, an amount must not be treated as included in the distribution if the amount has been treated under s HC 16 as being included in an earlier distribution (earlier in the income year or in a previous income year) or in a distribution made at the same time.

Example 23. Accumulated income available for distribution

The trustee of a non-complying or foreign trust derived $100 of income in the previous income year. Of that amount, $60 was treated, under s HC 16(2)(a), as being included in a distribution in the previous income year. As a result, only $40 of that income is available to be treated, under s HC 16(2)(b), as being included in a distribution in the current year.

Distribution thirdly treated as being made up of current year's capital gains

8.124 The third element that a distribution is treated as being made up of is a capital gain that the trustee derives in the income year (s HC 16(2)(c)).

8.125 The concept of a capital gain is considered from [8.73] in the context of s HC 16 and the definition of taxable distribution. "Capital gain" has the same meaning in the ordering rules:

(a) A capital gain does not include any capital gain that is required to be taken into account for the purpose of calculating a person's income. These amounts will be covered by s HC 16(2)(a). An example, noted above, is a gain captured under s CB 6, which provides that an amount a person derives from disposing of land is income of the person if they acquired the land for a purpose of disposing of it. As an amount of income, the amount will be covered by s HC 16(2)(a). For the purposes of s HC 16(2)(a), the income amount will be adjusted by the deduction that the person is allowed under ss DA 1 and DB 23 for the cost of acquiring the land (s HC 16(4)(a)). In this way, the gain from the disposal of land is taken into account as income.

(b) A capital gain does not include a gain that the trustee derives through a transaction (or series of transactions) between the trustee and a person associated with the trustee.

(c) A capital gain is adjusted by subtracting the amount of any capital loss that the trustee incurs in the income year.

(d) A capital gain is an amount that has been realised. Similarly, a capital loss is an amount that has been realised and incurred.

Distribution fourthly treated as being made up of previous years' capital gains

8.126 The fourth element that a distribution is treated as being made up of is a capital gain that the trustee derived in an earlier income year (s HC 16(2)(d)).

8.127 The comments made above on s HC 16(2)(c) and the calculation of a capital gain also apply to s HC 16(2)(d).

Distribution fifthly treated as being made up of corpus

8.128 The fifth element that a distribution is treated as being made up of is the corpus of the trust (s HC 16(2)(e)). "Corpus" is discussed from [8.81]. Subject to some exclusions, "corpus" means an amount that is equal to the market value of a settlement of property on the trust.

Transactions that are not genuine and other ordering adjustments

8.129 Section HC 16(5) allows the order of amounts distributed to be amended in certain situations.

8.130 As noted above, if an amount of income or capital gain has been treated as being included in an earlier distribution or a distribution occurring at the same time, then the amount is not available to be treated as included in the distribution currently being considered. Whether an amount is available will depend on the order of distributions and, in the case of distributions made at the same time, the discretion of the trustee. Because of this, some scope to manipulate distributions still exists. For example, a foreign trust could distribute income to non-resident beneficiaries (who as non-residents may not be liable to tax on the income) and capital gains to resident beneficiaries. The s HC 16(2) ordering rules would not prevent the streaming of income and capital gains in this manner if the distribution to the non-resident was made before or contemporaneously with the distribution to the resident.

8.131 However, under s HC 16(5), in certain situations the streaming and availability of income and capital gain amounts can be modified. Section HC 16(5) acts as a type of anti-avoidance provision. Where the requirements of the section are met, the subsection can apply so that, when determining the elements of a distribution to a beneficiary (beneficiary A), amounts of income or capital gain previously distributed to another beneficiary (beneficiary B) must be ignored. This results in the amount of income or capital gain still being available to be included in determining the elements of a distribution to beneficiary A.

8.132 If s HC 16(5) applied in the example in [8.130] above, it would treat the income as not having been distributed to the non-resident beneficiary and as still being available to be included in the distribution to the resident beneficiary, for whom the amount may be a taxable distribution.

8.133 Section HC 16(5) will apply if:

(a) some or all of a distribution to beneficiary A would not be treated as a taxable distribution, because of a previous distribution to beneficiary B of income and capital gains;

(b) **unless**, the distribution to beneficiary B:

- (i) is a genuine transaction entered into and carried out in good faith; and
- (ii) places the amount beyond the possession and control of the trustee in their capacity as trustee; and
- (iii) is not a settlement.

Effect requirement

8.134 If the treatment of the distribution to beneficiary B would have no effect on whether the distribution to beneficiary A would be a taxable distribution (eg, if both distributions were of current year income), then s HC 16(5) will not apply and there will be no change to the ordering under s HC 16(2). The important consideration is the effect of the treatment of the earlier distribution, rather than the subjective purpose of the trustee in making the distribution.

Distribution not a genuine transaction entered into and carried out in good faith

8.135 Section HC 16(5) applies where the distribution to beneficiary B is not a genuine transaction entered into and carried out in good faith.

8.136 This requirement was reworded with the introduction of the ITA 2007. This expression of the requirement replaced the earlier expression, which referred to a distribution not being a "*bona fide* transaction". No policy change was intended with this rewording. The Courts have held that a transaction is a *bona fide* transaction if it is real and genuine to all intents and purposes (*CIR v Simpson* (1989) 11 NZTC 6,140 (CA)).

Not placing the amount beyond the possession and control of the trustee

8.137 Section HC 16(5) applies where the distribution to beneficiary B does not place the amount distributed beyond the possession and control of the trustee.

8.138 A distribution would not place an amount beyond the possession and control of a trustee of a trust if, for example, the trustee made the distribution by recording a credit in a beneficiary's current account with the trust and the amount was retained and used as working capital by the trustee (this type of distribution featured in *CIR v Ward* [1970] NZLR 1 (CA)).

Where the distribution is a settlement

8.139 The third situation in which s HC 16(5) applies is where the distribution is a settlement.

8.140 Example 24 illustrates this requirement.

Example 24. Reordering where there is a settlement

The trustee of a foreign trust settles all of the income derived by the trustee on a sub-trust for the benefit of a non-resident beneficiary. The trustee then makes a distribution to a resident beneficiary on the basis that only capital gains and the corpus of the trust remain to be distributed.

Section HC 16(5) will apply. It will treat the amount settled on the sub-trust for the benefit of a non-resident beneficiary as still being available for inclusion in the distribution to the resident beneficiary. It does not matter that the transaction may have been genuine and that the distribution to the non-resident placed the income beyond the possession and control of the trustee.

Section HC 16(5) applies only to the extent necessary to re-order distributions

8.141 Section HC 16(5) applies only to the extent necessary to determine the elements of the distribution to beneficiary A (as identified and discussed at [8.131] to [8.133]). This means the treatment of the distribution to beneficiary B, will not necessarily be modified completely.

Example 25. Distribution only partially modified

A trustee of a non-complying trust derives a $10,000 capital gain in an income year. The trust also has corpus of $10,000. During the income year, the trustee distributes $10,000 to Non-stick Ltd, a beneficiary of the trust (assume Non-stick Ltd is not taxable on this amount because it is a trustee of a registered charity). This is followed by a distribution of $8,000 to Cast Iron Ltd, another beneficiary of the trust. Cast Iron Ltd is a New Zealand resident and would be liable for tax on any distribution of income or capital gain from the non-complying trust. The $10,000 distribution to Non-stick Ltd is made by crediting Non-stick Ltd's current account with the trust. The amount remains in the trustee's possession and control.

Applying the ordering rules under s HC 16(2), because of the order in which the distributions were made, the capital gain of $10,000 is treated as being included in the distribution to Non-stick Ltd and $8,000 of corpus is treated as being included in the distribution to Cast Iron Ltd.

However, these distributions will be reordered under s HC 16(5). This is because if the $10,000 capital gain had not been treated as being included in the distribution to Non-stick Ltd, that amount would have been available to be treated as included in the distribution to Cast Iron Ltd and the amount would have been taxable income to Cast Iron Ltd. Further, the distribution to Non-stick Ltd did not place the amount distributed beyond the possession and control of the trustee.

The effect of s HC 16(5) applying is that the $10,000 capital gain is available to be treated as included in the $8,000 distribution to Cast Iron Ltd. This means that $8,000 of the capital gain will be treated as included in the distribution to Cast Iron Ltd. This leaves $2,000 of the capital gain amount, which will still be treated as being included in the distribution to Non-stick Ltd. The remainder of the distribution to Non-stick Ltd ($8,000) will be treated as being made up of corpus. Therefore, the result is that the $8,000 distribution to Cast Iron Ltd is treated as including $8,000 of capital gain. This will be a taxable distribution. And the distribution to Non-stick Ltd will be treated as including $2,000 of capital gain and $8,000 of corpus.

If an additional distribution of $2,000 is later made to Cast Iron Ltd, the remaining $2,000 of capital gain will also be treated as not being included in the distribution to Non-stick Ltd and will be available to be treated as included in the additional distribution to Cast Iron Ltd.

Exceptions to the ordering rules

8.142 Section HC 16(6) contains exceptions to the ordering rules.

Distribution by the trustee of a complying trust (s HC 16(6)(a))

8.143 The exception in s HC 16(6)(a) confirms that the ordering rules do not apply to a distribution by the trustee of a complying trust. This is consistent with s HC 16(1), which states that s HC 16 applies only when a distribution is made by a trustee of a non-complying trust or a foreign trust.

8.144 Section HC 16 does not apply to distributions from complying trusts. Generally, a trust will be a complying trust only if, over the life of the trust up to the distribution, the trustee's worldwide income has been liable to New Zealand income tax and the trustee's obligations in relation to that liability have been satisfied for every tax year (s HC 10(1)). As this income will have been taxed either to the beneficiary as beneficiary income or to the trustee as trustee income it is not necessary to apply the ordering rules to limit opportunities for manipulation of distributions.

8.145 The overriding exclusion from the ordering rules for distributions from complying trusts that are treated as exempt (that is all distributions except beneficiary income) means that these distributions made by dual status trusts will also not be subject to the ordering rules.

Distribution from a non-discretionary trust (s HC 16(6)(b))

8.146 Section HC 16 does not apply to a distribution if:

(a) the trust is a "non-discretionary trust"; and

(b) one of the following applies:

(i) the trust was created by will or codicil (an amendment to a will) or by an order of court modifying a will or codicil;

(ii) the trust was created on an intestacy or partial intestacy; or

(iii) no settlement has been made on the trust after 17 December 1987.

8.147 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.

8.148 In these circumstances there is less scope for distributions to be manipulated deliberately to avoid New Zealand income tax. This is because:

(a) the trustee of the trust has no discretion to direct distributions to beneficiaries in a manner that results in the avoidance of New Zealand income tax; and

(b) the trusts are of a type where it is unlikely that the provisions governing distributions (eg, the terms of a trust deed) would have been structured with a view towards avoiding New Zealand income tax.

8.149 Non-discretionary trusts on which a settlement has been made after 17 December 1987 (apart from those created by will or codicil or on any intestacy or partial intestacy) are outside the scope of the exception. If this were not the case, it would be possible to create non-discretionary trusts or to use non-discretionary trusts established on or before 17 December 1987 to avoid the ordering rules.

Distribution made by disposing of property or providing services at less than market value

8.150 The ordering rules do not apply to a distribution to which s HC 15(6) applies (s HC 16(7)). Section HC 15(6) is discussed at [8.69].

8.151 Where a distribution like that described in s HC 15(6) is made there may be no amounts derived by the trustee that correspond to the distributions. Although it is appropriate to recognise these transactions as distributions, it is not appropriate to apply the ordering rules to the distributions because the distributions are not actually made from a trust's income, capital gains or corpus.

Distribution where a foreign trust becomes a complying trust

8.152 Section HC 16(6)(c) relates to trusts that were foreign trusts before a settlor of the trust became resident in New Zealand. It provides that the ordering rules in s HC 16 will not apply to a distribution from such a trust if the distribution is made subsequent to the settlor becoming resident and the trust is treated (under s HC 30(3)) as a complying trust in relation to the distribution. This is consistent with the fact that the ordering rules do not apply to distributions made from complying trusts.

8.153 This exception applies to only a distribution from a trust that is settled by a natural person.

8.154 Also, the exception applies only if an election has been made under s HC 30(2) (treatment of foreign trusts when settlor becomes resident). Elections made under s HC 30(2) are discussed in Part 10 of this Interpretation Statement.

Taxable distribution where records are inadequate

8.155 If the records of a foreign or non-complying trust do not allow an accurate determination of the elements of a distribution under s HC 16 (ie, current and previous year income and capital gain amounts and the corpus of the trust), the distribution is a taxable distribution (s HC 15(7)).

8.156 Section HC 15(7) does not apply to a distribution if the ordering rules in s HC 16 do not apply to the distribution.

8.157 Section HC 15(7) applies where the records of a trust do not permit an accurate determination of the components of a taxable distribution when applying the ordering rules in s HC 16. The focus is on the accuracy of records relating to a particular distribution. This means for example that if a trust had inaccurate records for its income and capital gains but accurate ones for its corpus, it could still be possible to make a distribution of solely corpus as its final act on windup and not have it treated as a taxable distribution. Where however a trust had inaccurate records relating to income, but accurate records in relation to capital gains and it purported to make a distribution of a capital gain amount, there would be no certainty that the trust had distributed all of its current and accumulated income so as to properly characterise the distribution as a capital gain under the ordering rules. Consequently, s HC 15(7) would operate to treat the amount as a taxable distribution.

Resettlements

8.158 A resettlement occurs when the trustee of one trust (the first trust) makes a settlement of property on a new trust (the recipient trust).

8.159 As noted at [2.136], a distinction should be made between:

- A resettlement that is made on behalf of a beneficiary that coincides with the trustee transferring an absolute interest in the property to the beneficiary.
- A resettlement that does not coincide with the trustee transferring an absolute interest in the property to the beneficiary, but which may give a beneficiary an interest in the property as a beneficiary of the new trust.

Resettlement made on behalf of a beneficiary

8.160 The first situation involves:

- A "payment" made by the trustee to the beneficiary for the purposes of the definitions of "beneficiary income" and "distribution".
- A settlement by the beneficiary on the new trust.

8.161 The tax treatment of this type of resettlement will follow from the two elements above. Depending on the type of trust, the operation of the ordering rules, and the available income and capital gains of the first trust, the "payment" may be treated as beneficiary income or a taxable distribution to the beneficiary. For the trustee of the new trust, the property settled by the beneficiary will normally be corpus, subject to any of the exclusions in s HC 4(3) to (5) applying.

Resettlement not made on behalf of a beneficiary

8.162 The following discusses the tax treatment of resettlements that do not coincide with the trustee transferring an absolute interest in the property to a beneficiary.

Corpus

8.163 The tax treatment of this type of resettlement largely depends on whether the resettlement is treated as "corpus" of the recipient trust.

8.164 The definition of "corpus" has already been discussed from [8.81] to [8.83]. In the context of a resettlement, to describe again briefly, subject to the exclusions discussed below, "corpus" means an amount that is equal to the market value of a settlement of property by the first trust on the recipient trust. A property settlement is excluded from the corpus of the recipient trust:

- To the extent to which, if the property was distributed to a beneficiary of the first trust and the beneficiary was resident in New Zealand, the distribution would be beneficiary income or a taxable distribution to that beneficiary (s HC 4(3)).
- If the settlor is allowed a deduction for the settlement (s HC 4(4)).
- If, but for the fact of the settlement, it would be income of the settlor (or would be income if the settlor was resident in New Zealand at the time of settlement) (s HC 4(5)).

8.165 If a property settlement from one trust to another is corpus (ie, it is not excluded under s HC 4(3)), then the settlement will not give rise to income for the trustee of the recipient trust. It will also not be a distribution under s HC 14.

8.166 If a property settlement from one trust to another is excluded from corpus, then the settlement will be:

- "trustee income" under s HC 7(3); and
- a "distribution" under s HC 14.

Trustee income

8.167 As covered at [7.5], s HC 7(3) extends trustee income to include the market value of any property settlement a trust receives that is excluded from "corpus" under s HC 4(3) to (5). Section CV 13(b) includes such amounts in the income of the trustee. An amount included under s HC 7(3) is income that cannot be treated as "beneficiary income".

Distribution

8.168 A resettlement of property from one trust to another that is excluded from corpus under s HC 4(3) is also a "distribution" under s HC 14.

8.169 Section HC 14(1) provides that a trustee makes a "distribution" when the trustee transfers value to a person because the person is a beneficiary of the trust. This includes a situation where one trust (the first trust) settles property on another trust (the recipient trust). In this situation, the recipient trust is a beneficiary of the first trust.

8.170 Section HC 14(2) provides that a resettlement will only be a distribution if the amount or the property settled would have been beneficiary income or a taxable distribution to a beneficiary of the first trust, had it been distributed at the time to a beneficiary resident in New Zealand. These are the same circumstances as described under s HC 4(3).

Tax consequences for the recipient trustee

8.171 As noted at [8.167], for the recipient trustee, a resettlement of property from one trust to another that is excluded from corpus under s HC 4(3) will be "trustee income" under s HC 7(3) and "income" under s CV 13(b).

8.172 If the resettlement was made by a non-complying trust, the income will be excluded income for the recipient trustee and, therefore, not included in the recipient trustee's assessable income and not taxed at the 33% trustee rate. Instead the income will be taxed under s BF 1(b) at 45%. Therefore, the treatment of the settlement as trustee income and a distribution does not result in double taxation of the settlement (however, as discussed below, it is possible for beneficiaries of the recipient trust to be taxed on subsequent distributions from the recipient trustee).

8.173 If the resettlement was made by a complying or foreign trust, the income may be assessable income (subject to other exclusions from assessable income applying) for the recipient trustee and taxed at the 33% trustee tax rate.

Subsequent distributions by the recipient trustee

8.174 The following discusses the tax implications of a subsequent distribution by the recipient trustee that includes an amount settled on the recipient trustee, being an amount that was excluded from corpus under s HC 4(3) to (5).

8.175 As noted above at [8.167], the market value of the property settled will be treated as "trustee income" of the recipient trustee and cannot be treated as "beneficiary income". The treatment of these amounts as "trustee income" was introduced in 1991, after the 1989 Explanation was published.

8.176 If the recipient trust is a complying trust, then a subsequent distribution by the recipient trustee of the resettlement amount to a beneficiary of the recipient trust will be exempt income of the beneficiary under s HC 20.

8.177 Although a subsequent distribution by the recipient trustee of the resettlement amount cannot be "beneficiary income", it will be a taxable distribution if the recipient trust is a foreign trust or a non-complying trust. This is because the resettlement amount is income derived by the trustee of the recipient trust that is treated as not being beneficiary income. This would be a taxable distribution under s HC 15 for a foreign or non-complying trust. This means that the amount resettled could be taxed twice:

- once to the trustee of the recipient trust as assessable income (if the first trust is a complying or foreign trust) or as a taxable distribution at 45% (if the first trust is a non-complying trust); and
- again as a distribution to the beneficiary of the recipient trust at either the beneficiary's marginal tax rate (if the recipient trust is a foreign trust) or at 45% (if the recipient trust is a non-complying trust).

The nature of a settlement excluded from corpus for the purposes of the ordering rules

8.178 The following discusses the nature of a settlement excluded from corpus for the purposes of applying the ordering rules to a subsequent distribution made by the trustee of the recipient trust.

8.179 Again, a resettlement of property that is excluded from corpus under s HC 4(3) to (5) is "trustee income" of the recipient trustee derived in the income year of settlement under s HC 7(3) and is included in the "income" of the trustee under s CV 13(b).

8.180 This means that a resettlement of property that is excluded from corpus under s HC 4(3) to (5) is an amount of **income** that the recipient trustee derives or has derived for the purposes of the ordering rules in s HC 16(2)(a) and (b).

8.181 Note that the settlement amount is treated as income for the purposes of the ordering rules, even if the amount was a capital gain in the hands of the first trust. On being resettled on the recipient trust, the amount, which is excluded from corpus under s HC 4(3), is recharacterised as "trustee income" and "income" under ss HC 7(3) and CV 13(b).

Part 9 Other types of trusts

Introduction

9.1 The general tax treatment discussed in the above parts of this Interpretation Statement applies to most trusts, including the standard family or trading trust structures often used in New Zealand. However, in some situations, different tax rules apply to specific types of trusts including:

(a) charitable trusts;

(b) deceased estates;

(c) community trusts;

(d) superannuation funds;

(e) lines trusts;

(f) licensing trusts;

(g) bare trusts;

(h) unit trusts;

(i) Maori authorities;

(j) foreign investment funds; and

(k) foreign superannuation schemes.

9.2 The tax treatments of these entities are considered in the next sections.

Charitable trusts

9.3 Section HC 13 defines a charitable trust, for the purposes of the trust rules, as a trust:

(a) for which all income derived or accumulated, in the current or any earlier income year, is held for charitable purposes; and

(b) any income derived in the current year is exempt income under s CW 41(1) or s CW 42(1).

9.4 For the exemptions to apply, the trust must be a "tax charity" (discussed further at [9.11] and [9.12] below).

Charitable purposes

9.5 For a trust to be a charitable trust, all income derived or accumulated by the trustee must be held for charitable purposes. This test must be satisfied for each income year.

9.6 "Charitable purpose" is defined in s YA 1 as including every charitable purpose, whether it relates to the relief of poverty, the advancement of education or religion, or any other matter beneficial to the community. The definition in s YA 1 also confirms that:

(a) a trust will be charitable for the purposes of the ITA 2007 if it meets the public benefit requirement apart from the fact that the beneficiaries are related by blood; and

(b) a marae has a charitable purpose if the physical structure is situated on land that is a Māori reservation and the funds of the marae are not used for a purpose other than the administration and maintenance of the land and physical structure of the marae or for a purpose that is not otherwise a charitable purpose.

9.7 The definition of "charitable purpose" in s YA 1 is the same as the definition in s 5(1) and (2) of the Charities Act 2005.

9.8 The general definition of "charitable purpose" in s YA 1 and the Charities Act 2005 is a statutory restatement of the established common law classification of charitable purposes stated by Lord Mcnaughten in *Commissioners for Special Purposes of Income Tax v Pemsel* [1891] AC 531 (HL). In *Re Greenpeace of New Zealand Inc* [2014] 26 NZSC 105, the Supreme Court said that charitable purposes must be recognised on a case-by-case basis by analogy with previous common law authorities.

9.9 Section 5(3) of the Charities Act 2005 confirms, for the avoidance of doubt, that if the purposes of an entity include a non-charitable purpose that is merely ancillary to a charitable purpose of the entity (eg, advocacy), the presence of that

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non-charitable purpose does not prevent the entity from qualifying for registration as a charitable entity. This provision restates an established common law principle (see, for example, *Molloy v CIR* [1981] 1 NZLR 688 (CA)).

Exemption under ss CW 41 and CW 42

9.10 Under ss CW 41 and CW 42, income derived for charitable purposes is exempt income. However, these provisions apply only if the entity carrying on the charitable purposes is a "tax charity".

9.11 A "tax charity" is defined as an entity that is registered as a charitable entity under the Charities Act 2005 (and includes any entity that has been removed from the register for the period that it was eligible to be registered) (s CW 41(5)). An entity will qualify for registration under the Charities Act 2005 where it is established and maintained exclusively for charitable purposes and is not carried on for the private pecuniary profit of any individual (s 13 of the Charities Act 2005).

9.12 In addition, an entity can be a "tax charity" if it is a non-resident entity that carries out its charitable purposes outside New Zealand and the Commissioner has approved it as a tax charity in circumstances where registration under the Charities Act 2005 is unavailable (s CW 41(5)(c)).

9.13 Under s CW 41, an amount of income derived by a trustee of a trust for charitable purposes will be exempt income, provided the trust is a tax charity. However, this provision does not apply to income derived from a business carried on by, for, or for the benefit of the trust.

9.14 Section CW 42 applies to exempt income derived directly or indirectly from a business carried on by, for, or for the benefit of a trust, if:

(a) the trust carries out its charitable purposes in New Zealand; and

(b) the trustee of the trust is a tax charity; and

(c) no person with some control over the business is able to direct or divert, to their own benefit or advantage, an amount derived from the business, unless the person with control is the trustee of a trust that is a tax charity, and the amount is used for the purposes of the trust.

9.15 The exemption in s CW 42 applies only to the extent to which the charitable purposes of the trust are carried out in New Zealand (s CW 42(4)).

9.16 Under s CW 42(3), a trustee will be treated as carrying on a business if they acquire a revenue producing asset from a person of a kind discussed immediately below at [9.17] (b) and that person retains or reserves an interest in the asset, or the asset will revert to that person.

9.17 A person is treated as having some control over the business and as being able to direct or divert amounts from the business to their own benefit or advantage, if (s CW 42(5)):

(a) they are in any way, whether directly or indirectly through another person or entity, able to determine or materially influence the determination of the nature or extent of a relevant benefit or advantage, or the circumstances in which a relevant benefit or advantage is to be given or received; and

(b) that ability or influence arises because they are:

(i) a settlor or trustee of the trust carrying on the business, or of a trust that is a shareholder of the company that is carrying on the business;

(ii) a director or shareholder of the company that is carrying on the business; or

(iii) associated with any relevant trustee, settlor, director or shareholder.

9.18 This requirement will be satisfied if there is an ability to direct or divert an amount from the business to the person's own benefit or advantage. It is not necessary that this actually occurs.

9.19 For the purposes of s CW 42(5), a person is treated as a settlor of a trust where they have disposed of an asset to the trust that is used by the trust in carrying on its business and they retain or reserve an interest in the asset or the asset will revert to them (s CW 42(6)).

9.20 A person is not treated as having some control over the business merely because they provide professional services to the trust or company carrying on the business (s CW 42(7)). This is the case where the person's ability to determine the nature or extent of a relevant benefit or advantage arises because they:

(a) provide services in the course of their professional public practice; or

(b) are a statutory trustee company, Public Trust or the Māori Trustee.

9.21 A relevant benefit or advantage may or may not be something that is convertible to money and includes:

(a) deriving an amount that would be income under the ITA 2007; or

(b) retaining or reserving an interest in an asset disposed of to a trust or where the asset disposed of will revert to them.

9.22 However, a relevant benefit or advantage will not arise merely because a person earns interest on money lent at current commercial rates (s CW 42(8)).

Distributions

9.23 While many charitable trusts will not have "beneficiaries", and will instead use funds for charitable purposes, the definition of "charitable purpose" for tax purposes is broad enough to include trusts that will have beneficiaries. Trust law determines the tax treatment of distributions from charitable trusts. Therefore, distributions from a charitable trust that is a complying trust, of amounts that are not beneficiary income, are exempt income under ss HC 20 and CW 53. Distributions of beneficiary income from a charitable trust retain their exempt income character, under s CW 41 or s CW 42, in the hands of the beneficiary.

Settlor liability

9.24 A settlor can be liable as agent of the trustee for the tax liabilities of the trustee where no trustee is resident in New Zealand. However, this rule does not apply to settlors of charitable trusts (s HC 29(4)). This rule ensures residents who make donations to charitable trusts that have non-resident trustees are not liable for any tax liabilities of the trust.

Deceased estates

9.25 The mere fact that a person has died and an executor has been appointed to manage their estate does not give rise to a trust relationship. Trustees and executors have different capacities (*Re Hayes* [1971] 1 WLR 758 (Ch)). However, it will often be the case that a trust will be created by will (referred to as a testamentary trust). This can occur expressly by way of a statement in a will that specific property of the deceased will be held on trust for a named beneficiary. This could also occur where property is left for a minor beneficiary that needs to be held until the beneficiary is of age. Property that is intended to be the subject of a testamentary trust will vest in the trustees of that trust on the date of assent, after the "final distribution" of the deceased's estate (*Nevill's Law of Trusts, Wills and Administration* (10th ed, Lexis Nexis, Wellington (2010)) at [1.2.6]).

9.26 Under s 43 of the TAA, an executor or administrator is responsible for filing a return on behalf of the deceased covering the period from the beginning of the income year until the date of the taxpayer's death, assuming a return is required. Income derived by the taxpayer's estate after their death is accounted for by the estate in its return. Despite an estate (up until assent) not being a trust, "trustee" is defined in s YA 1 of the ITA 2007 as including an executor and administrator (as noted in Part 3 of this Interpretation Statement). The trust rules also contain specific rules that apply to estates for administrative convenience.

9.27 Section HC 8 provides that an amount received in an income year by the trustee of an estate of a deceased person for the period after death is treated under s CV 12 as assessable income derived by the trustee during that income year. The estate trustees must file the form *Income Tax Return: Estate or trust (IR6)* (March 2016).

9.28 As a result, there is a need to correctly account for different sources of income when derived. The trustee is required to register the estate as a new taxpayer and apply for an Inland Revenue Department (IRD) number in the name of the estate.

9.29 Section HC 8 overrides the common law principle that income earned but not derived for tax purposes by a deceased person before death is capital in the hands of the beneficiary of that person's estate. This situation could arise, for example, where the deceased person returned income on a receipts basis and the person performed services before death for which payment was not received until after death. Employees, barristers and doctors may fall into this category.

9.30 Section HC 8 applies only where the amount received by the trustee of the estate is not income derived by the deceased person during their lifetime. Any income derived by the deceased during their lifetime should be returned on behalf of the deceased in a return under s 43 of the TAA, as discussed at [9.26]. Section HC 8 also applies only if the amount received by the trustee would have been included in the deceased person's income, if they had been alive when it was received. That is, the amount must be one that would have had the character of income in the hands of the deceased person, if it had been received by the deceased person while alive.

9.31 The effect of s HC 8 is that the amount the trustee of the estate receives is deemed to be income derived by the trustee. Because the amount is treated as income derived by the trustee, and not trustee income it can be vested absolutely in interest in a beneficiary of the estate, or can be paid to a beneficiary of the estate, so can become beneficiary income where there is an interim distribution of the estate. If there is no such vesting or payment, the income will be taxed as trustee income.

9.32 The trustee of the estate is liable for income tax owed by the deceased as well as for any tax liability as trustee of the estate. But the deceased's tax liability is limited to the net assets of the estate, and the Commissioner is empowered to write off any outstanding tax, if an estate has been distributed, under s 177C(2) of the TAA.

9.33 A final tax return must be prepared for the period up to the date of distribution when the estate is wound up. The trustee of the estate routinely secures an indemnity from beneficiaries to ensure there is cover for any tax liabilities that might arise in excess of those expected before making or completing distributions.

9.34 The tax treatment of property transfers after a person dies was clarified by the asset transfer rules introduced by the Taxation (Base Maintenance and Miscellaneous Provisions) Act 2005. Subject to exceptions for close relatives, transfers of property following death are treated as disposals at market value. There is a transfer from the deceased to the estate and again when the estate is distributed. When the death occurred before 1 October 2005, transitional rules apply to preserve the pre-existing regime.

9.35 For details about the asset transfer regime following death, see "Death and Asset Transfers", *Tax Information Bulletin* Vol 17, No 7 (September 2005): 41.

Deduction of irrecoverable book debts (s DB 32)

9.36 Section DB 32 applies where a debt owing to a person at the date of their death is written off, in whole or in part, by the trustee because it is not recoverable. This applies only to amounts written off as bad debts where the amount written off was earlier included in the deceased's assessable income or in the assessable income of the trustee of the deceased's estate.

9.37 In these circumstances, the amount written off is allowed as a deduction in this order:

(a) first, against any income derived by the trustee as trustee income during that income year;

(b) second, any balance is deductible against income derived by or in trust for a beneficiary who has a vested interest in the capital of the estate to the extent that the loss is chargeable against the capital of that beneficiary; and

(c) third, any balance is carried forward to the next income year and offset against trustee income and beneficiary income according to the rules outlined above, with any further excess being carried over to subsequent income years and offset according to the same rules.

9.38 Therefore, to apply s DB 32 it is necessary first to calculate the trustee income and the beneficiary income in the income year in question, ignoring the loss incurred by the debt write-off.

9.39 The amount written off is not deductible against beneficiary income derived by beneficiaries who have an interest in the income of the trust only.

Community trusts

9.40 Section YA 1 defines a "community trust" as a trust established under s 4 of the Community Trusts Act 1999 as a result of the restructuring of a trustee bank. The income derived by the trustees of a community trust is exempt under s CW 52.

9.41 Distributions from community trusts that are "beneficiary income" are taxed in the ordinary way under ss HC 17 and CV 13. Other distributions from community trusts are also taxable to recipients at their marginal rates under ss HC 21(3) and CV 14. The income exemption in s HC 20 for distributions from complying trusts that are not beneficiary income does not apply to community trusts.

9.42 Exceptions to the general rule that community trust distributions are taxable are in ss HC 21(2) and s CZ 19. These exceptions relate to:

(a) amounts derived by the trustees before the 2004 income year;

(b) distributions of corpus or capital gains; and

(c) distributions, settlements or dividends made or paid to the trust in the 2005 and 2006 income years on the winding up of a trust or company in particular circumstances.

9.43 Contrary to the usual position, trustees of community trusts are not liable for tax as agents for recipients of distributions from community trusts under ss HC 32(3) and HD 12(1). Consequently, the obligation lies on the recipient of the distribution to include such income in a return and pay tax on it.

Superannuation funds

9.44 A "superannuation fund" is defined in s YA 1 as a retirement scheme within the meaning of s 6(1) of the Financial Markets Conduct Act 2013.

9.45 Superannuation funds are complying trusts under s HC 10(1)(b). All income derived by a superannuation fund is assessable as trustee income under the trust rules. In contrast to other complying trusts, superannuation funds cannot make distributions of beneficiary income (s HC 6(2)(a)). The effect of this is that all distributions to members of a superannuation fund are exempt income for the beneficiaries (ss HC 20 and CW 53).

9.46 Under s HC 24(5), the general rules for calculating trustee income are modified by ss CX 40 and DV 1 to DV 4. Under s CX 40, amounts derived from investments in life insurance policies entered into in New Zealand are excluded income. Sections DV 1 to DV 4 provide for specific deductions for superannuation funds relating to promotion costs and transfers of costs to master funds.

9.47 The income of a superannuation fund, including foreign-sourced amounts, is always assessable trustee income even where there is no New Zealand resident trustee (ss HC 25(2) and HC 26(1)).

Trusts not taxed under the trust rules

Lines trusts

9.48 A "lines trust" is defined in s YA 1 to mean a trustee of a trust that:

(a) has had shares allocated, transferred or vested in it, being shares in:

(i) an energy company as defined in s 2(1) of the Energy Companies Act 1992 under an approved establishment plan under that Act;

(ii) a company under s 76 of the Energy Companies Act 1992; or

(iii) a company that has had assets and liabilities of the Crown transferred to it under s 16 of the Southland Electricity Act 1993; and

(b) continues to hold those shares.

9.49 There are no specific rules in the ITA 2007 for the taxation of lines trusts. Therefore, they will generally be taxed as complying trusts, provided they qualify to do so. However, some lines trusts are registered charities, so will be taxed as charitable trusts (discussed above from [9.3]).

Licensing trusts

9.50 A "licensing trust" is included in paragraph (a) of the definition of "company" in s YA 1 as they are a body corporate under ss 302 and 303 of the Sale and Supply of Alcohol Act 2012. This means they have a legal existence separate from their members. A licensing trust may convert to be a community trust under ss 351 to 358 of the Sale and Supply of Alcohol Act but if they do their status as a body corporate is preserved under ss 359 and 360 of that Act and so they will continue to be treated as a company under the ITA 2017.

9.51 Consequently both licensing trusts and community trusts regulated by the Sale and Supply of Alcohol Act are not taxed as complying trusts.

Bare trusts

9.52 "Bare trust" is not a defined term in the ITA 2007. Under common law, a bare trust is a trust where the trustee has no obligations or duties to perform other than to maintain or transfer the property held by the trustee to, or as directed by, the beneficiary. The duties of a bare trustee are passive in the sense that a bare trustee must comply with the directions of the beneficiary and has no independent power, discretion or responsibility in connection with the trust property (*Estate of Frank Hillyer King and Ors v CIR* [2007] NZCA 474, *Herdegen v FCT* (1988) 20 ATR 24 (FCA)).

9.53 Under s YB 21, where a person holds something or does something as a bare trustee for another person, the bare trustee is ignored, and the other person is treated as holding or doing that thing for tax purposes.

Unit trusts

9.54 A "unit trust" is defined in s YA 1 as being:

> a scheme or arrangement that is made for the purpose or has the effect of providing facilities for subscribers, purchasers or contributors to participate as beneficiaries under a trust, in income and capital gains arising from the property that is subject to the trust.

9.55 Section HC 1(2)(a) excludes unit trusts from the trust rules. Unit trusts are treated as companies for tax purposes. The tax treatment of distributions from and interests in unit trusts is determined largely under the dividend rules in subpart CD. Unit trusts can also elect to become portfolio investment entities (PIEs), which have their own tax regime in subpart HM.

Maori authorities

9.56 Section HF 2 sets out the persons who are eligible to become a "Maori authority" by making an election under s HF 11. The trusts eligible to make an election to become a "Maori authority" are the:

(a) trustees of a trust established by an order made under Te Ture Whenua Maori Act 1993;

(b) trustees of a trust who own land that is subject to Te Ture Whenua Maori Act 1993;

(c) trustees of a trust that is recognised by Te Ohu Kai Moana Trustees Ltd as a mandated iwi organisation under s 13(1) of the Maori Fisheries Act 2004;

(d) trustees of a trust that is established by Te Ohu Kai Moana Trustees Ltd as a mandated iwi organisation under ss 79 and 92 of the Maori Fisheries Act;

(e) trustees of a trust who receive and manage assets that are transferred by the Crown as part of a settlement of a claim under the Treaty of Waitangi on behalf of Māori claimants and are contemplated by the deed of settlement; and

(f) Māori Trustee in their capacity as an agent for the owner of land that is subject to Te Ture Whenua Maori Act 1993.

9.57 Section HC 1(2)(c) excludes Maori authorities from the trust rules. In addition, under s HC 35(4), the minor beneficiary rules do not apply to a distribution from a Maori authority. The ITA 2007 contains specific rules (mostly in subpart HF) relating to the tax treatment of Maori authorities and distributions from Maori authorities.

Taxation of investments in trusts

Foreign investment funds

9.58 A "foreign investment fund" (FIF) is defined in s EX 28 as:

(a) a "foreign company";

(b) a "foreign superannuation scheme";

(c) an insurer under a life insurance policy that is offered or entered into outside New Zealand; or

(d) an entity described in sch 25, part A (no entities are currently listed).

9.59 A "foreign company" includes a "foreign unit trust", which is essentially a unit trust that is non-resident. A "foreign superannuation scheme" is defined in s YA 1 as a superannuation scheme constituted outside New Zealand. A "superannuation scheme" is defined in s YA 1 as including a trust established for the purposes of providing retirement benefits to members or beneficiaries. Therefore, trusts that are constituted and/or administered outside New Zealand have the potential to fall within the definition of a FIF.

9.60 However, distributions from FIFs are taxed under specific rules in subparts EW and CQ and not under the trust rules. Several methods are available to calculate FIF income, but the principal ones are the fair dividend rate and comparative value. For more information on FIFs, see Inland Revenue Department NZ, *A Guide to the Foreign Investment Fund Rules and the Fair Dividend Rate (IR461)* (May 2016).

Foreign superannuation schemes

9.61 Distributions from foreign superannuation schemes that are trusts in foreign jurisdictions set up mainly to provide retirement benefits to natural persons, are taxed either under the FIF rules or the foreign superannuation scheme rules in s CF 3, and not under the trust rules.

Part 10 Entry to the trust regime

Overview

10.1 When an individual (a natural person) immigrates to New Zealand or a returning New Zealander resumes residency, there are tax implications when that person is a settlor, trustee or beneficiary of a foreign trust. This part of the Interpretation Statement explores the options available to settlors to deal with their foreign trust, and the tax implications for all three categories of persons when they become New Zealand resident.

10.2 Also discussed in this part is an individual's right to become a transitional resident. Transitional residence status applies for at least 48 months after becoming tax resident, plus the part remaining of the month in which the person becomes a transitional resident. During this period, they enjoy an exemption on foreign-sourced passive income. Transitional resident status affects the timing for the settlor to elect to turn a foreign trust into a complying trust, and the treatment of income from a foreign trust.

Settlor's residence determines on-going foreign trust status

10.3 A trust a non-resident settles before immigrating to New Zealand is a foreign trust under s HC 11 until the day before the settlor becomes resident. Trustee and non-resident beneficiary income of such a trust is taxed only if it has a New Zealand source.

10.4 Once a settlor with a pre-migration trust becomes resident, distributions from the trust are treated under s HC 30 as made by a foreign trust for income derived up to a year after the settlor is resident and is not (or no longer is) a transitional resident. Income derived by the trust after that time, when distributed, is treated as from a complying trust if an election is made in time, but if not, then from a non-complying trust. This is discussed further at [10.15].

Transitional resident status

10.5 A transitional resident is a natural person who is resident after being previously non-resident for at least 10 continuous years and who has not been a transitional resident before. They are exempt from tax under ss HR 8 and CW 27 on foreign-sourced amounts (other than employment and services income) for a period:

- beginning on the earliest day they acquired New Zealand tax residency (through either having a permanent place of abode or the first day of the 183-day rule, as applicable); and
- ending at the earlier of:
  - the end of the 48th month after the month in which they acquired a permanent place of abode; or
  - the end of the 48th month after the last day on which they satisfied the 183 day test.

The consequence of this rule is that the period will frequently exceed 48 months.

10.6 A person can elect to stop being a transitional resident under s HR 8(4) and an election once made is irrevocable. If an application is made under s 41 of the TAA for tax credits for families by a person eligible to be a transitional resident they and their spouse, partner or de facto (if also a transitional resident) are treated as having made an application under s HR 8(4).

10.7 The regime was introduced from 1 April 2006 to reduce the tax barriers to international recruitment. For more information, see "Temporary Exemption from Tax on Foreign Income for New Migrants and Certain Returning New Zealanders", *Tax Information Bulletin* Vol 18, No 5 (June 2006): 103 and "IS 16/03: Tax Residence", *Tax Information Bulletin* Vol 28, No 10 (October 2016): 2 at [206] to [219].

Elections into the complying trust regime

10.8 A non-resident settlor who is a natural person has one year after becoming tax resident and ceasing to be a transitional resident to elect under s HC 30 that any foreign trust they have settled becomes a complying trust. If the election is not made in this timeframe, any such trust will be classified as a non-complying trust for any distribution made of amounts derived after the term has expired. If the settlor is a company or other entity the election under s HC 30 is not available. A dual status trust is not treated as subject to the requirements of s HC 30 (see [10.19]).

10.9 To qualify for the election under s HC 30(1), the trust must be a foreign trust for a distribution if it were made immediately before the settlor became resident. This requirement will be satisfied, if no settlor was resident at any time between:

(a) the later of 17 December 1987 and the date the trust was first settled; and

(b) the date of deemed distribution on the day before the settlor becomes resident.

10.10 Under s HC 30(2), a settlor, trustee or beneficiary of a foreign trust can choose to satisfy the income tax liability of the trustee under s HC 33 by making an election before the expiry date using the form *Election to pay income tax on trustee income (IR463)* (June 2008). The effect of an election is that the elector is liable to pay income tax on trustee income, including foreign-sourced amounts (but not on beneficiary income for which a trustee is liable as agent), and the trust is treated as a complying trust for distributions of amounts derived by the trustees after the date of the election.

10.11 The trust is treated as a foreign trust in relation to distributions of amounts derived before the election (s HC 30(3). If a transitional resident who is a settlor makes a further settlement on their trust during the period they are a transitional resident, distributions from that trust will still be treated as coming from a foreign trust. This is because even though s HC 11 will not be satisfied, s HC 30 continues to apply to treat the trust as a foreign trust for distribution purposes for so long as its requirements are met.

10.12 An election can also be made under s HC 33 to pay tax on trustee income of foreign or non-complying trusts if this requirement would not otherwise exist. The due date for making the election in these circumstances is the due date for filing the tax return for the income year of settlement. For more detail see the discussion from [8.28] to [8.30] and also *Election to pay income tax on trustee income (IR463)* (June 2008).

10.13 The liability of any other person to tax on the trustee income is not removed because a party has made an election under s HC 33. For example, if a newly resident settlor (who was not or was no longer a transitional resident) made the election, a non-resident trustee of the trust would also remain liable for tax on New Zealand sourced income (or worldwide income if the settlor continued to make settlements on the trust after becoming resident). The Commissioner is not constrained from pursuing any of the liable parties jointly or severally when assessing or collecting that tax. However, because the settlor has made the election, the Commissioner will only pursue the trustee if the settlor failed to satisfy the liability of the trustee. The Commissioner would not use these powers to collect any more than 100% of tax due.

10.14 A trustee is also a person able to make an election under s HC 33(1). If the trustee makes the election, then only the trustee will be liable for the trustee's income tax. A trustee can make the election even though they will be the person liable in any event once the trust is a complying trust.

10.15 If an election is not made within the period, the trust becomes a non-complying trust under s HC 30(4)(b) for distributions of amounts derived by the trustee after the election expiry date, even if the trustee has paid tax on trustee income under s HC 24(1). Distributions of amounts derived before that date continue to be treated as derived from a foreign trust.

10.16 Section HC 30(6) sets out two options for calculating income derived before the election is made or when it has expired. One option tracks the actual date of income derivation in the period and the other is a time-based apportionment method. No options are prescribed for calculating the income derived in the period after the election is made or has expired (as the case may be), but the Commissioner will accept either of the same two methods for this or any other reasonable method of apportionment adopted.

10.17 When applying the ordering rules to distributions made by a pre-migration trust subject to s HC 30, the trust fund must still be treated as a single fund. This is despite the distributions being treated as sourced from different types of trusts depending on when it was derived. For example, if current year income was all derived after the election expiry date, the first distribution made after the expiry date would be deemed to consist of that current year income and be treated as from a non-complying trust if no election was made. The trustee could not override the ordering rules and designate that as being from accumulated income derived in the period before the expiry date sourced from a foreign trust.

10.18 If an election is not made and no further settlements are made on the trust after the settlor becomes tax resident in New Zealand, the settlor is not liable for tax on trustee income. This is the result of s HC 29(1) for trusts settled on or before 17 December 1987 and of s HC 29(5) for trusts on which a settlement has been made after 17 December 1987.

10.19 If the trust of a settlor who is a new or returning resident or transitional resident has a dual status as both a complying trust and a foreign trust immediately prior to the settlor becoming resident in New Zealand, it will not be treated as meeting the requirements of s HC 30(1)(b) such that s HC 30 will not apply. The Commissioner considers that provision applies to trusts that are only a foreign trust,and not also a complying trust. As a consequence, such a dual status trust will lose its status as a foreign trust on the day the settlor becomes resident and continue as a complying trust for so long as it meets the requirements of s HC 10. If subsequently the status of complying trust was lost such a trust would not then be able to rely on s HC 30 as the prerequisite condition of s HC 30(1)(b) would never have been satisfied.

10.20 If a transitional resident establishes a trust whilst they are a transitional resident, that trust will not be a foreign trust. This is because s HC 11 cannot be satisfied as a transitional resident is resident in New Zealand under s HR 8(2). Moreover, s HC 30(1)(b) cannot apply to treat distributions as being from a foreign trust as the trust does not exist immediately prior to the settlor becoming a resident. Whether the trust is a complying or non-complying trust depends on whether the requirements of s HC 10 have been met. These are set out at [8.17].

Application of s HC 30 – examples

10.21 Example 26 discusses new migrants with an existing trust. Example 27 to Example 29 illustrate the application of s HC 30 in the three circumstances contemplated by that section. The three circumstances being: where an election is made to pay tax on trustee income and the trustee's obligations are satisfied, where an election is made but the trustee's obligations are not satisfied, and where no election is made.

Example 26. New immigrants with existing trust

Facts

Anna settled property on trust on 1 June 1986 when she was resident in Australia having been born there. The trust has two trustees: one is Anna's Australian partner (Rick) and the other is an Australian solicitor. The trust property earns Australian-sourced income. Rick became resident in New Zealand for the first time on 1 October 2011 when he immigrated here with Anna, and his status as a transitional resident ended on 31 October 2015. He continues to be resident in New Zealand after his transitional residency stops.

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Result

Rick, as a trustee of the trust, is liable to pay tax in New Zealand on the Australian-sourced trustee income from the income year commencing on 1 April 2015. This is because a settlor of the trust, Anna, is a New Zealand resident who stops being a transitional resident during this income year (s HC 25(2)). The exception in s HC 25(3) for a non-resident trustee does not apply, because Rick is not resident outside New Zealand at all times during the income year.

Even though Anna is the settlor, she is not liable as agent of the trustee for tax on trustee income because the trust was settled before 17 December 1987 and no further settlements were made after she became resident (s HC 29(1)). (If the trust had been settled after 17 December 1987, s HC 29(5) would still ensure Anna would not be liable for tax on trustee income.)

However, Anna can make an election under ss HC 30(2) and HC 33 to satisfy the income tax liability of the trustee from the date of the election. This is because Anna is a natural person who is a New Zealand resident. And, if a distribution had been made from the trust on the day before she became resident in New Zealand, the trust would have been a foreign trust for the distribution (s HC 30(1)).

If Anna, Rick, the Australian solicitor trustee or any beneficiary of the trust makes an election, the tax treatment of distributions will be:

- Where the amount (being distributed) was derived before the election was made, the trust will be treated as a foreign trust (s HC 30(3)(a));
- Where the amount was derived after the election was made and the requirements of s HC 10(1)(a) are met, the trust will be treated as a complying trust (s HC 30(3)(b));
- Where the amount was derived after the election date and the requirements of s HC 10(1)(a) were not met, the trust will be treated as a non-complying trust (s HC 30(3)(c)).

If an election is not made under ss HC 30(2) and HC 33, the tax treatment of distributions will be:

- Where the amount (being distributed) was derived before the election expiry date (ie, before 31 October 2016), the trust will be treated as a foreign trust (s HC 30(4)(a));
- Where the amount was derived after the election expiry date, the trust will be treated as a non-complying trust (s HC 30(4)(b)).

Rick being a New Zealand resident trustee will continue to be liable for tax in New Zealand on Australian-sourced amounts of trustee income if the trust becomes non-complying as the exemption in ss HC 26(1) and CW 54 will not apply from the income year in which Anna as settlor ceased to be a transitional resident.

In the event that the facts changed such that both trustees were always non-resident then the trustees as a notional single person would be treated as non-resident with the consequence that foreign-sourced trustee income would not be assessable income under ss HC 25(3) or HC 25(4) provided no further settlements were made on the trust by a New Zealand resident or by a person that had been a New Zealand resident at any time between 17 December 1987 and the date of settlement.

Once the trust becomes a non-complying trust under s HC 30(4)(b) it can never subsequently adopt a status as a complying trust because it is unable to satisfy any of the requirements of s HC 10.

Example 27. Election made and trustee's obligations satisfied

Facts

Len settled $100,000 on trust on 1 April 2007 when he was resident in Hong Kong. The trustees are all resident in Hong Kong. Two members of Len's family (Kim and Jack) are beneficiaries of the trust. The trustees have discretion to pay income or capital to Kim and Jack. No further settlements were made on the trust after 1 April 2007.

Len, Kim and Jack all became resident in New Zealand on 1 May 2007 and were transitional residents for a 4-year period. None had previously been resident in New Zealand.

On 1 November 2011, Len made an election under ss HC 30(2) and HC 33 to pay tax on trustee income. All of the income the trustees derived was from outside New Zealand. The amounts the trustees derived and accumulated were:

Income year	Income	Capital gains
2008	$1,000	Nil
2009	$10,000	$5,000
2010	$11,000	$5,000
2011	$13,000	$2,000
2012	$8,000	$3,000
2013	$10,000	$3,000

On 1 April 2013, the trustees made distributions to Kim of $51,000 and to Jack of $30,000. Len had paid tax on the trustee income derived between 1 November 2011 (the date of election) and 1 April 2013. Kim and Jack were still resident in New Zealand on 1 April 2013.

Tax consequences:

Entitlement to make election

Len is entitled to make an election under ss HC 30(2) and HC 33. This is because he is a natural person who became resident in New Zealand, and the trust would have been a foreign trust for a distribution made on 30 April 2007 (the day before Len became resident).

Kim and Jack, as beneficiaries of the trust, are also entitled (but not required) to make an election under ss HC 30(2) and HC 33, as are the Hong Kong trustees.

The election must be made within one year of the day on which the settlor became resident and ceased being a transitional resident. Len stopped being a transitional resident on 31 May 2011. The election may be made at any time on or before 31 May 2012. Therefore, Len's election on 1 November 2011 is within time.

Trustee income

Before Len stopped being a transitional resident, the trustee income was not liable to New Zealand tax because no settlor of the trust had stopped being a transitional resident and the income was all derived from outside New Zealand (ss BD 1(4) and HC 25(2)). Also, the trustees are not liable for tax on the trustee income derived in the income year when Len stopped being a transitional resident and in later income years. This is because the income derived by the trustee was from outside New Zealand and the trustees are non-resident at all times during those income years and the settlor was not resident in New Zealand at the time of settlement (s HC 25(4)).

The exclusion for non-resident trustees in s HC 25(4) does not affect a settlor's liability (or the requirements for a complying trust) (s HC 25(5)). However, Len is not liable as agent for the trustees for tax on trustee income. This is because Len was not resident in New Zealand when the settlement was made on the trust (s HC 29(5)). Len is liable to meet the income tax liability of the trustees from the date of his election under s HC 33(1) and the consequential assumption of any income tax liability the trustee would have if the settlor and trustees were New Zealand residents (s HC 33(2)).

The effect of the election is that Len is liable to pay tax on the trustee income derived from the date of election. No method is prescribed for calculating the income derived in the year of election after the date on which the election is made. However, methods modelled on s HC 30(6), namely either a time-based apportionment or a calculation based on income actually derived, will be acceptable as will any other reasonable apportionment method.

Assuming that a time-based apportionment is made, the trustee income on which Len is liable for tax for the 2012 income year is:

$8,000 × (151 ÷ 365) = $3,310

Len is also liable to tax on trustee income derived in all subsequent income years. However, the $10,000 derived by the trustees in the 2013 income year is distributed to Kim as beneficiary income so there is no trustee income.

Distributions

The trust is a discretionary trust, and an election to pay tax on trustee income has been made under ss HC 30(2) and HC 33. The ordering rules in s HC 16(2) do not apply to the distributions to Kim and Jack, and the distributions are deemed to reflect the terms of the exercise of the trustees' discretion (see the exclusion from the ordering rules in s HC 16(6)).

If it is assumed that Kim is an income beneficiary only, that Jack is an income and capital beneficiary, and that the trustees exercised their discretion to pay capital to Jack, the treatment of the distributions is as follows:

(a) $51,000 distribution to Kim

The trustees exercise their discretion to distribute income derived in the 2008 to 2013 income years.

The $10,000 derived in the 2013 income year is assessable as beneficiary income (s HC 17).

An amount of $33,000 from the $35,000 of income derived in the 2008 to 2011 income years is distributed with the remaining $2,000 left in the 2009 income year.

The $33,000 and the portion of income derived in the 2012 income year before the election (ie, $8,000 × (214 ÷ 365) = $4,690) are assessable as a taxable distribution of $37,690 from a foreign trust (ss HC 30(3)(a) and HC 15(4)).

The taxable distribution is taxed at Kim's normal marginal rates.

The remaining portion of income derived in the 2012 income year, $3,310, is not assessable. This is because it is a distribution of income from a complying trust of an amount other than beneficiary income (ss HC 30(3)(b) and HC 20).

(b) $30,000 distribution to Jack

The trustees exercise their discretion to distribute capital to Jack. The distribution is of the $18,000 of capital gains derived by the trustees in the 2009 to 2013 income years and $12,000 of corpus.

Capital gains of $12,000 derived in the 2009 to 2011 income years and the portion of capital gains derived in the 2012 income year before the election are not assessable (ie, $3,000 × (214 ÷ 365) = $1,759). This is because they are distributions of capital gains from a foreign trust (ss HC 30(3)(a) and HC 15(4)).

The portion of capital gains derived in the 2012 income year after the election, $1,214, and capital gains of $3,000 in the 2013 income year are also not assessable. This is because they are distributions from a complying trust of amounts other than beneficiary income (ss HC 30(3)(b) and HC 20).

The distribution of corpus is not assessable.

The result is that no part of the $30,000 distribution is taxable to Jack.

Example 28. Election made but trustee's obligations not satisfied

Facts

The facts are the same as in Example 27, except that the trustee's income tax obligations are not satisfied in the 2013 income year.

Tax consequences:

Trustee income

The trustee income for the 2012 income year remains liable for tax as in Example 27. There is no liability to tax for the trustee income derived before the election to pay tax on trustee income was made (ie before 1 November 2011); but the settlor, Len, is liable to tax on trustee income derived after that date (ie, $3,310). Len is also liable to tax on trustee income derived in all subsequent income years. Len is liable to satisfy the tax on trustee income from his date of election on the deemed basis under s HC 33 that the trustee is resident when in fact the trustees are not resident.

Distributions

Any distributions made in the income year in which the trustee's obligations are not satisfied and in any subsequent income year are treated as distributions from a non complying trust except where they are of amounts derived before the day on which the election was made (s HC 30(3)(c)). Also, the ordering rules apply to such distributions because the trust is treated as a non-complying trust (s HC 16(1)). The ordering rules govern the order in which income, capital gains and corpus are deemed to be distributed.

The distributions made to Kim and Jack on 1 April 2013 are in an income year after the one in which the trustee's obligations are not satisfied (ie, the 2014 income year). Therefore, the trust is treated as a non-complying trust for the distributions, except where they are of amounts derived by the trustees before the election was made, and the ordering rules in s HC 16(2) apply.

The distributions are made at the same time. Rules for how contemporaneous distributions are to be ordered are in s HC 16(3). If an amount is included in an earlier or contemporaneous distribution, then it is not treated as included in the relevant distribution. The characterisation of distributions made at the same time is generally for the trustee to decide, subject to the ordering rules in s HC 16(2) and (3). In this case, it is assumed that the trustee has by resolution recorded the distribution in the order reflecting its decision. The resolution first of all allocated $51,000 of the income from the 2008 to 2013 income years to Kim. The remaining $2,000 of the income from the 2009 income year is then allocated to Jack because s HC 16(3)(b) treats all income as having been distributed before capital gains are distributed. The treatment of the distributions is as follows.

(a) $51,000 distribution to Kim

As noted earlier, it is assumed the trustees make distributions to Kim first and then Jack. The trustee's discretion to pay out earlier years' income is overridden by s HC 16(2). Under s HC 16(2)(a) the current year's income must be paid out first and then the earlier years' income. In this case, none of the income was derived by the trustee in the same year it was distributed to the beneficiaries. Therefore, the treatment of the income is determined by the ordering rules in s HC 16(2)(b) and by the extended period for paying beneficiary income in s HC 6(1B).

The ordering rules do not specify that preceding years' income must be regarded as having been distributed to the beneficiaries in any particular order, and it is the order in which the trustees resolve to make distributions that applies.

If the income is distributed to Kim from the same income years identified in Example 27, $37,690 of the distribution to Kim is assessable as a taxable distribution from a foreign trust at Kim's normal marginal rates. The $37,690 comes from the same income years and amounts identified in Example 27. This is the combined effect of the ordering rules at s HC 16(2) and the calculation required by s HC 30(6) at the date of election under s HC 33(3) and s HC 30(3).

The remaining portion of income derived in the 2012 income year after the election was made, $3,310, is also assessable, but as a taxable distribution from a non-complying trust at 45% (ss HC 30(3)(c) and HC 34(1)).

The $10,000 derived in the 2013 income year is assessable as beneficiary income. Although the amount was paid on 1 April 2013 and the 2013 income year ended on 31 March 2013 it was still within the extended period available under s HC 6(1B) in which beneficiary income can be allocated.

(b) $30,000 distribution to Jack

The distributions are recorded by the trustee as first going to Kim and then to Jack. Therefore, the distribution to Jack cannot be of amounts that are deemed to have been distributed to Kim, including all the income from the 2008 income year. Consequently, Jack is deemed to receive $2,000 of the income remaining from the 2009 income year, the capital gains of $18,000 derived in the 2009 to 2013 income years, and corpus of $10,000.

The distribution of corpus is not assessable.

The capital gains derived in the 2009 to 2011 income years and the portion of the capital gain derived in the 2012 income year before the election are also not assessable. This is because they are distributions of capital from a foreign trust (ss HC 30(3)(a) and HC 15(4)).

However, the remaining portion of capital gains derived in the 2012 income year after the election was made, $1,241, and the capital gain of $3,000 derived in the 2013 income year, are assessable as a taxable distribution from a non-complying trust at 45%.

The $2,000 of income derived from the 2009 income year is also assessable, but as a taxable distribution from a foreign trust at Jack's normal marginal rates.

Example 29. No election to pay tax on trustee income

Facts

The facts are the same as in Example 27 except that no election is made to pay tax on trustee income.

The election expiry date is one year from the date on which Len stopped being a transitional resident. Len stopped being a transitional resident on 31 May 2011. Therefore, the election expiry date is 31 May 2012.

Tax consequences:

Trustee income

Because no election has been made, the trustee income is not liable to tax, and Len is not liable as agent for the trustees (for the reasons set out in Example 27 under the heading "trustee income" that explains he was not resident when the settlement was made).

Distributions

The trust is deemed to be a foreign trust for any distribution of amounts derived before the election expiry date and a non-complying trust where the distribution is of amounts derived after that date (s HC 30(4)). The ordering rules in s HC 16 apply to determine the different elements of the distribution.

The distributions to Kim and Jack are made on the same date of 1 April 2013, and it is assumed that the trustees followed the order they adopted in their resolution as treating $51,000 of the income from the 2008 to 2013 income years as having been distributed to Kim first and the remaining $2,000 from the 2009 income year as having been distributed to Jack, because this is the order in which the relevant trustees' resolution dealt with it.

(a) $51,000 distribution to Kim

The ordering rules at s HC 16(2) will apply to any distribution to Kim.

The $33,000 from the income derived in the 2008 to 2011 income years is assessable as a taxable distribution from a foreign trust at Kim's normal marginal rates (ss HC 30(4)(a) and HC 15(4) and HC 16(2)(b)).

The $8,000 of income derived in the 2012 income year is also assessable as a taxable distribution from a foreign trust. This is because the income in the 2008 to 2012 income years was derived before the election expiry date of 1 May 2012.

The $10,000 derived in the 2013 income year is assessable as beneficiary income. Although the amount was paid on 1 April 2013 and the 2013 income year ended on 31 March 2013 it was still within the extended period available under s HC 6(1B) in which beneficiary income can be allocated.

If it were not beneficiary income (ie the distribution was made outside of the scope of s HC 6(1B)) then it is a taxable distribution and it would have been necessary to apportion the amount. The portion derived before the election expiry date would be a taxable distribution from a foreign trust (s HC 30(4)(a) and (6)). The portion derived after the election expiry date would also be a taxable distribution but from a non complying trust (s HC 30(4)(b)).

(b) $30,000 distribution to Jack

Once again the ordering rules apply to Jack's distribution.

Jack is deemed to receive $2,000 of the income remaining from the 2009 income year, the capital gains of $18,000 derived in the 2009 to 2013 income years, and corpus of $10,000 (s HC 16(2)(b), HC 16(2)(d) and HC 16(2)(e)).

The distribution of corpus is not assessable.

The capital gains derived in the 2009 to 2012 income years and the portion of the capital gain derived in the 2013 income year before the election expiry date (ie, $3,000 x (30 ÷ 365) = $246.57) are also not assessable. This is because they are distributions of capital from a foreign trust that are not taxable distributions (ss HC 30(4)(a) and HC 15(4)).

However, the remaining portion of capital gains derived in the 2013 income year after the election expiry date, $2,753.43, is assessable as a taxable distribution from a non-complying trust at 45% (ss HC 30(4)(b) and HC 15(2)).

The $2,000 of income derived from the 2009 income year is also assessable, but as a taxable distribution from a foreign trust at Jack's normal marginal rates.

Valuation of property, trading stock and financial arrangements on becoming a complying trust

10.22 Trustee income may become subject to New Zealand income tax some time after a trust was first established. This will occur, most commonly, when a non-resident settlor becomes resident in New Zealand and an election is made under ss HC 30 and HC 33 for a foreign trust to be a complying trust. When this happens, it is necessary to establish, at the date of change, the cost of trading stock and depreciable assets the trust owns, and to ensure income or expenses that would have already been accrued for financial arrangements of the trust (had the trustee income been liable to New Zealand income tax) are not accrued after the trustee income becomes liable to income tax. This is achieved by the rules in s HC 31.

Application of s HC 31

10.23 Section HC 31(1) has application when an amount a trustee derives on a date is assessable income when immediately before that date the income was not liable to New Zealand income tax other than as non-resident passive income. For ease of reference, this is referred to as the "change date."

10.24 Section HC 31(1) also applies when trustee income was previously liable to New Zealand income tax as non-resident passive income and subsequently becomes liable to New Zealand income tax as income of another type. For example, if the trustee income of a trust settled by a non-resident included interest paid by a New Zealand company, the interest would cease to be liable to income tax as non-resident passive income if the settlor and trustee became resident in New Zealand and an election was made under ss HC 30(2) and HC 33 to pay tax on trustee income.

10.25 Section HC 31 also applies when some trustee income was previously liable to New Zealand income tax while another portion was not, and the latter portion then becomes liable. In this situation, s HC 31 will apply only to the assets and financial arrangements used to produce income that was not previously liable to income tax. For example, if a trustee of a trust settled by a non-resident had trading income from within and outside New Zealand, only the profits from New Zealand would be liable to income tax. However, if the settlor became resident in New Zealand and an election was made to pay tax on trustee income, both the New Zealand and foreign business profits would be liable to income tax. Then, s HC 31 would apply in relation to the assets and financial arrangements used to earn the foreign-sourced business profits.

10.26 Section HC 31(1B) confirms that from 14 April 2014, s HC 31 does not apply to charitable trusts that fail to meet the requirements for deriving exempt income under ss CW 41 or CW 42. From that date, such charities are subject to the provisions of ss HR 11 and HR 12 relating to non-exempt charities ceasing their tax-exempt status and entering the tax base.

Premises, plant, machinery, equipment and trading stock

10.27 Section HC 31(3) sets out the method for determining the "cost" of premises, plant, machinery, equipment and trading stock on the change date. For premises, plant, machinery and equipment, the "cost" determined forms the basis for any depreciation losses that are deductible from trustee income. Cost also establishes an opening value for the trading stock provisions.

10.28 Either of two methods may be used to calculate the cost of the premises, plant, machinery, equipment or trading stock. The person liable for income tax on trustee income chooses the method and should indicate the method taken in the trust income tax return.

10.29 The first method is the historical cost of the asset, less accumulated depreciation or other value at that date (not exceeding market value) used to calculate income tax in a country (or territory) in which the trustee income has been liable to income tax. That is, the person may elect to use the depreciated basis or other value of the asset that is used for the purpose of income tax calculations in another country. If the relevant date falls within the income year in the other country, rather than at year end, it will be necessary to calculate the depreciated value by apportioning the depreciation allowed in the foreign country to the before and after periods in that income year. It will also be necessary to value the trading stock on the change date according to the methods used for income tax purposes in the foreign country, even if a valuation is not required under that country's tax laws on that date.

10.30 For this first method to be available, the trustee income must have been liable to income tax in another country, and the asset must have a value (whether historical cost less depreciation or any other value but not exceeding market value) for the purposes of income tax calculations in that country.

10.31 Under the second method, the person may use the value that would be used for the ITA 2007 at the relevant date as if the trustee income had always been assessable other than only as non-resident passive income. For premises, plant, machinery and equipment the "cost" under this option is calculated in two steps:

(a) The first step is to establish the value of the asset that would have been used for New Zealand depreciation purposes when the asset was first available to produce income that would have been liable to New Zealand tax.

(b) The second step is to deduct from the original depreciation basis calculated in step 1, the total amount of depreciation that would have been allowed as a deduction up to the change date, assuming a liability to New Zealand tax had always existed.

10.32 For trading stock, the person may use any of the applicable valuation methods in subpart EB to obtain a value on the date on which the trustee income became liable to New Zealand income tax.

10.33 Under the second method, it is assumed that the trustee income had at all times been liable to New Zealand income tax. This does not, however, include an assumption that assets are located in New Zealand and that, therefore, any special rates of depreciation historically available in New Zealand are applicable. If, for example, assets were used to carrying on a business in Hong Kong, the depreciation is calculated by assuming that the trustee income derived from the Hong Kong business was always liable to New Zealand income tax and that depreciation was allowed on the basis of the assets being in Hong Kong.

Financial arrangements

10.34 Section HC 31(4) and (5) sets out a method for calculating the consideration for a financial arrangement on the change date. The amount determined is then used to calculate the base price adjustment when it matures, or when it is remitted, sold or otherwise transferred. The intent is to ensure income or expenses that would have been notionally accrued in relation to the financial arrangement in the period before becoming liable to New Zealand income tax (assuming the trustee income had been liable to income tax all along) are not accrued in the period after actually becoming liable to income tax.

10.35 There are two options for establishing the consideration. The first option is the market value of the financial arrangement on the change date. The second option is the value calculated from the formula (s HC 31(5)):

consideration paid to the person + expenditure − consideration paid by a person − income

Where (s HC 31(5)):

- **consideration paid to the person** is the consideration amount paid to the person before the change date;
- **expenditure** is the amount that would have been incurred under the financial arrangement rules before the change date;
- **consideration paid by the person** is the amount paid by the person before the change date; and
- **income** is the income that would have been derived under the financial arrangement rules before the change date.

10.36 The consideration calculated is taken into account in the formula in s EW 31 when calculating the base price adjustment for the financial arrangement.

Impact of transitional residence

Distributions from foreign trusts and non-complying trusts

10.37 Transitional residents are treated the same as non-residents under s HR 8(1)(a) when they derive a foreign-sourced amount under a number of provisions including s CW 27. This indicates that a foreign-sourced amount derived by a transitional resident that is not their employment income or income from a supply of services is exempt income. Consequently, a transitional resident who derives a foreign-sourced amount as either beneficiary income or as a taxable distribution from either a foreign or non-complying trust is treated as deriving exempt income which is excluded from assessable income under s BD 1(5).

10.38 Beneficiary income retains the character that it had when derived by the trustee because the trust provisions, such as s HC 5, are structured to retain the dual derivation of such income by both the trustee and the beneficiary as discussed at [5.13] and [5.14].

10.39 Although taxable distributions are a construct of the trust tax regime, it is implicit from both the ordering rules in s HC 16, and from s YD 4(13) and (18), that the source of the income or capital gains in the hands of the trustee that are subsequently included in such distributions remains relevant in characterising them for tax purposes. Refer to the discussion on taxable distributions from [8.102] for more detail on the relevance of source and residency for the tax treatment to non-residents.

10.40 Where a trustee of a foreign trust derives income or capital gains sourced from New Zealand, a taxable distribution to a beneficiary is treated as income having a New Zealand source to the same extent under s YD 4(13) and (18). The ordering rules in s HC 16 will determine the character of the taxable distribution. This means taxable distributions will not be exempt to transitional residents under s CW 27 as foreign-sourced amounts to the extent that they comprise accumulated income and associated party capital gain amounts sourced from New Zealand.

10.41 A transitional resident who derives New Zealand sourced beneficiary income or taxable distributions from foreign trusts must include this in their assessable income. New Zealand sourced income included in taxable distributions to transitional residents from non-complying trusts is excluded income taxable to the transitional resident at 45%.

Distributions from complying trusts

10.42 Beneficiary income retains its underlying character (see [5.13]). Consequently, a transitional resident receiving beneficiary income will be taxed on New Zealand sourced income within that distribution, but not on other foreign-sourced amounts.

Taxation of trustee income when settlor is a transitional resident

10.43 The treatment of foreign-sourced amounts derived by a trustee between the date on which the settlor of that foreign trust became resident and the date on which any election is made, is determined under ss HC 25 (foreign-sourced amounts: non-resident trustees) and HC 26 (foreign-sourced amounts: resident trustees). Section HC 25 does not make non-resident trustees liable for tax on foreign-sourced amounts while the settlor is a transitional resident, but does in the income year any settlor ceases to be a transitional resident. Section HC 26, in conjunction with s CW 54, treats foreign-sourced amounts derived by resident trustees as exempt where the settlor is a transitional resident (and the trust is a registered foreign trust that complies with certain disclosure requirements) but not in the income year the settlor ceases to be a transitional resident.

10.44 A consequence of a transitional resident making further settlements after becoming resident is that the exemption in s HC 25(4) will not apply for foreign-sourced amounts derived by a non-resident trustee because a settlement has been made by a New Zealand resident. This means that from the income year in which the settlor ceases to be a transitional resident, any foreign-sourced amounts will be taxable where the trustee is non-resident. Equivalent treatment applies where the trustee is resident as the exemption for foreign-sourced amounts derived by a trustee under ss HC 26(1) and CW 54 also expires in the income year that a settlor ceases to be a transitional resident.

10.45 New Zealand sourced income of a trustee of a foreign trust is taxable at all times irrespective of the status of the settlor.

Liability of settlor while a transitional resident

10.46 Where a settlor makes no settlements on a foreign trust after they become resident, and the settlor has not previously been resident in New Zealand after 17 December 1989, they will not be liable under s HC 29(5) for the tax on trustee income of that trust unless they make an election under s HC 30.

10.47 If a settlor makes further settlements on a foreign trust with non-resident trustees while they are a transitional resident, they would be liable for tax on the New Zealand sourced trustee income from the time they made that settlement under s HC 29(1). From the beginning of the income year in which they cease to be a transitional resident, they will be liable for tax on the foreign-sourced amounts of the trustee through the combination of ss HC 25(2) and HC 29(1).

10.48 If a settlor makes settlements on a foreign trust with a resident trustee while a transitional resident, s HC 29(3) will apply to exclude the settlor from liability on trustee income.

Issues with pre-migration trusts

10.49 Where immigrants to New Zealand and returning New Zealanders who have been absent for more than 10 years settle a trust prior to coming to New Zealand, they may intend to have it treated as a non-complying trust under s HC 30(4) after it ceases to be a foreign trust, without the settlor having agency liability on trustee income under s HC 29(2). But agency liability will be triggered if any further settlements occur while they are resident. This can arise for example if the settlor has made a loan to the trust and fails to charge market rate interest on it. Also returning New Zealanders will continue to have an agency liability on trustee income of a non-complying trust they have settled under s HC 29(5) if they had previously been resident in New Zealand after 17 December 1987.

Taxation of distributions to new or returning residents who are not transitional residents

Beneficiary income

10.50 The residency of a beneficiary determines how they are taxed on beneficiary income. A newly resident beneficiary who is not or who has ceased to be a transitional resident is taxable at marginal rates on all beneficiary income in the same manner as any resident.

Taxable distributions

10.51 Newly resident beneficiaries who are not or who have ceased to be transitional residents are taxed on taxable distributions at applicable rates being their marginal rate for such distributions from foreign trusts and 45% for non-complying trusts.

New Zealanders returning within 5 years

10.52 If a person ceases to be resident and then returns to New Zealand within 5 years and resumes tax residency, they are taxed on all beneficiary income and taxable distributions that they derived over the period of absence from foreign and non-complying trusts. The intention of s HC 23 is to prevent such beneficiaries from changing residence so as to defeat the trust rules.

10.53 Where s HC 23 applies, the resulting income is treated under s CV 15 as being derived on the day the person becomes resident again.

10.54 Any beneficiary income taxable under s HC 23 may be accompanied by relevant foreign tax credits or NRWT. However, s LJ 6(2) permits foreign tax credits on taxable distributions only if they are substantially the same as NRWT. This means no credit is available for underlying tax paid on that type of income, the credit is only for tax in the nature of a withholding tax imposed on non-residents.

Trustees immigrating to New Zealand

10.55 If a trustee migrates to New Zealand and becomes resident that alone will not result in the trust being taxable, because prime liability on foreign-sourced amounts is determined by the residency of the settlor and beneficiaries and the source of the income. If the settlor is non-resident, no beneficiaries are resident and no income has a New Zealand source, the trustee would have no liability for New Zealand tax in their capacity as trustee.

10.56 A resident trustee must, however, disclose details of trusts they are a trustee of with non-resident settlors (foreign trusts) under s 59B of the TAA. These obligations are discussed in Part 13 of this Interpretation Statement.

10.57 A trustee will only be a transitional resident under s HR 8 in their personal capacity as a "natural person", which excludes their status as a trustee. Therefore, s CW 27 does not apply to exempt foreign-sourced amounts from tax that a transitional resident derives as a trustee.

Part 11 Exit from the trust regime

Impact of settlor leaving New Zealand

11.1 New Zealand does not have a residence test for trusts. Therefore, there is no specific regime for the emigration of trusts (unlike for companies).

11.2 The taxation of trustee income is generally dependent on the residence of the settlor. Therefore, if the tax residence of a New Zealand settlor changes, there may be tax implications in relation to the treatment of trustee income. Specifically, foreign-sourced amounts derived by a non-resident trustee are liable to tax under s HC 25 where a settlor is resident and not a transitional resident. Foreign-sourced amounts derived by a resident trustee are taxable, if the settlor is resident and not a transitional resident, because the tax exemption for foreign-sourced trustee income in ss HC 26 and CW 54 does not apply in such circumstances. New Zealand sourced income of a trustee is always taxable. However, the tax rate on New Zealand-sourced trustee income will depend on the type of income, the residence of the trustees, whether or not the trustees have made an election under s HC 33, and the potential relevance of a double tax treaty (eg, in setting rates of NRWT on interest, dividends and royalties). Therefore, it will not always be the case that the flat trustee rate of 33% will be applicable.

11.3 If all the settlors of a complying trust leave New Zealand, ss HC 26(1) and CW 54 will result in the foreign-sourced amounts of a resident trustee being exempt income in the income year following the departure of the last of the settlors. The same applies under s HC 25 where the trustee is non-resident. If the trustee does not pay tax on worldwide trustee income, the trust will cease to be a complying trust at the time it next makes a distribution.

11.4 If complying trust status is lost, under s HC 10(1)(a) the trust will become a non-complying trust and subject to the ordering rules in s HC 16 (discussed in Part 8 of this Interpretation Statement) with taxable distributions derived by any New Zealand resident beneficiaries attracting tax at 45%. New Zealand sourced taxable distributions to non-resident beneficiaries will also be subject to tax at 45%.

11.5 Sections HC 33(1B) and HC 10(1)(ab) permit the trustee of a complying trust that ceases to meet the requirements under s HC 10(1)(a) to retain that status even after the last settlor leaves New Zealand. From 1 April 2008, a trustee in this position can be treated as having made an election to satisfy the income tax liability of the trustee under s HC 33 just by indicating that it is a complying trust in the annual return and continuing to pay tax on the worldwide trustee income before making any distribution.

11.6 Consequently, when a settlor leaves New Zealand they can effectively choose to migrate their trust and thereafter have it treated as a non-complying trust or carry on as a complying trust and pay full tax in New Zealand on the worldwide trustee income.

Impact of trustee leaving New Zealand

11.7 Many other countries base the tax residence of trusts on the residence of the trustee. Consequently, even if one trustee of a complying trust adopts residency in another country it may result in the new country of residence seeking to tax the trustee income of that trust.

11.8 In New Zealand, the residency of the trustee is not the main factor in determining the liability of the trustee to pay tax on trustee income. Where a trustee ceases to be New Zealand resident, that trustee will remain liable for tax on worldwide trustee income of a trust settled by a person who remains resident in New Zealand, including in the income year such a settlor ceases to be a transitional resident. Tax liability on foreign-sourced amounts is imposed under s HC 25 on foreign trustees where the settlor is resident and not a transitional resident. New Zealand sourced income derived by a non-resident trustee in such a situation will be taxable based on the source rules in s YD 4.

Beneficiaries ceasing to be resident in New Zealand

11.9 A beneficiary of a complying trust who ceases to be New Zealand tax resident is treated for tax purposes in the same manner as any non-resident beneficiary. Tax is paid by the trustee as their agent or withheld at applicable NRWT rates from beneficiary income that is New Zealand sourced.

11.10 A taxable distribution from a foreign trust to a non-resident beneficiary is taxable to the same extent as the income has a New Zealand source under s YD 4(13) and (18). The ordering rules in s HC 16 are applied to determine the character of the amounts distributed as accumulated income and associated party capital gains.

11.11 A taxable distribution from a non-complying trust to a non-resident beneficiary is taxed at 45% under s BF 1(b) to the extent that it consists of New Zealand sourced income and capital gains but not foreign-sourced amounts.

11.12 Beneficiary income derived by a non-resident is taxed if it has a New Zealand source. Foreign-sourced amounts are not assessable income of a non-resident under s BD 1(5).

Part 12 Associated persons

Overview

12.1 Subpart YB sets out the rules for determining when persons will be associated for tax purposes. Several provisions in subpart YB deal with trusts. The associated persons rules relating to trusts were strengthened from 1 April 2010 with some exceptions where the rules apply to land transactions.

12.2 The associated persons rules are designed to prevent changes to the tax treatment of a transaction by conducting it with or flowing it through an associated party. They also treat transactions between associated persons as being undertaken at arm's length for tax purposes. A major area of concern has been the use of trusts by property developers to move property transactions from a taxable business to a non-taxable capital investment by a related party trust. As a result, the rules were strengthened in relation to trusts. See Inland Revenue Department NZ, *A guide to associated persons definitions for income tax purposes (IR620)* (November 2010) at 6.

12.3 The broad rules for associated persons in the trust context can be summarised as:

Associated persons rule	Income tax – land	Income tax – other
Trustees and beneficiaries	No	Yes
Trustee and relative of beneficiary	No	Yes
Trustee and settlor	Yes	Yes
Settlor and beneficiary	No	Yes
Two trustees and same settlor	Yes	Yes
Trustees and person with power to appoint and remove trustees	Yes	Yes

12.4 Several modifications apply to the trust-based tests to ensure the rules do not over-reach in their object of protecting the tax base. These modifications include:

(a) not having the beneficiary association tests, or person and the trustee for a relative test, applying to land sales transactions;

(b) excluding charities as beneficiaries for the tests and excluding charitable trusts from the trustee and settlor test; and

(c) not including the provision of services to a trust for less than market value in the settlor definition for associated person tests.

Trust-specific associated person tests

12.5 Under s YB 6(1), a trustee is associated to the beneficiaries of a trust. This rule does not apply for the purposes of the "land provisions" under s YB 6(2). "Land provisions" is defined in s YA 1 to cover numerous land-related transactions:

> **land provisions** means the following provisions:
>
> (a) sections CB 7 to CB 11 (which relate to certain land transactions), except CB 8 (Disposal: land used for landfill, if notice of election):
>
> (b) section CB 15 (Transactions between associated persons):
>
> (bba) section CC 1B (Consideration relating to grant, renewal, extension, or transfer of leasehold estate or licence):
>
> (bbab) section EE 67 (Other definitions):
>
> (bb) section EI 4B (Consideration for agreement to grant, renew, extend, or transfer leasehold estate or licence):
>
> (c) sections FB 3 to FB 5 (which relate to the transfer of land on a settlement of relationship property)

12.6 Beneficiaries are defined under s YB 6(1) to include those that have benefited under a trust as well as those eligible to benefit. This latter class includes any person named by the trustee as a beneficiary as well as discretionary beneficiaries that are named or within a designated class.

12.7 Importantly, where trustees or other persons have a general power to appoint beneficiaries, any person yet to be appointed is not included as a beneficiary. For elaboration of the policy on when a person under a trust is eligible to benefit, see "Income Tax: Associated Persons", *Tax Information Bulletin* Vol 7, No 9 (February 1996): 25.

12.8 Exceptions for certain employer trusts exist under s YB 15, the bonus bonds unit trust and energy consumer trusts (lines trusts) under s YB 16(1), as well as charities under s YB 16(2). Community trusts that hold shares in the successor companies to the former trustee banks are excluded, because, technically, these "purpose" trusts do not have beneficiaries at law.

12.9 Two persons are associated under s YB 5(1) if one is a trustee and the other is associated under the "two relatives test" with a person who has benefited or is eligible to benefit under the trust. The "two relatives test" is in s YB 4 and determines that two relatives are associated if they are within two degrees of relationship; they are married, in a civil union or in a de facto relationship; or if one person is within two degrees of blood relationship to the other person's spouse, civil union partner or de facto partner. Again the provision does not apply to land provisions under s YB 5(2), and there is also the same exception under s YB 16(1) described above. A trustee will be associated to the person's relatives within the second degree (ie, their spouse, civil union partner, de facto partner, parents, grandparents, children, grandchildren, siblings, and parents of the person's spouse, civil union partner or de facto partner).

12.10 Trusts with a common settlor are associated under s YB 7. Under this provision two persons who are married, in a civil union or in a de facto relationship are treated as the same person to prevent circumvention by the use of mirror trusts. Further, for the purposes of s YB 7, a settlor does not include someone who provides services to the trusts for less than market value, for example a family member who provides accounting services to a family trust for no consideration (s YB 10). Also s YB 7 does not apply where a trust is only for the benefit of employees (s YB 15).

12.11 A trustee and a settlor are associated under s YB 8. The same exceptions listed in [12.10] apply with the addition of an exception for charitable trusts under s YB 8(2).

12.12 A settlor and any beneficiary of the trust are associated under s YB 9. Again, the same exceptions described in [12.10] apply.

12.13 The associated persons rules do not apply to associate a deceased person with their estate. While a trustee is defined as including an executor and an administrator, an estate is not the same as a trust, as discussed in Part 9 of this Interpretation Statement (in relation to deceased estates). In addition, under ss FC 1 and FC 2, a transfer of a deceased person's assets to their executor is treated as a transfer for market value. This means a deceased person is not a "settlor" of their estate because there is no transfer for less than market value.

12.14 A trustee and a person with power to appoint or remove a trustee are associated under s YB 11. An exception exists for certain employer trusts under s YB 15.

12.15 Corporate trustees are not looked through when testing association.

12.16 For more detail on the associated persons regime and for an explanation of the reasoning behind various exclusions such as charities and energy consumer trusts (lines trusts) with examples, see Inland Revenue Department NZ, *A guide to associated persons definitions for income tax purposes (IR620)* (November 2010).

Part 13 Compliance

Introduction

13.1 There are tax obligations placed on settlors, trustees and beneficiaries of trusts. Many such obligations are common to all taxpayers (eg, the obligation to pay tax on the due date), and are not dealt with in this Interpretation Statement. Rather, this part of the Interpretation Statement explains the compliance obligations that are unique to trusts.

Settlor disclosure obligations where no resident trustee

13.2 Section 59 of the TAA requires a resident who makes a settlement on a trust after 17 December 1987 to disclose that settlement to the Commissioner if there is:

(a) no resident trustee, at the time of settlement; or

(b) a resident trustee and later there are no resident trustees, then when there are no resident trustees.

13.3 Where a nominee settlor (as set out in s YB 21) is resident, they must make the disclosure regarding the person deemed to be the settlor under s YB 21, if there is no resident trustee at settlement.

13.4 Disclosure must be made on the prescribed form *Settlors of trusts disclosure (IR462)* (January 2008) within 3 months of the date when the settlement is made on non-resident trustees or all trustees become non-resident, as the case may be.

13.5 The disclosure requirement does not apply to superannuation funds or to any person in respect of a superannuation fund. Consequently, members of such schemes do not have to disclose their contributions. It also does not apply before 1 April 2009 to any offshore superannuation scheme classified by the Government Actuary under regs 29 or 30 of the Superannuation Schemes Regulations 1983.

Disclosure details for resident settlors under s 59

13.6 Each time a settlement is made resident settlors (or their nominee settlors if applicable) must disclose under s 59(1) and (2) of the TAA using the prescribed form *Settlors of trusts disclosure (IR462)* (January 2008):

(a) the name of the trust;

(b) details of the settlement (covering both the original and any later settlement amounts and dates);

(c) the market value of property transferred to the trust;

(d) details of consideration received by a settlor for property settled on the trust;

(e) the names and addresses of trustees and beneficiaries;

(f) copies of the trust deed and any amending deeds;

(g) the name and address of persons for whom a nominee is acting;

(h) the full legal description and address of any real property settled on a trust;

(i) the number, type and name of the company and country of incorporation of any shares settled;

(j) details of the parties, interest rate and term of financial arrangements settled;

(k) the consideration paid and the nature of the services provided that are settlements; and

(l) any other information the Commissioner requires.

13.7 Disclosure on the prescribed form is required within 3 months of the date of settlement or of the date on which there is no trustee of the trust resident in New Zealand.

Disclosure obligations for resident trustee of foreign trust

13.8 Resident foreign trustees are required to register foreign trusts with Inland Revenue (s 59B(2) of the TAA). A "resident foreign trustee" is defined in s 3(1) of the TAA as a New Zealand tax resident who alone or jointly acts as a trustee of a foreign trust that is not a charity registered under the Charities Act 2005.

13.9 A resident foreign trustee must apply to register the foreign trust within 30 days of the date of formation, or the date any trustee first becomes a resident foreign trustee (s 59C(1)(b) of the TAA). Sections 59C(3) and (4) of the TAA provide for a "grace period" for registration if all of the trustees of a foreign trust are natural persons not in the business of providing trustee services, and none of them have been resident foreign trustees before. In that case, the time limit for application extends to four years and 30 days from the first date on which the foreign trust had a resident foreign trustee. This concession recognises that some people may become resident foreign trustees due to changes of circumstances, and allows them time to understand their obligations. However, a trust must apply for registration by the end of this "grace period" to obtain the benefit of the tax exemption for foreign-sourced amounts under ss HC 26 and CW 54 for the income years during the "grace period". This is the case even if the trust has ceased to be a foreign trust by the time the "grace period" ends.

13.10 The resident foreign trustee must provide the following information about a foreign trust at the time of registration (s 59B(3) of the TAA):

- the name of the trust;
- information about all settlements made on the trust, including the provision of services to the trust for less than market value, other than minor services that are incidental to the activities of the trust (where all the trustees of the foreign trust are natural persons who are not in the business of providing trustee services, it will only be necessary to provide information about settlements for the four years prior to the earliest date that the trust was required to be registered);
- the name, email address, physical address, jurisdiction of tax residence, and taxpayer identification number of all settlors, beneficiaries, trustees and persons with control over the trust (eg, protectors and people with powers of appointment); and
- a copy of the trust deed or functional equivalent, including any documents that amend or supplement the trust deed.

13.11 The resident foreign trustee must also provide a signed declaration that each person referred to on the registration form has either been informed of, and has agreed to provide the information necessary for compliance with these rules, and the requirements of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009, is deceased or, despite the efforts of the resident foreign trustee, cannot be located (s 59B(4) of the TAA).

13.12 Resident foreign trustees must also comply with on-going disclosure requirements. These disclosure requirements include:

- A requirement to file annual returns, including the trust's financial statements, and details of any settlements and distributions made over the year. The due date for filing the return is six months after the trust's balance date or by 30 September if the trust does not have a balance date (s 59D of the TAA).
- A requirement to provide any updates to the information provided at registration within 30 days after becoming aware of the alteration (ss 59B(5) and 59C(2) of the TAA).
- General record keeping requirements (s 22 of the TAA) (discussed further from [13.20]).

13.13 An initial registration fee of $270 and annual filing fees of $50 are payable. However, no fees are payable where all resident foreign trustees of the foreign trust are natural persons that are not in the business of providing trustee services (s 59E of the TAA).

13.14 Where there is more than one resident foreign trustee, all of the resident foreign trustees will be responsible for the performance of the trustee obligations (s 59B(7) of the TAA). However, the trustee that applies for registration of the trust will be the "contact trustee", and will be responsible for all communication with Inland Revenue (s 59B(3) of the TAA). If the contact trustee wishes to relinquish that role, or expects to cease being a resident foreign trustee for the trust, they must inform Inland Revenue of the date this will occur, the contact details for any replacement contact trustee, and their updated contact details (s 59B(6) of the TAA).

13.15 A trust that has a dual status as both a complying trust and a foreign trust must still meet the registration and on-going disclosure requirements of a foreign trust if it has a resident foreign trustee.

13.16 Failing to comply with the registration and on-going disclosure requirements will mean that the foreign trust will cease to be eligible for an exemption from tax on its foreign sourced income under ss CW 54 and HC 26.

13.17 Information obtained by Inland Revenue about foreign trusts can be shared with the Department of Internal Affairs, the New Zealand Police and the Overseas Investment Office. In addition, the information can be shared internationally with New Zealand's tax treaty partners.

13.18 For further information on the foreign trust disclosure rules, refer to the Policy and Strategy special report *Foreign trust disclosure rules* (March 2017). This report also discusses the transitional rules that are applicable for foreign trusts that existed on 21 February 2017 when the new rules were enacted.

Disclosure obligations for beneficiaries

13.19 Beneficiaries who receive beneficiary income and taxable distributions from foreign or non-complying trusts must fill in form *Schedule of beneficiary's estate or trust income (IR307)* (September 2014). A new form must be completed for each trust that income is received from. The form is attached to the beneficiary's tax return and filed with it.

Records to be kept by resident foreign trustee

13.20 A resident foreign trustee is obliged to keep (and produce on request) records that disclose the history and operation of the trust under s 22(7)(d) of the TAA. This information need not include the 2-year concession period referred to above in s 59B(3), but must otherwise cover:

(a) a copy of the trust deed and any other constitutional documents;

(b) settlement and distribution details made on or by the trust;

(c) a record of the assets and liabilities of the trust; and

(d) records of the accounting information system if the trust carries on a business, which extends to the charts and codes of accounts, relevant accounting system instruction manuals, and relevant system and programme documentation used in every income year to administer the trust.

13.21 If there is more than one resident foreign trustee, they may appoint one to be the official agent for recordkeeping duties under s 22(2C) of the TAA. This option is also available for making disclosure under s 59B(7).

13.22 Permission can be obtained from the Commissioner to keep records in languages other than English and to keep records off-shore under s 22(2BA) of the TAA. For information about when and how the Commissioner may authorise keeping records offshore and in languages other than English, see "SPS 13/01: Retention of business records in electronic format, application to store records offshore and application to keep records in Māori", *Tax Information Bulletin* Vol 25, No 3 (April 2013): 8.

Sanctions for non-compliance

13.23 If a settlor or trustee knowingly does not provide information about a trust or knowingly does not keep proper records, a penalty can be imposed on them under s 143A of the TAA. The penalty is a fine of up to $50,000 for knowingly providing false information or knowingly not disclosing or imprisonment for up to 5 years or both. A person who aids, abets or incites either of these offences is liable to the same fine or term of imprisonment.

13.24 The penalty under s 143A of the TAA will not apply if a resident foreign trustee convicted of knowingly not providing information subsequently provides that information.

13.25 The Commissioner's policy is that penalties for failure to make disclosure will not apply if a resident foreign trustee is unaware of the disclosure obligations. The lack of awareness is a question of fact determined on a case-by-case basis. For more information concerning the obligations, duties and implications in this area, see "New Disclosure and Record-Keeping Rules for Foreign Trusts", *Tax Information Bulletin* Vol 18, No 5 (June 2006): 107 at 110.

Default assessments

13.26 Section 93B of the TAA empowers the Commissioner to make default assessments in three situations relevant in this context under that Act; that is, where a person:

(a) has failed to disclose the details of a trust under s 59 of the TAA;

(b) has failed to provide information in relation to a trust requested by the Commissioner under s 17 of the TAA; and

(c) is unable to obtain sufficient information to calculate the trustee income of the trust.

13.27 In any of these circumstances, the Commissioner may determine (in a fair and reasonable manner) the amount of trustee income for the income year.

Requests for information about trusts from other countries

13.28 Inland Revenue provides information about a foreign trust to the Australian Tax Office under the Exchange of Information article in the double tax treaty between New Zealand and Australia, if the resident foreign trustee discloses that a settlor of the foreign trust is an Australian resident.

13.29 Inland Revenue also provides information about foreign trusts to other countries New Zealand has agreements with on a case-by-case basis when a treaty partner makes a valid request. Inland Revenue is permitted to require information to be provided under s 17 of the TAA by a person if considered necessary to satisfy New Zealand's treaty obligations subject to tax confidentiality laws in ss 20 and 20B of the TAA and litigation privilege if relevant.

13.30 There is no obligation to send information to treaty partners if there is considered to be a risk in how that information will be used or disclosed. There are also restrictions on disclosure where the information is contrary to public policy, or would disclose any trade, business, industrial, commercial or professional secret or trade process.

13.31 However, changes have been made to the ITA 2007 and the TAA to incorporate the G20/OECD standard for Automatic Exchange of Financial Account Information in Tax Matters (AEOI). The AEOI focuses on imposing due diligence and reporting obligations on certain financial institutions, broadly involving identifying and reporting prescribed information about relevant foreign tax residents that hold (or in certain circumstances control) accounts with such institutions. These obligations are in the CRS, which is supplemented by OECD Commentary. The approach is to incorporate CRS directly into law by reference and to require application of the CRS consistently with the OECD Commentary. Because of similarities, the CRS provisions have been merged with the FATCA framework in part 11B of the TAA.

13.32 The CRS includes certain unit trusts and managed investment trusts in the term "financial institution". Settlors, mandatory beneficiaries, discretionary beneficiaries (if they receive distributions), any other natural persons that have effective control over the trust, and any persons that provide a loan (or other debt funding) to the trust, will be deemed to hold a "financial account" with such a financial institution trust.

13.33 From 1 July 2017 trusts that are Reporting New Zealand financial institutions must commence CRS due diligence reviews and thereafter an annual reporting regime commences.

13.34 If a trust is not a financial institution, but is a type of passive entity (known as a passive non-financial entity) that holds an account with a financial institution, it may be asked by that institution to confirm who its controlling persons are (ie, when that financial institution is carrying out its own due diligence on the trust's account). The trust's controlling persons are the settlors, trustees, protectors, beneficiaries, and any other natural person that controls the trust.

13.35 For more guidance on AEOI/CRS obligations for trusts that are financial institutions refer to *Tax Information Bulletin* Vol 29, No 4 on the Taxation (Business Tax, Exchange of Information and Remedial Matters) Act 2017. Inland Revenue has also published two comprehensive guides (see Inland Revenue Department NZ, Is *the trust a reporting NZFI under CRS? (IR1052)* (August 2017) and Inland Revenue Department NZ, *Family trust obligations under the CRS (IR1053)* (August 2017)). The guides deal with the AEOI standard and the implementation legislation at a detailed technical level.

13.36 Inland Revenue has also published guidance on the operation of the FATCA framework as it applies to trusts in Inland Revenue Department NZ, Trust guidance notes: *Foreign Account Tax Compliance Act (FATCA) (IR1087)* (October 2017).

Filing of tax returns

13.37 Under s 59(3) of the TAA, trustees are required to make a return of all income derived by the trustees for each separate trust they are responsible for. This extends to both trustee income and beneficiary income. Superannuation funds are included in this obligation. This requirement also applies to settlors or beneficiaries who make an election to satisfy the income tax liability of a trustee of a trust under s HC 33.

13.38 One return for each trust must be filed, if it derives income. Co-trustees file jointly and do not include any of their personal income. The trustee is liable for tax on all income as if beneficially entitled under s HC 24.

13.39 Each year a trust must file the tax return *Income tax return: estate or trust (IR6)* (March 2016) and include:

(a) all income derived by the trust;

(b) the tax credits relating to that income;

(c) the allocation of income between trustee income and beneficiary income; and

(d) any taxable distributions made.

The completed form *Estate or trust beneficiary details (IR6B)* (March 2016) should be attached to the IR 6.

13.40 From 16 November 2015 s 43B of the TAA permits a trustee of a trust that is required to file a tax return to make a declaration that the trust is a non-active trust. The declaration is made using the form *Non-active trust declaration (IR633)* (November 2015). The trustee is then not required to file a tax return, and must inform the Commissioner if that status changes. Previously, such trusts were required to file nil tax returns. However, the Commissioner has the power to override a non-active trust declaration and request that a trust files a tax return. This measure provides relief to trusts with little or no income and, in particular, those trusts owning houses on land occupied by beneficiaries who do not pay rent who are required to have IRD numbers if such land is either transferred or received.

13.41 Under s 43B(1)(a) of the TAA, a trustee of a complying trust is not required to file an income tax return if throughout the year:

(a) the trust is a non-active trust, meaning:

(i) the trust has not derived or been deemed to derive any income;

(ii) the trust has no deductions;

(iii) the trust has had no transactions involving assets of the trust that gave rise to income for the trust; and

(iv) the trust has not had any fringe benefits for current or former employees; and

(b) the trust meets the criteria to be a complying trust under s HC 10.

13.42 In determining the non-active status of the trust the following minimal income and expense items can be ignored to ease the compliance burden:

(a) reasonable fees paid to "professional trustees" (as defined in s 20 of the TAA) to administer the trust;

(b) bank charges and other minimal administration fees not exceeding $200 per year;

(c) bank account interest not exceeding $200 per year; and

(d) rates, insurance and other expenditure incidental to a dwelling owned by the trust and incurred by beneficiaries.

Allocation of tax credits

13.43 Any tax credits associated with income derived by a trustee are generally allocated in the same proportion as the income is allocated between beneficiary income, trustee income and taxable distributions. However, there are exceptions to this general rule.

Imputation credits

13.44 Imputation credits must be allocated in proportion to the total distributions received from the trust under s LE 5. The purpose of this rule is to prevent trustees from streaming imputation credits to those beneficiaries that are best able to use them. Under s LE 5, a trustee cannot allocate such credits to beneficiaries as they choose and must use this formula under s LE 5(2):

(person's distributions ÷ trust distributions) × (total beneficiary credits – person's supplementary credits)

In this formula:

- **person's distributions** is the total distributions for the tax year made to the person in their capacity as beneficiary;
- **trust distributions** is the total distributions for the tax year made to all beneficiaries (in their capacity as such) including any supplementary dividends;
- **total beneficiary credits** is the total imputation credits attached to dividends and total supplementary dividends for the tax year paid to all beneficiaries; and
- **person's supplementary dividend** is the total supplementary dividends for the tax year paid to the person as beneficiary of the trust.

13.45 When applying the formula, all distributions, including those of corpus and non taxable capital gains, are taken into account, not just beneficiary income. The meaning of "distribution" is discussed from [8.6], and includes the use of trust property for less than market value. The formula applies whether or not the trustees have any discretion to differentiate between beneficiaries.

Example 30. Allocation of imputation credits to beneficiaries

A trust has three adult beneficiaries, Daniel, Rebecca and Mick, and income of $40,000, consisting of $30,000 of interest and dividends of $10,000 with $600 of attached imputation credits. The $40,000 of income is distributed between the income beneficiaries Daniel and Rebecca equally, and Mick as a capital beneficiary is distributed corpus of $20,000.

The formula requires the imputation credits to be allocated like this:

Beneficiary	Distribution	%	Imputation credits
Daniel	$20,000	33.33	33.33% × $600 = $200
Rebecca	$20,000	33.33	33.33% × $600 = $200
Mick	$20,000	33.33	nil

Accordingly, $200 of imputation credits are lost, because Mick's corpus distribution is ineligible to receive them, yet it still dilutes the imputation credit entitlements of the other income beneficiaries.

13.46 Beneficiaries can claim a credit for tax paid on beneficiary income and taxable distributions and their share of tax credits in their personal tax returns.

13.47 When dividend income is distributed to a minor beneficiary, imputation and RWT credits remain with the trustee to be assessed along with the minor beneficiary income at the trustee rate (s LE 4). However, the amount of these credits that may be attached to the distribution is calculated by ignoring the minor beneficiary rule under ss LE 5 and LF 3. Consequently, the minor beneficiaries are treated, effectively, as deriving the distribution for the purposes of the tax credit rules.

Resident withholding tax

13.48 The RWT rules allow a trustee to choose to detach some or all of an RWT tax credit from distributions made to a beneficiary on a lower tax rate (Beneficiary A) and replace those detached RWT credits with a cash payment (referred to as an RWT substitution payment) (ss LB 3(4) and RE 2(7)). The trustee is then allowed to pass all, some or none of those detached tax credits to another beneficiary (Beneficiary B) (s LB 3(5)). The trustee can use tax credits not passed to a beneficiary to satisfy the tax liability on trustee income (s LE 3(5)). These rules will only apply where the trustee pays tax as agent for the beneficiary (s LE 3(7)).

13.49 The effect of these rules is that Beneficiary A does not have to seek a refund for RWT deducted over and above their marginal tax rate as they get RWT credits at their correct rate and the RWT substitution payment. The RWT substitution payment is treated by s RE 2(8) as being resident passive income that is beneficiary income. There is no obligation on the trustee to withhold RWT from the substitution payment despite its deemed status as resident passive income. These rules also allow the trustee to allocate RWT credits to beneficiaries in a way that will ensure they can best be utilised.

Example 31. Trustee pays RWT substitution payment

The trustees of the Egmont trust receive $1,000 of gross interest from government stock with RWT deducted at 33%. They have $670 net cash and $330 of RWT credits. They wish to distribute the income to Emma, a beneficiary with a marginal tax rate of 17.5%. They resolve to detach $155 of the RWT tax credits from the distribution to Emma, and replace them with an equal RWT substitution payment.

As a result, Emma has beneficiary income of $1,000. Her marginal tax rate is 17.5%, so she will have tax to pay of $175. This tax can be satisfied using the remaining RWT credit of $175 that was distributed to her, so she has no further tax to pay. In economic terms, Emma is in the same position as having obtained a refund of the excess RWT paid.

The trustees choose to allocate the detached RWT tax credit of $155 to another beneficiary, Sarah.

Maori authority distributions

13.50 Where a trustee receives a taxable Maori authority distribution, with attached Maori authority tax credits (including any tax withheld from a Maori authority distribution that is treated as a Maori authority tax credit under s RE 24), and distributes that amount to a beneficiary, the trustee cannot allocate the Maori authority tax credits as they choose. Instead, s LO 2 requires the trustee to apply the following formula to determine the amount of Maori authority tax credits that can be distributed to each beneficiary:

(person's distributions ÷ trust distributions) × (total beneficiary credits − person's supplementary dividend).

13.51 In this formula:

- **person's distributions** is the total taxable Maori authority distributions for the tax year made to the person in their capacity as beneficiary of the trust;
- **trust distributions** is the total distributions for the tax year made to all beneficiaries of the trust in their capacity as beneficiaries, and includes all supplementary dividends paid to them;
- **total beneficiary credits** is the total Maori authority credits attached to taxable Maori authority distributions and total supplementary dividends for the tax year made to all beneficiaries of the trust in their capacity as beneficiaries; and
- **person's supplementary dividend** is the total supplementary dividends for the tax year paid to the person in their capacity as beneficiary of the trust.

13.52 When applying the formula, all distributions, including those of corpus and non taxable capital gains, are taken into account, not just beneficiary income. The meaning of "distribution" is discussed from [8.6], and includes the use of trust property for less than market value. The formula applies whether or not the trustees have any discretion to differentiate between beneficiaries.

Withholding tax obligations on trustees

13.53 A trustee has an obligation to withhold RWT for distributions made to beneficiaries of resident passive income if the trustee holds an exemption certificate such that RWT was not previously withheld on that income (ss RE 3 and RE 4). "Resident passive income" is defined in s RE 2(1) to include interest, dividends, taxable Maori authority distributions and replacement payments under share-lending arrangements. The trustee will not, however, have any obligation to withhold RWT if the beneficiary holds an RWT exemption certificate (s RE 5). If the trustee does not hold an RWT exemption certificate, and receives the resident passive income in the conduct of a taxable activity, the trustee will also have an obligation to withhold RWT and pay it to the Commissioner if the trustee receives a payment of resident passive income and the correct amount of RWT has not previously been withheld (s RE 7).

13.54 If trustees are issued an RWT exemption certificate, the certificate is in the name of the trust. Therefore, the certificate continues when trustees change. However, a trustee will remain jointly and severally liable for any RWT the trust is required to pay (eg, RWT payable on distributions to beneficiaries) until written notification of retirement is provided to the Commissioner under s RE 30.

13.55 Non-resident passive income is defined in s RF 2 as meaning:

> income having a source in New Zealand that a non-resident derives and that consists of—
>
> (a) a dividend other than an investment society dividend:
>
> (b) a royalty:
>
> (c) an investment society dividend when the non-resident is not engaged in business in New Zealand through a fixed establishment in New Zealand:
>
> (d) interest when the non-resident is not engaged in business in New Zealand through a fixed establishment.

13.56 A resident trustee of a complying trust who derives passive income such as interest and dividends will frequently have RWT withheld from them by the payer. Any passive income including royalties a resident trustee distributes to a non-resident beneficiary is treated as non-resident passive income. The trustee has an obligation, at the time of payment, to withhold NRWT at the appropriate rate from the distribution under ss RF 3 and RF 4. The NRWT withheld must then be paid to Inland Revenue by the 20th of the following month or at 6-month intervals if the annual amount is less than $500. For more details on the obligations for NRWT payers, see Inland Revenue Department NZ, *NRWT: payer's guide (IR291)* (October 2015).

13.57 The time of payment is not when the trustee receives the income, but when it is paid to a non-resident beneficiary. This includes crediting to an account or being dealt with in their interest or on their behalf as well as when vested absolutely in their interest.

13.58 If RWT has already been deducted from the income, then, under s RF 5, the RWT paid is used to offset the NRWT payable. If more RWT has been withheld than the NRWT payable, the non-resident beneficiary can file a tax return to seek a refund of the excess. If the RWT is less than the NRWT payable, then the trustee must withhold the difference as NRWT from the payment.

13.59 The NRWT is payable on the amount actually paid to the beneficiary because this is gross income of the beneficiary. The trustee may not have passed on all the income derived because the trustee has funded some or all of its expenses from that income. In this situation, the part of the income retained to meet expenses will be trustee income. If, however, any charges are made by the trustee directly to the non-resident beneficiary in relation to the distribution, such as handling fees or commissions, then the amount subject to NRWT is the amount paid before these charges are deducted.

13.60 If a non-resident beneficiary has a fixed entitlement under the terms of the trust to any non-resident passive income the trustee can arrange for the payer at source to deduct NRWT at the appropriate rate, or have approved issuer levy (AIL) paid on payments of interest if applicable, rather than have the trustee attend to this. The trustee will need to prove the beneficiary's entitlement to the payer's satisfaction.

13.61 If a trustee distributes other New Zealand sourced income (eg, rents) to non-residents as either beneficiary income or taxable distributions, the trustee must pay tax as agent for the beneficiary at their relevant marginal tax rate under s HC 32. Consequently, the trustee will routinely deduct that tax from the distribution to fund its obligation.

Agency obligations for trustees and settlors

Trustee and settlor agency liability

13.62 Where a beneficiary derives beneficiary income or a taxable distribution during any income year the trustee is liable to satisfy the income tax liability of the beneficiary on that income as their agent under s HC 32. This means the agency provisions in subpart HD (Agents) apply. This agency liability does not apply to distributions from community trusts under ss HC 32(2) and HD 12(1) since the beneficiaries of community trusts account for their own tax.

13.63 Section HD 3(2) requires every person who is an agent to make returns of the income for which the person is an agent. A trustee deriving income must file an *Annual tax return (IR6)* (March 2016), attaching the form *Estate or trust beneficiary details (IR6B)* (March 2016) to record the income distributed and tax paid for each beneficiary.

13.64 An agent is assessed on such income as if the agent were the principal. This means the trustee is personally liable for tax on beneficiary income and taxable distributions as if that income were the trustee's income.

13.65 Section HD 4(a) ensures the liability of the agent (trustee) does not release the principal (beneficiary) from liability for their tax obligations. Further, under s HD 2, any assessment of the agent for tax does not preclude an assessment of the principal for the same tax and vice versa. Consequently, the trustee and beneficiary are jointly and severally liable for tax on beneficiary income and on taxable distributions. In practical terms, these provisions are used as a collection mechanism, but are never used to collect more than 100% of the tax due. The beneficiary remains liable to furnish returns and to assessment for tax on beneficiary income and taxable distributions.

13.66 Section HC 29(2) sets out a settlor's liability for tax as agent of a trustee. It does not apply where there is a resident trustee for the full income year and from the time of the initial settlement on a trust to the end of that first income year (s HC 29(3)). The settlor will also have no liability if they were not resident in New Zealand when any settlement was made on the trust, and they were not, after 17 December 2017, previously resident in New Zealand (s HC 29(5)). Consequently, s HC 29 routinely applies to settlors of non-complying trusts. The intention of the provision is to enable tax to be captured from resident settlors on trustee income of non-complying trusts when trustees are non-resident.

13.67 Where there is more than one settlor, they are jointly and severally liable for tax on that income. The settlor's liability does not, however, extend to the trustees' liability for income tax as agent for beneficiaries under s HC 32.

13.68 Settlor liability applies to trusts (other than charitable trusts and superannuation funds) where a settlement was made to or for the benefit of a trust after 17 December 1987. It does not apply under s HC 29(4)(c) where the trustee income is derived from a settlor remitting an amount under a financial arrangement.

Trustee liability as agent of beneficiary (s HC 32)

Residency of a trustee is not relevant

13.69 The residence of a trustee is not relevant for the purposes of s HC 32. A trustee is liable for tax as agent on beneficiary income and taxable distributions whether the trustee is resident or not.

13.70 When a beneficiary is non-resident, the trustee's agency liability is limited to income sourced from New Zealand that the beneficiary derives. When a trustee fails to meet a resident beneficiary's tax obligations, the liability falls under s HD 4 on the beneficiary.

Beneficiary may undertake the duties with consent

13.71 Under s HD 4(b), if the Commissioner agrees, the beneficiary and trustee may decide that a beneficiary is to undertake the duties of making assessments, providing returns, and satisfying the beneficiary's tax liability rather than the trustee. Where this occurs, the trustee is not relieved from having to file a return for the trust's other income. If the beneficiary fails to perform its direct assessment duties, the trustee remains personally liable for the beneficiary's tax liability under s HD 4(a).

Calculating the tax payable by the trustee as agent

13.72 Section HD 7 prescribes that the rate of tax for which an agent is assessable and liable is determined by reference to the taxable income of the principal. However, tax is payable on the amount of agency income only as a proportion of the taxable income of that principal. This means a trustee must first calculate the tax payable on the total taxable income of the beneficiary and then determine the portion referable to just the beneficiary's income and taxable distributions.

13.73 For example, if during the income year ending 31 March 2016 an individual beneficiary derives beneficiary income of $5,000 and total taxable income, (including the beneficiary income) of $50,000, the tax payable by the trustee on the beneficiary income would be calculated as follows:

Tax payable on taxable income at current marginal rates

$48,000 × (10.5% to $14,000 then 17.5%)	=	$7,420
$2,000 × 30%	=	$600
Total	=	$8,020

Tax payable on beneficiary income

$8,020 × ($5,000 ÷ $50,000)	=	$802

13.74 Where a beneficiary derives a taxable distribution from a non-complying trust the taxable distribution is assessable at the rate of 45% (s HC 34 and in sch 1, part A, cl 4). Consequently, the amount of tax is calculated at the flat rate of 45% on such a distribution rather than using the method described above.

13.75 In practical terms, where the trustee has paid tax on beneficiary income or on a taxable distribution in full, the beneficiary will not be required to pay tax on that income. If the trustee pays tax on the beneficiary income or taxable distribution but the amount paid is less than the correct amount, the beneficiary will be required to pay the difference; if they do not, the trustee remains liable. Practically, ensuring that the correct amount of tax is paid will require communication between the trustee and the beneficiary.

Right of recovery against beneficiary

13.76 Under s HD 5(2), when an agent pays tax, the agent may recover the amount from the principal, or the agent may deduct the amount from any money held that belongs to the principal. Therefore, a trustee has an effective right of indemnity against a beneficiary for any tax paid as their agent. Section HD 5(3) permits an agent to retain an amount out of money belonging or payable to the principal that is reasonably sufficient to pay the tax when it is due or in a later income year. As a result, where the trustee has not yet paid tax on beneficiary income or on a taxable distribution, the trustee may deduct an appropriate amount from either the income or distribution to cover the tax.

Settlor agency liability on trustee income (s HC 29)

13.77 Where a settlement has been made on a trust after 17 December 1987 and during any income year the trustee derives trustee income, any settlor of the trust who is resident in New Zealand at any time during that income year is liable to income tax on the trustee income for the entire income year as agent of the trustee.

13.78 Under s HC 29(2) the settlor liability for trustee income does not extend to beneficiary income for which the trustee is liable as agent under s HC 32. The settlor has a statutory right of indemnity against the trustee for any tax paid by the settlor on trustee income in s HD 5(2) and (3).

13.79 The same agency consequences applicable to trustees liable as agent for beneficiaries apply to settlors in this context. Section HD 3(2) requires every agent to make returns of the agency income that the principal is required to make and must satisfy their principal's tax liability. Under s HD 2, the principal and agent are jointly and severally liable for the tax obligations and the liability of one remains despite the assessment of the other. Therefore, the Commissioner may assess the settlor for income tax on trustee income whether or not the Commissioner also assesses the trustee for income tax on such income. There is no requirement for the Commissioner to assess the trustee on the trustee income and to attempt to collect the tax from the trustee before an assessment can be made on the settlor. Where an assessment is made on the settlor, this does not preclude an assessment being made on the trustee. However, these tax collection aids are never used to collect more than 100% of the tax payable. If an assessment is made on the settlor under s HD 4 this does not release the trustee from the liability to make returns and to be assessed and charged with tax. However, the Commissioner can agree that the principal is to undertake the duties on application by the parties.

13.80 Settlors are, therefore, jointly and severally liable for tax on the entire trustee income, and it is for the settlors to apportion liability among themselves. Section HC 29(6) provides an exception to this general rule. An apportionment of the liability can be made where the settlor can satisfy the Commissioner (with full disclosure) that another settlor or others settlors should be liable, having regard to their respective settlements.

Exceptions to settlor liability (s HC 29(3)–(6))

Trustee resident (s HC 29(3))

13.81 Section HC 29(3) provides that a settlor of a trust is not liable if the trust has a resident trustee for the full income year. Where the first settlement on a trust with a resident trustee is made during an income year then the settlor is not liable from that time until the year ends.

13.82 A resident corporate settlor of a foreign trust unable to elect into the complying trust regime under s HC 30 on migration to New Zealand, because the settlor is not a natural person, would be liable for the tax on trustee income under s HC 29 unless an exception applied. The most likely exception is the presence of a New Zealand resident trustee for the entire income year during which the corporate settlor is resident under s HC 29(3).

13.83 Liability is not imposed on the settlor because a resident trustee can pay the tax. Where no trustee is resident during the income year or where a trustee is resident for only part of the income year, it may be less likely that the tax can be collected from the trustee.

Superannuation funds and charities (s HC 29(4))

13.84 Settlors of superannuation funds and charitable trusts are not liable for tax on trustee income under s HC 29(4). The trustees of superannuation funds are liable for tax on world-wide income and there is no beneficiary income for members of superannuation funds because all income is taxed to the trustee. Settlors of charitable trusts are not liable for any tax payable by charitable trustees (eg, fringe benefit tax paid on benefits provided to employees of a business run by a charity). The settlors of charitable trusts who make charitable gifts and donations might be discouraged from making such gifts and donations if they were liable for trustee income, even though that income would usually be exempt to charitable trusts under ss CW 41 and CW 42.

Non-resident settlors (s HC 29(5))

13.85 A settlor of a trust is not liable to income tax on trustee income if the settlor is a natural person who was not resident in New Zealand at the time of any settlement by that settlor and who was not resident at the time of any settlement since 17 December 1987. This rule does not apply if the settlor elects to pay tax on trustee income under s HC 33.

13.86 Section HC 29(5) ties in with s HC 30, which permits a settlor of a foreign trust who becomes resident in New Zealand and is not or is no longer a transitional resident to elect to convert the trust to a complying trust. Read together, the effect of these provisions is that settlors of foreign trusts who become resident in New Zealand and are not (or cease to be) transitional residents are not liable for income tax on trustee income unless they elect to pay tax on such income within the period of a year after ceasing to be a transitional resident. Immigrants who settled trusts before becoming resident in New Zealand (and ex-patriate New Zealanders returning after more than 10 years abroad) may have made the settlement without knowledge of the New Zealand trust tax regime. Therefore, they are not automatically liable for income tax on trustee income on becoming resident and before ceasing transitional residence. In this regard, new immigrant settlors of such trusts are treated in a similar manner to resident settlors who settled trusts before 17 December 1987. For more information on the election procedure for newly resident settlors, see Part 10 of this Interpretation Statement.

13.87 For s HC 29(5) to apply the settlor must be a natural person. This is consistent with the s HC 30 election option, which also applies only to natural persons. The settlor must not have been resident in New Zealand at the time of any settlement by that settlor or by any other person after 17 December 1987.

13.88 Section HC 29(5) does not apply where the settlor elects to pay tax on trustee income under s HC 33. Several categories of election are covered by the s HC 33 procedure, including elections under s HC 30 when a foreign trust can be converted to a complying trust within a year of transitional residence ceasing. If an election under s HC 33 to pay tax on trustee income is made by a trustee or beneficiary, and not by the settlor, the settlor will continue to be exempted from liability for tax on trustee income if s HC 29(5) is satisfied.

Limitation of liability (s HC 29(6))

Requirements and application

13.89 Section HC 29(6) may be used to limit the liability of settlors where there is more than one settlor of the trust. It provides that a settlor is not liable to income tax on trustee income to the extent to which the settlor can satisfy the Commissioner, through full disclosure of the settlements made, that another settlor should be liable having regard to the respective settlements made.

13.90 Section HC 29(6) may apply where the settlors are all resident in New Zealand, and the settlors prefer an apportionment of liability under that provision to the joint and several liability imposed by s HC 29(2). It may also apply where there is a mix of resident and non-resident settlors, and the resident settlors seek to limit their liability to a proportionate share of the trustee income.

13.91 In determining whether the liability of a settlor should be limited, the Commissioner must have regard to the respective settlements made by the settlor and by other settlors. It is incumbent on the applicant to propose a method of apportionment that is fair and reasonable. An apportionment may be relatively simple, if different settlements result from dispositions of property to the trust. The two following methods are examples of apportionments that would be acceptable to the Commissioner:

(a) The first method is by determining, at the time of the settlement, the proportion that the market value of the property settled by the settlor on the trust bears to the market value of the trust's net assets. This proportion then remains unchanged until a further settlement is made on the trust. When a further settlement is made, the property settled earlier is revalued and the liability of the settlors is worked out by comparing the current values of all property settled on the trust.

(b) The second method is by tracing the income attributable to the property settled on the trust by the settlor

Example 32. Apportioning liability between settlors

To illustrate the first method, assume that in year 1 Megan and Grant each transfer property with a market value of $10,000 to a trust. In year 4, Grant transfers more property with a market value of $5,000 to the trust. In year 4, the properties transferred by Megan and Grant in year 1 have each increased 50% to a market value of $15,000, so trust assets are $30,000 before Grant's second settlement. The liability of Megan and Grant for tax on trustee income in years 1 to 3 is calculated in each of those income years as:

trustee income × ($10,000 ÷ $20,000)

In year 4, the proportions of trustee income for which Megan and Grant are liable are recalculated by revaluing the property originally contributed by them and by taking into account the additional settlement made by Grant. The proportion of trustee income for which Megan would be liable to income tax would be:

($15,000 ÷ $35,000) × 100% = 43%

Grant would be liable to income tax on the remaining 57% of the trustee income.

13.92 Where different types of property are settled producing different returns, a tracing approach may be more appropriate. This approach could be used, for example, if one settlor transferred shares to a trust while another transferred land. The liability of the settlors could then be determined by allocating the income derived from the shares to that settlor and by allocating the income derived from the land to the other settlor.

13.93 The examples discussed above assume quite simple facts. In more complex cases, for example, where property settled by one settlor has been later disposed of by the trustee, or where settlements have arisen from the contribution of property or the provision of services, it may not be possible to make a sensible comparison of the settlements for the purpose of s HC 29(6). If this is the case, the provision will not apply. Whether it can be applied or not will depend on the facts of each case.

Limitation of liability and complying trust definition (s HC 29(7))

13.94 Section HC 29(7) provides that s HC 29(6) does not apply to determine whether the tax obligations for a trustee's income tax liability are met for the purposes of s HC 10(1)(a)(ii) when meeting the requirements of a complying trust.

13.95 As a consequence, if tax is not paid on all the income of a trustee under s HC 24 because the resident settlor's liability to tax is limited by s HC 29(6), the trust will not be a complying trust in relation to any distribution made from it. However, as noted previously at [8.33], a trust that loses its complying trust status can regain that status by satisfying the trustee's income tax liability for the life of the trust up to the time of distribution.

Trustee income from remittance of debt (s HC 29(4)(c))

13.96 Under s HC 29(4)(c), a settlor is not liable to income tax on trustee income to the extent that the trustee income is derived under ss EW 31 or EZ 38 from amounts remitted by the settlor using the base price adjustment mechanism under the financial arrangement rules.

13.97 The remittance of a financial arrangement will generally give rise to income to the issuer of the financial arrangement. Where the remittance of a financial arrangement by the settlor results in trustee income, s HC 29(4)(c) exempts the settlor from liability to tax for that. However, the trustee will remain liable to tax for the trustee income arising from the remittance, and, if the trustee's obligations for that liability are not satisfied, the trust will not be a complying trust for distribution purposes.

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"Rewriting the Income Tax Act: Exposure Draft—Part H" (Policy Advice Division of the Inland Revenue Department, 4 March 2005): 7

OPERATIONAL STATEMENTS

Operational statements set out the Commissioner's view of the law in respect of the matter discussed. They are intended to be a preliminary view in the absence of a public binding ruling or an interpretation statement on the subject

Operational Statement 18/01: Commissioner's statement on using a kilometre rate for business running of a motor vehicle

Introduction

All legislative references are to the Income Tax Act 2007.

This Operational Statement (the Statement) updates and replaces Operation Statement OS 09/01 *Commissioner's statement on use of a kilometre rate for expenditure incurred for business use of a motor vehicle*, issued in May 2009. This Statement explains how the kilometre rates are to be applied and also sets the rates for the current year. Future rates will be set each year as third party data becomes available.

This Statement is made up of two parts. Part One deals with deductions for the business use of a motor vehicle. Part Two deals with the tax treatment of reimbursement payments made by an employer to an employee where the employee uses their private motor vehicle for employment purposes. Both Parts are followed by examples and a flowchart that sets out the process that applies to each.

Part One - Deductions for business running of a motor vehicle using a kilometre rate

Where a person intends to claim an expense deduction for a motor vehicle that is used partly for business purposes and partly for other purposes they must calculate the proportion of business use using either a logbook or actual records. Under section DE 2, a person may use one of two methods to calculate the deduction for that proportion of business use, namely:

- A cost method based on actual costs; or
- A kilometre rate method.
- Section DE 12(4) requires the Commissioner to set and publish kilometre rates that taxpayers may use to calculate the expenditure or loss on a motor vehicle that represents the proportion of business use of a motor vehicle. This Statement sets out how the kilometre rates are applied.

Application

The kilometre rates apply from the 2017/2018 income year.

Operational Practice

Summary

1. A person must determine the business use of a motor vehicle against the total kilometres travelled by that motor vehicle. A logbook[1], diary, calendar or other suitable method may be used for this purpose. This information will be used to calculate the income tax deduction.
2. A deduction can be made in respect of the business portion of their actual motor vehicle costs. This is known as the cost method. Alternatively, a person may use the section DE 12 kilometre rates set annually by the Commissioner for each vehicle type. This is known as the kilometre rate method.
3. A person wishing to use the kilometre rate method must make an (irrevocable) election to use this method. That election will apply until the vehicle is disposed of.
4. The election must be made on a vehicle by vehicle basis and be made in the year the vehicle is acquired or first used for business purposes. The election to use the kilometre rate method is made by using this method in the person's return of income. If no election is made to use the kilometre rate method the person is deemed to have elected to use the cost method. In either case, the election is irrevocable.

[1] Refer paragraph 19 which explains the use of log books

5. An election may also be made for any vehicle used for business that is held at the beginning of the 2017/2018 income year except where that vehicle is disposed of during that income year.
6. The kilometre rates will be set by the Commissioner by reference to industry figures that represent the average cost of operating a motor vehicle.
7. The various rates for selected vehicle types will be made up of two Tier rates.
8. The Tier One rate is a combination of the vehicles fixed and running costs. The Tier One rate applies for the business portion of the first 14,000 kilometres travelled by the motor vehicle in a year. After which the Tier Two rates which includes only the running costs, applies for the business portion of any travel in excess of 14,000kms.
9. The following are the rates per kilometre that will apply for the 2017/2018 income year:

2017/2018 Kilometre Rates		
Vehicle Type	**Tier One Rate**	**Tier Two rate**
Petrol or Diesel	76 cents	26 cents
Petrol Hybrid		18 cents
Electric		9 cents

10. A person wishing to use the kilometre rate method will be required to keep a record of all travel undertaken by the vehicle. This requirement may be met through the use of a logbook in accordance with sections DE 6 to DE 11, or some other recording method such as a diary. Paragraphs 19 to 22 of this Statement contain more information on logbooks. Note that although not all travel (non-business as well as business travel) needs to be recorded, a person who uses the kilometre rate method will need to be able to show whether, and when, the vehicle exceeds the 14,000 annual kilometres.
11. The cost method must be used for any vehicle type not included in the above table.
12. The 5,000 kilometre limit to deductions of motor vehicle expenditure using the section DE 12 kilometre rates set out in OS 09/01 no longer applies.
13. There is no depreciation deduction or recovery of depreciation where a person has elected to use the section DE 12 kilometre rate method for a motor vehicle.
14. Close companies may now use the section DE 2 cost method or kilometre rate method as an alternative to paying FBT where a motor vehicle is provided to a shareholder employee, so long as that close company's only non-cash benefit is the availability of a motor vehicle for the private use of the shareholder. The close company must make an irrevocable election to use section DE 2 to calculate the amount of their deduction.
15. The election by a close company to make deductions under section DE 2 instead of applying the FBT rules must be made within the time for filing the company's return of income in which the election is made. Elections are only available for vehicles acquired or first used for business purposes on or after 1 April 2017.
16. Where a close company elects to use subpart DE to calculate the cost of business use of a motor vehicle, any interest deductions are to be included in those calculations. This means that a close company applying subpart DE will need to ensure that any interest deduction under sections DB 7 or 8 does not relate to a motor vehicle.

Detailed Discussion

Recent legislation changes

17. The Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 introduced a number of amendments that allow a person to use a simplified method of calculating deductions for motor vehicles that are used for both business and other purposes, such as for private purposes. These changes came in to effect from the 2017/2018 income year and are explained in detail in *Tax Information Bulletin* Vol 29, No 4, May 2017. This can be viewed on Inland Revenue's website.
18. Without completely restating that explanation, the key features in respect of claiming motor vehicle expenses where a vehicle is used for both business and other purposes are as follows:
    - Instead of making a claim for the business use of a motor vehicle based on the actual costs, a taxpayer may elect to have a deduction for the business use portion based on a kilometre rate method.
    - In respect of the kilometre rate method, the Commissioner will set rates by reference to industry figures that represent the average cost of using average motor vehicles.

- There is no longer a 5,000km limit restricting the use of these rates.
- The rates will be divided into two Tiers –
  - The first Tier will provide for deductions based on the recovery of both the vehicle's fixed costs and it's per kilometre running costs;
  - The second Tier will provide for the recovery of the vehicle's per kilometre running costs only.
- The Tier One rate is limited to the first 14,000 kilometres (total kilometres in each income year) as the fixed costs of the vehicle ownership would be over deducted with increasing usage if a single rate were used. The Tier Two rates apply for any use above 14,000 kilometres.
- The election to use the kilometre rate method applies on a per vehicle basis and is irrevocable (section DE 2B(3) refers), so a person may not switch back and forth between methods for the same vehicle.
- The election is made by using this method in a tax return for the year in which the vehicle is acquired or first used for business purposes.
- For a vehicle held at 1 April 2017, the election must be made in the return of income for the 2017/2018 income year unless the vehicle is disposed of during that year. Note, there are different rules that apply to close companies wishing to adopt the kilometre rates instead of paying FBT for shareholder employees. This is further explained below.
- If a person uses a vehicle for dual purposes (business and other purposes) but does not make an election to use the kilometre rate method, they are deemed to have made an irrevocable election to use the cost method (section DE 2B(3) refers).
- There is no depreciation deduction or recovery of depreciation for a motor vehicle where a person has elected to use the section DE 12 kilometre rate method for that motor vehicle.
- Where a close company's only non-cash benefit is the availability of a motor vehicle for the private use of a shareholder, that close company may use section DE 2 as an alternative to paying FBT provided that close company also makes an election to apply the kilometre rate method to calculate the amount of their deduction.
- The election by a close company to make deductions using section DE 2 instead of applying the FBT rules must be made within the time for filing the company's relevant return of income.
- Where a close company uses section DE 2 to calculate the cost of business use of a motor vehicle, any interest deductions are to be included in those calculations. This means that there is no separate interest deduction in respect of that vehicle under sections DB 7 or 8.

Use of logbooks

19. Sections DE 6 to DE 11 provide the rules for establishing the proportion of business use of a motor vehicle. These rules provide that a person may keep a logbook for a test period of at least 90 consecutive days.

20. That logbook test period is used to establish the average proportion of travel by the vehicle for business purposes during the logbook term (up to three years). This proportion may be used for deductions using the cost method or where the taxpayer has elected to use the kilometre rate method.

21. The logbook must record:
    - The start and the end of the 90 day test period; and
    - The vehicle's odometer readings at the start and end of the test period; and
    - The distance of each business journey; and
    - The date of each business journey; and
    - The reason for each business journey; and
    - Any other detail that the Commissioner may require.

22. In the absence of a logbook (or actual records), section DE 4(2) limits any deductions to a maximum of 25% as a proportion of business use of a motor vehicle, assuming, of course, that such a percentage can be justified.

Record of total kilometres travelled each income year

23. A person who has elected to use the kilometre rate method must record their odometer reading every balance date for each vehicle covered by an election so that they can determine whether the vehicle has travelled 14,000 kilometres (business and non-business) for the year. This is because the deduction for the kilometre rate method is based on a two Tier approach where the Tier One rate is only available for the first 14,000 total kilometres.

Examples of kilometre rate method to calculate deductions:

Example one – Greater than 14,000 kms travelled – log book maintained:

The taxpayer uses their Holden Commodore 3.6 litre petrol car for both business and private purposes.

The previous log book test period calculates that 60% of the travel is for business purposes.

The car travelled a total of 20,000 kilometres for the 2017/2018 income year.

Deduction:

Tier One 14,000 × \$0.76 × 60%	=	6,384.00
Tier Two 6,000 × \$0.26 × 60%	=	936.00
Total deduction		**\$7,320.00**

Example two – Greater than 14,000 kms travelled – no log book:

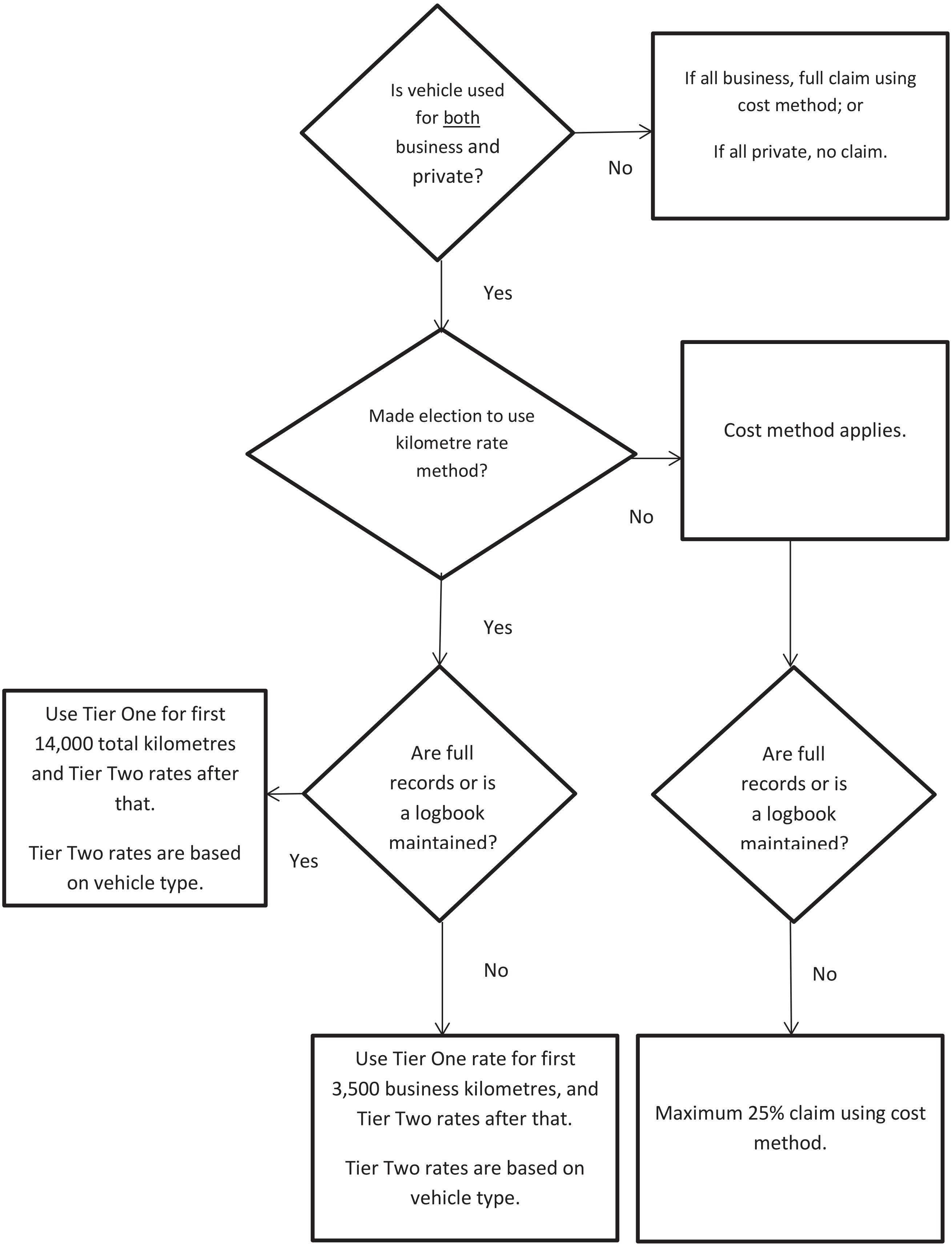
The taxpayer uses their Holden Commodore 3.6 litre petrol car for both business and private purposes.

No log book breakdown or other record of motor vehicle use is maintained. However, it is known that the car travelled a total of 20,000 kilometres for the 2017/2018 income year and at least 25% of this travel was for business purposes.

Deduction:

Tier One 14,000 × \$0.76 × 25%	=	2,660.00
Tier Two 6,000 × \$0.26 × 25%	=	390.00
Total deduction		**\$3,050.00**

Supart DE Deductions



Part Two - Employee reimbursement for business running of an employee's motor vehicle using a kilometre rate

Introduction

24. This Part explains the acceptable method to establish the tax exempt portion of an amount paid to an employee as reimbursement of expenditure incurred by that employee where the employee uses their private motor vehicle in the employer's business.

25. Employers may reimburse their employee based on the actual expenditure incurred by that employee. Alternatively, section CW 17(3) provides that an employer may make a reasonable estimate of expenditure likely to be incurred by an employee or group of employees. It is acceptable to use third party data to assist in making such an estimate.

26. In OS 09/01 the Commissioner accepted that the mileage rate set under that statement could be regarded as being a reasonable estimate of expenditure under section CW 17(3). That general position has not changed except that the method of calculating the kilometre rate method for business deductions has changed and this has necessitated a review of the calculation of using the kilometre rate method for employee reimbursements.

Operational Practice

Employee reimbursement

27. Where the employee maintains a logbook, or other evidence that establishes the proportion of employment use for an income year, the calculation of the exempt portion of reimbursement may be based on the kilometre rate set by Inland Revenue. The Tier One rate can be applied for the business portion of the first 14,000 kms (total) travelled by the vehicle in each income year, after which the Tier Two rates will apply. Note that even where the employee records a logbook test period in accordance with the rules in section DE 6 to DE 11, the annual kilometres travelled must still be monitored so that it is known whether the 14,000 figure is reached each year.

28. However, where no logbook or other records are maintained, the use of the Tier One rate to calculate the exemption for employee reimbursement is limited to the first 3,500 kilometres travelled for employment purposes. The Tier Two rates may be used for kilometres travelled for employment purposes above the 3,500km figure.

29. The 3,500 kilometres is based on 25% of the average annual expected (14,000) kilometres travelled for each motor vehicle. 25% is the maximum percentage allowed for business deductions where no logbook is maintained.

30. The changes to the business deductions take effect for the 2018 income year onwards and require a different approach and calculation of those rates. It is accepted that the changes with regard to employee reimbursement will always be subject to a time lag using those figures. As such, for the 2018/2019 income year employers may reimburse employees using the new Tier one rate of 76 cents per kilometre from the date of this Statement. However, the two tiered rates as set out above must be used for the 2019/2020 and subsequent income years.

31. The following are the rates per kilometre that will apply for the 2019/2020 income year:

2017/2018 Kilometre Rates		
Vehicle Type	**Tier One Rate**	**Tier Two rate**
Petrol or Diesel	76 cents	26 cents
Petrol Hybrid		18 cents
Electric		9 cents

The following are examples using kilometre rate method to calculate employee reimbursement for the 2019/2020 income year:

Example three – Greater than 14,000 kms travelled – Logbook maintained:

The employee uses their Holden Commodore 3.6 litre petrol car for both employment and private purposes.

The previous logbook test period calculates that 60% of the travel is for employment purposes.

The car travelled a total of 20,000 kilometres for the 2019/2020 income year.

Deduction:

Tier One 14,000 × \$0.76 × 60%	=	6,384.00
Tier Two 6,000 × \$0.26 × 60%	=	936.00
Total deduction		**\$7,320.00**

Example four – Greater than 14,000 kms travelled – No logbook:

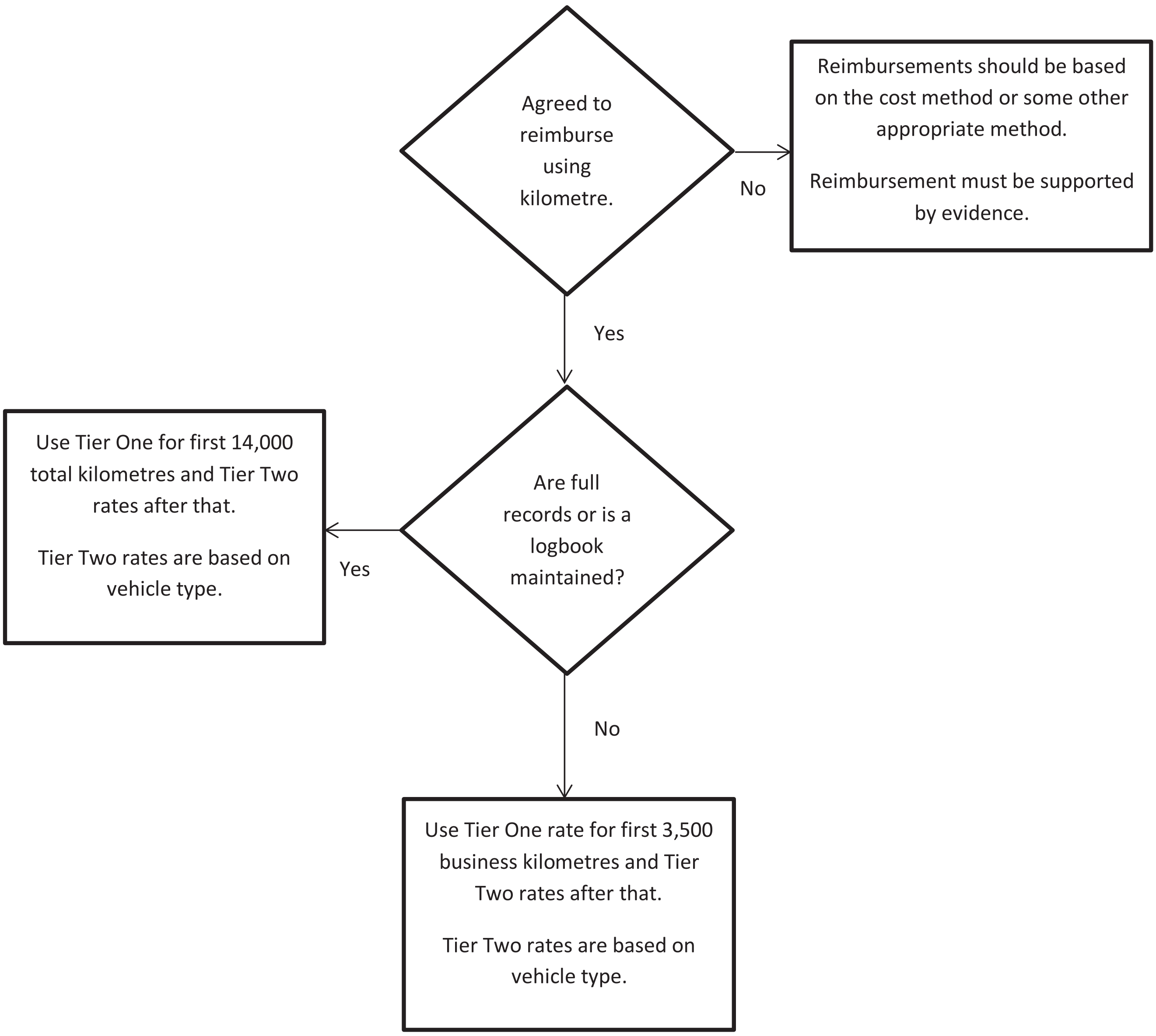
The employee uses their Holden Commodore 3.6 litre petrol car for both business and private purposes.

The journey's related to their employment equated to a total of 16,000kms.

Exempt calculation:

Tier One 3,500 × $0.76	=	2,660.00
Tier Two 12,500 (kms in excess of 3,500) × $0.26	=	3,250.00
Total deduction		**$5,910.00**

Employee Reimbursement



This Operational Statement is signed on 4 July 2018.

Vanessa Montgomery
Manager – Technical Standards

Operational Statement OS 18/02: Non-disclosure right for tax advice documents

Introduction

Operational statements set out the Commissioner's view of the law in respect of the matter discussed and deal with practical issues arising out of the administration of the Inland Revenue Acts.

This operational statement (the "Statement") sets out the process that the Commissioner will follow when issuing a notice to a taxpayer, tax advisor and/or a third party requiring the disclosure of documents, which may contain tax advice and may be subject to the right to claim non-disclosure under sections 20B to 20G of the Tax Administration Act 1994 (the Act).

Unless specified otherwise, all legislative references in this Statement refer to the Act.

Application

This Statement updates and replaces Standard Practice Statement 05/07 *Non-disclosure right for tax advice documents*.

The Statement incorporates amendments to the legislation (in particular the extension of the non-disclosure right in 2009 to apply to discovery and similar processes that occur during litigation), and incorporates principles established in cases since SPS 05/07 was published in 2005.

The requirement to disclose the information to the Commissioner will be made pursuant to a notice requiring either access to or disclosure of information under sections 16 to 19 (collectively referred to in this Statement as an "information demand").

This Statement applies to tax advisors who may or may not be a chartered accountant, but are members of an approved advisory group.

This Statement supplements the protocol on *Access to Audit Working Papers* (the "protocol") that was signed between the New Zealand Institute of Chartered Accountants (now Chartered Accountants Australia New Zealand) and Inland Revenue on 29 April 2008.[1] Documents that are prepared solely for audit purposes in relation to a client's accounting or tax positions and exposures constitute "audit working papers". They are the property of the auditor and not of the client and generally do not include tax advice documents. However if an inconsistency arises between this Statement and the protocol this Statement shall apply where appropriate.

Documents or other communications which are legally privileged under section 20 are not subject to these requirements. The Search and Surveillance Act 2012 also has no impact on the taxpayer's right or their authorised tax advisor's right to claim non-disclosure under the Act.

This Statement should be read in conjunction with the Operational Statement *OS 13/02 Section 17 Notices* or any statement issued in replacement.

This Statement applies to information demands or discovery obligations issued on or after 1 July 2018.

Background

Information demands and discovery obligations

1. The Act contains specific legislative provisions which deal with requesting and obtaining information related to a taxpayer's affairs. Together with sections 6 and 6A, these provisions play an important role in enabling the Commissioner to administer the Inland Revenue Acts.
2. The Commissioner may choose to limit inquiries in respect of independent advice on the interpretation of tax laws sought by taxpayers from tax advisors. However, in circumstances where the information provided previously by the taxpayer, their tax advisor or a third party does not lead to a complete factual description of the transactions under review, or where the taxpayer, their tax advisor or a third party refuses to answer questions in relation to the transactions under review, the Commissioner may request tax advice documents.
3. Subject to the right of non-disclosure, an information demand may require that tax advice documents be disclosed to resolve issues in more complex situations and where there are apparent material gaps in the information available to the Commissioner. Tax advice documents often contain factual information. This factual information may include information relevant to establishing the purpose or effect of the transaction or intent of the taxpayer involved if that is relevant to the statutory provisions under consideration (such as recording what has been stated to be the reason for acquiring an item of property). Inland Revenue officers are generally not concerned with the substance of the tax advice contained in the tax advice documents, but rather with the relevant facts which relate to the taxpayer's tax positions.

[1] Available at **www.ird.govt.nz/technical-tax/general-articles/ga-access-to-audit-working-papers.html**

4. The High Court in *Blakeley v C of IR* (2008) 23 NZTC 21,865 considered the scope of protection against disclosure of a tax advice document provided by sections 20B to 20G. The case concerned a section 17 notice issued to the appellant requiring him to provide a list of names and IRD numbers of clients to whom he had provided tax advice in respect of certain transactions. The appellant declined to provide the information on the basis that it would involve the disclosure of a tax advice document which was protected by section 20B. The High Court dismissed the appeal and confirmed the finding of the District Court that the right to non-disclosure of a tax advice document in respect of the information required is not available to the appellant. The following observations made by the Court indicate the scope of non-disclosure right:

- the protection afforded by section 20B is more confined than legal professional privilege. It is not a new substantive right of equivalent utility to legal professional privilege. It was a creature of statute and protected defined parts of a limited category of written communications.
- the plain words of the legislation gave no protection to the information from disclosure sought by the Commissioner.
- tax contextual information contained in the opinions would not be protected from disclosure even if the tax advice itself was.
- waiver did not arise under sections 20B to 20G. The protection against disclosure provided by the legislation was not susceptible to waiver. The right to disclosure must be claimed by following the detailed procedure set out in section 20D. If the procedure set out in the legislation was not followed, there would be no right to non-disclosure.

5. Where tax advice documents are referred to in an information demand, a two-step process will generally be followed (outlined in [45 to 63] and [73 to 83]):

(1) the taxpayer (or their authorised tax advisor) claims the right of non-disclosure for documents that are eligible to be tax advice documents; and

(2) if required by the Commissioner, the taxpayer (or their authorised tax advisor) discloses the factual content (i.e. the tax contextual information) of the tax advice documents.

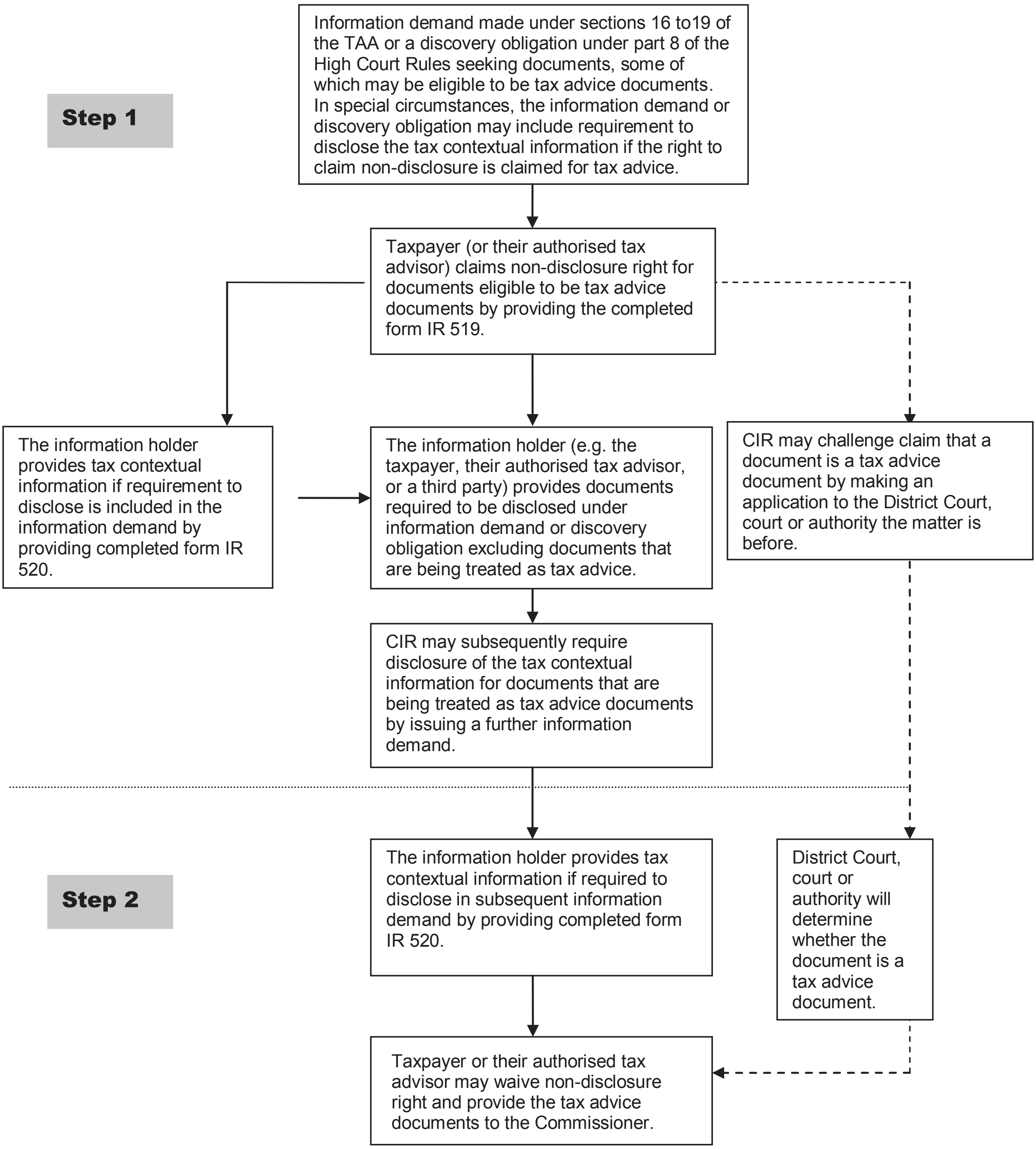
6. Where an information demand is issued directly to a taxpayer's tax advisor the Commissioner will be as specific as practicable about the transactions to which the information demand relates, based on information the Commissioner already holds. The information demand will be made in a manner consistent with the Commissioner's information gathering powers and standard practices.

7. While not limited to cases of potential evasion or avoidance, requests to a taxpayer's tax advisor will generally involve more complex matters and will usually only be made when direct inquiry from the taxpayer has not yielded the level of information which in the Commissioner's view is reasonably required to complete her inquiry.

8. The issuing of an information demand is limited to an appropriately delegated Inland Revenue officer on behalf of the Commissioner. They will take careful consideration of the statutory requirements of the provisions which provide for the information-gathering powers of the Commissioner and the Commissioner's standard practice and other relevant statements (if any).

9. The Commissioner and the taxpayer may also be subject to a discovery obligation under part 8 of the High Court Rules, which requires the parties to a proceeding to discover the existence of documents to every other party of the proceeding. In these cases the same two-step process set out in [5] applies.

The right to claim non-disclosure



Key Terms

Tax advisor

10. A “tax advisor” is defined in section 20B(4) to mean a natural person who is subject to the code of conduct and disciplinary process of an “approved advisor group”.

11. Generally, due to the professional standards imposed through the approved advisor group’s code of conduct in giving tax advice, a tax advisor will be someone who is technically qualified and is experienced and competent to give advice on the operation and effect of tax laws.

12. The definition covers tax advisors in public practice such as tax advisors within professional firms and also professionals holding in-house positions involved in tax advisory work for their employer.

13. When complying with an information demand, in-house tax advisors will need to ensure that they distinguish documents which are commercial or transactional in nature such as a sale and purchase agreement, as opposed to those documents being created for the main purpose of giving tax advice such as a tax opinion.

14. Where tax advice has been provided to a taxpayer by an offshore tax advisor, that advice can only be withheld from disclosure where the tax advisor is a member of an approved tax advisory group and the tax advisor has sufficient knowledge of New Zealand tax laws.

Approved advisory group

15. An "approved advisor group" is defined in section 20B(5) as a group that includes natural persons who meet all of the following requirements:
    - have a significant function of giving advice on the operation and effect of tax laws; and
    - are subject to a professional code of conduct in giving that advice; and
    - are subject to a disciplinary process that enforces compliance with the code of conduct; and
    - is approved by the Commissioner.

16. The ability for a taxpayer to exercise their right to claim non-disclosure depends on the tax advisor who gave the advice being subject to an approved advisor's group code of conduct and disciplinary procedures at the time the tax advice document was created.

17. Typically, a tax advisor will be subject to an approved advisor group's code of conduct and disciplinary procedures because they are a member of the approved advisor group. Some organisations may allow non-members to be subject to an approved advisor group's code of conduct and disciplinary procedures under certain circumstances such as where a non-member is practising in partnership with a member of an approved advisor group.

18. The group must also be approved by the Commissioner. The Commissioner will exercise this power of approval at a high level of delegated authority having regard to the statutory requirements and other relevant considerations as may be applicable.

19. The list of approved tax advisory groups is available to view at:
www.ird.govt.nz/taxagents/maintain/maintain-tax-agent-status.html

Tax advice document

20. Whether or not a "document" is a "tax advice document" depends on whether it meets the criteria set out in section 20B(3):

    (3) A document is a tax advice document for a person if—

    (a) the document is eligible under subsection (2) to be a tax advice document for the person; and

    (b) the person makes a claim, under section 20D, that the document is a tax advice document; and

    (c) the person satisfies the requirements of sections 20E and 20F for the document.

    If it is not a tax advice document, it must be disclosed if required under an information demand.

    A "document" is defined in section 3:

    document means—

    (a) a thing that is used to hold, in or on the thing and in any form, items of information:

    (b) an item of information held in or on a thing referred to in paragraph (a):

    (c) a device associated with a thing referred to in paragraph (a) and required for the expression, in any form, of an item of information held in or on the thing

21. The definition is wide and applies to both paper and electronic communications such as books, accounts, records, letters, faxes, reports, memos, file-notes, photographs, images, e-mails and other data however stored.

22. The right of non-disclosure only applies to documents that are "tax advice documents". It is not intended to limit the Commissioner's ability to ask general questions about a taxpayer's affairs either to a taxpayer or their tax advisor.

Requirements of a tax advice document

23. Under section 20B(3), in order for a document to be a tax advice document, three requirements must be met:
    1. the document must be **eligible** to be a tax advice document (section 20B(2)); and
    2. the taxpayer or their authorised tax advisor must **make a claim** that the document is a tax advice document (see [58 to 59] which set out the claim requirements); and

3. the taxpayer or their authorised tax advisor must satisfy the **disclosure requirements** for tax contextual information (if such a disclosure is required) and disclose documents (or parts of documents) that do not meet the tax advice document requirements (see [35 to 42]).

24 In order to be **eligible** to be a tax advice document the document must have been intended to be confidential. That is the document was intended to be treated as a private document for non-public purposes, in the same way that a communication between a legal practitioner and their clients is required to be a confidential communication before legal professional privilege attaches to it. Additionally, the document must have been:

- created by a person ("the taxpayer") for the main purpose of instructing a tax advisor to act for the taxpayer by giving the taxpayer advice about the operation and effect of tax laws; or
- have been created by a tax advisor (or where the tax advisor is in public practice, an employee of the tax advisor's firm whether this is a company, partnership or other business entity) for the main purpose of giving the taxpayer confidential advice about the operation and effect of tax laws; or
- the document must record tax advice previously provided to the taxpayer by their tax advisor; or
- the document must record research or analysis of tax laws by a tax advisor (or where the tax advisor is in public practice, an employee of the tax advisor's firm) and the document was created for the main purpose of the tax advisor providing tax advice to the taxpayer; and
- the document must not have been created for the purpose of committing, or promoting or assisting the committing of, an illegal or wrongful act. Tax evasion would be an example of an illegal or wrongful act, but it would also extend to tax advice given in the course of committing some other illegal or quasi-illegal act, such as a wider act of fraud or some other crime.

25. Therefore the types of confidential documents to which the right to claim non-disclosure may apply will be those which are created in order to seek or obtain tax advice, and would not have been created except for such purpose, even though they may serve ancillary functions such as conveying factual information.

26. Documents which simply record decisions or transactions, set out calculations or summarise facts, whether or not they are part of the process of generating tax advice, will generally not be eligible to be tax advice documents. Document or forms completed for the main purpose of meeting tax compliance obligations will also not be eligible to be tax advice documents.

27. Other examples of documents which will generally not be tax advice documents are:

- tax calculations and worksheets;
- transfer pricing documentation ;
- reports on factual matters in support of tax returns;
- financial statements (including the tax notes, tax worksheets and tax provisioning calculations);
- board minutes;
- valuation reports;
- invoices, agreements and other transaction documents;
- structure diagrams;
- memoranda of understanding;
- tax indemnity agreements;
- term sheets;
- guarantees;
- compliance forms and certificates;
- communications with third parties;
- employment contracts;
- confidentiality agreements;
- bank statements and other similar documents.

28. All these types of documents will need to be disclosed in full (any advice referred to or contained in them may not be deleted or blanked out) if subject to an information demand. The above list is not intended to be an exhaustive list.

29. It is fundamental that the document must have been intended to be and remain confidential between the tax advisor and the taxpayer, and not intended to be read by third parties or members of the public. The expression "third parties" in this context however does not include the taxpayer's other advisors such as their legal advisors, financial advisors, employees of the taxpayer or the taxpayer's shareholders or owners or where the third party is subject to a confidentiality agreement. The way in which the document is treated by the taxpayer and/or the tax advisor is relevant in determining whether confidentiality has been maintained. A confidentiality obligation should exist on the part of the third party, such as is commonly the case in due diligence exercises, joint venture arrangements, insurance proposals etc.

30. If the document is eligible to be a tax advice document, the taxpayer or their authorised tax advisor must make a claim that the document is a tax advice document. Refer to [54 to 63] which outline the procedure for making a claim. If the claim is not made in the required time period the right to claim non-disclosure will not apply to the document after the expiry of that period even if a further information demand is issued in relation to the same document or a claim for the right of non-disclosure is later made.

31. If the taxpayer or their authorised tax advisor has made a claim that a document is a tax advice document, the taxpayer or their authorised tax advisor must also satisfy the tax contextual information disclosure requirements if required to do so by the Commissioner. The tax contextual information disclosure requirements are outlined in [35 to 42].

Tax laws

32. "Tax law" is a defined term in section 3 and means:
    (a) A provision of the Inland Revenue Acts or an Act that an Inland Revenue Act replaces:
    (b) An Order in Council or a regulation made under another tax law:
    (c) A non-disputable decision:
    (d) In relation to an obligation to provide a tax return or a tax form, also includes a provision of the Accident Rehabilitation and Compensation Insurance Act 1992 or a regulation made under that Act or the Accident Insurance Act 1998 or a regulation made under that Act of the Injury Prevention Rehabilitation and Compensation Act 2001 or a regulation made under that Act.

33. The tax advice must only be about New Zealand tax rules as they affect the taxpayer in question. Advice about the effect and application of tax laws in another jurisdiction (such as a country in which a controlled foreign company is resident) will not be subject to the right to claim non-disclosure.

34. Advice provided to taxpayers about non-tax issues such as accounting treatment (including materiality, provisioning, and related party disclosures), insolvency law, company and trust law will constitute tax contextual information, as discussed below. If the main purpose of the document is to give such advice, it will not be subject to the right to claim non-disclosure.

Tax contextual information

35. Tax contextual information may be required to be disclosed as a result of one of the following:
    - in special cases, where the Commissioner issues a subsequent information demand requiring disclosure of the tax contextual information after the taxpayer or their authorised tax advisor has made a claim for the non-disclosure right; or
    - in rare cases, where the Commissioner requires the tax contextual information as part of the original information demand.

36. The circumstances in which Inland Revenue may require disclosure of the tax contextual information under either of the above situations is discussed at [76 to 77].

37. Tax contextual information means information **relating to** a tax advice document that falls into any of the following categories, as defined in section 20F(3):
    - facts or assumptions relating to the transaction identified in the information demand and to which the advice relates, whether the transaction has occurred, or is expected to occur or is assumed to have occurred by the creator of the tax advice document (i.e. either the tax advisor or the taxpayer);
    - a description of steps involved or expected to be involved in the performance of the transaction;
    - advice related to the operation and effect of laws, other than tax laws, on the taxpayer and any related facts or assumptions that this advice is based on;
    - advice related to the operation and effect on the taxpayer of tax laws which relate to the collection of debts payable to the Commissioner (i.e. debt recovery issues) and any related facts or assumptions that this advice is based on;

- facts or assumptions from, or relating to the preparation of, the taxpayer's financial statements, supporting worksheets or other source documents or documents containing information that the taxpayer is required to provide the Commissioner under an Inland Revenue Act. This is including tax advisor's accounting and tax workpapers which support the financial statements and/or tax return.

38. Generally, the Commissioner will seek tax contextual information in order to establish the facts relating to a transaction or series of transactions. The information sought will include relevant information such as whether the transaction took place, the names of the parties involved, the purpose of the transaction, relevant dates, amounts, conditions, formulae, etc.

39. "Assumptions" are statements or propositions that have been accepted or assumed as true for the purpose of the tax advice whether the basis for the statement or proposition is factual or not.

40. Tax contextual information may be required to be provided in relation to one or more tax advice documents requested in the same information demand.

41. If an authorised tax advisor is providing the tax contextual information, that information should reflect the advisor's understanding of the transaction. Verbatim extracts from transaction documents may be included if the tax advisor considers that the extracts are the best representation of the information in order to meet the disclosure requirements of the tax contextual information. This is optional and is a matter for the judgment of the tax advisor.

42. Tax contextual information from a tax advice document is to be disclosed to the Commissioner in a statutory declaration in the prescribed form *Tax contextual information disclosure (IR520)*. A copy of this form can be found on Inland Revenue's website: **www.ird.govt.nz/forms-guides/number/forms-500-599/ir520-form-taxcontext.html**

Information holder

43. An information holder is a person who has been issued with an information demand pursuant to sections 16 to 19 requiring that information holder to disclose information in relation to a taxpayer. The information holder may be a taxpayer, a taxpayer's tax advisor or an unrelated third party such as a bank.

44. Irrespective of the relationship between the information holder and the taxpayer, the non-disclosure right must be claimed by the taxpayer to whom the information demand relates (or their authorised tax advisor). Where a taxpayer and their authorised tax advisor disagree or dispute the right to claim non-disclosure or any of the disclosure requirements related to the right to claim non-disclosure, the taxpayer's position will take precedence.

Process for claiming the right of non-disclosure

Step 1: The Commissioner must issue an information demand or the taxpayer and the Commissioner must be subject to a discovery obligation requiring the disclosure of a document which may be eligible to be a tax advice document

45. A claim that a document is a tax advice document can only be made where the Commissioner and the taxpayer are subject to a discovery obligation or where the Commissioner has issued the information holder with an information demand under any of the following sections:
    - section 16 access to premises, section 16B removal and copying of documents and section 16C removal and inspection of documents;
    - section 17 notice requiring production of information;
    - section 17A Court order for production of information or return;
    - section 18 inquiry before a District Court Judge; or
    - section 19 inquiry by the Commissioner.

46. If the information demand is a section 17 notice then the Commissioner must follow the practice set out in Operational Statement *OS 13/02 Section 17 Notices* or its replacement.

47. An information demand may be issued directly to a tax advisor but this action must be approved in accordance with the exercise of delegated powers conferred to Inland Revenue officers by the Commissioner.

48. Generally, Inland Revenue will only issue an information demand directly to a tax advisor where the information has not been provided voluntarily or in a timely manner by the information holder and cannot reasonably (in the opinion of the Commissioner) be obtained or verified elsewhere. For example records may have been lost, the taxpayer may no longer be available or may have left the country, or the taxpayer or information holder is being uncooperative in regard to reasonable inquiries made by the Commissioner.

49. Other examples of when an information demand may be issued to a tax advisor include cases involving suspected tax evasion or fraud, suspected tax avoidance, and cases involving complex international transactions or transfer pricing.

50. In some cases the information demand may be issued to a third party who is not the taxpayer's tax advisor. The legislation does not require the Commissioner to advise the taxpayer or their tax advisor of the information demand. However, where this does occur, and the Commissioner considers that the information demand may include documents that may be eligible to be a tax advice document, the Commissioner's practice is that the taxpayer or their tax advisor will be notified (by the Commissioner) of the notice, so as to provide the opportunity for a claim of non-disclosure to be made.

51. The Commissioner, however, reserves the right **not** to advise the taxpayer of an information demand to a third party where the Commissioner considers that to do so will endanger the safety of the third party or for reasons relating to her duty to protect the integrity of the tax system. A decision not to advise the taxpayer of an information demand made to a third party will be made by a senior officer of the department.

52. The notice to the third party will refer to the non-disclosure right and the third party may choose to advise the taxpayer of the notice and so allow the taxpayer the opportunity to make a claim of non-disclosure. However in some cases the Commissioner may specifically ask the third party not to advise the taxpayer of the information demand.

53. Where the information demand requires disclosure of the tax contextual information from the outset, this will be clearly stated in the information demand.

Notification to Commissioner that taxpayer or their authorised tax advisor is claiming the non-disclosure right.

54. A claim that a document is a tax advice document for a taxpayer must be made by either the taxpayer or their authorised tax advisor. This is also the case where the information holder is a third party, since a third party cannot make such a claim.

55. Where the non-disclosure right is made by a tax advisor on behalf of their client, section 20D(5) requires that the tax advisor must also include a statement that they are authorised to act on behalf of the taxpayer for the purposes of the non-disclosure right.

56. The Commissioner expects and prefers that the authorised tax advisor is the tax advisor who created the tax advice document. However if that tax advisor is unavailable, for example because the tax advisor is not in New Zealand, or has left the organisation originally instructed to provide the advice, or that organisation has ceased to operate, then an appropriate alternative tax advisor may be the authorised tax advisor.

57. Although the legislation does not provide for the claim to be made on a prescribed form, the Commissioner prefers that the claim that a document is a tax advice document be made on the form *Tax advice document claim (IR519)* which has been designed for this purpose. This form is available at: **www.ird.govt.nz/forms-guides/number/forms-500-599/ir519-form-nondisclosure.html**

58. The claim that a document is a tax advice document must contain certain information. Where the document was created by the taxpayer (i.e. a document instructing a tax advisor to provide advice on the operation and effect of tax laws), the claim must contain the following:

- a brief description of the form (such as a letter, email, report) and content (such as request for tax advice concerning fringe benefit tax) of the document;
- the name of the tax advisor for whom the document was intended; and
- the date on which the document was created (that is, finalised or sent to the taxpayer's tax advisor).

59. Where the document was created by a tax advisor the claim must contain the following:

- a brief description of the form (such as a letter, research paper, summary of phone conference, email) and content (such as tax advice concerning fringe benefit tax, depreciation, treatment of bloodstock) of the document; and
- the statute, enactment or regulation and the type of revenue such as income tax, fringe benefit tax, GST, PAYE or withholding tax which was the subject of the tax advice; and
- the name and if possible the contact details of the tax advisor who gave the tax advice in relation to the document; and
- the name of the approved advisor group that the tax advisor belonged to when the document was created; and
- the date on which the document was created (that is, finalised or sent to the taxpayer).

60. Different versions of the "same" tax advice document, where the content of the various versions are significantly different, may need to be separately identified in the IR519 form.

61. The following table sets out the time periods within which a claim that a document is a tax advice document must be made (section 20D(4)):

Type of information demand/obligation	Due date for non-disclosure claim
Access to premises for information (section 16 notice, sections 16B and 16C)	The date the right of inspection or removal is exercised, or later date agreed with Inland Revenue
Information demand (section 17 notice)	The later of the date given by the Commissioner or 28 days after the date of the section 17 notice
Court order for information (issued under section 17A or section 18)	The date the court requires the information
Inquiry by Commissioner (section 19)	The date the Commissioner requires the information
Discovery obligation	The date required by the discovery obligation

62. Where the taxpayer or their authorised tax advisor has not notified the Commissioner of their claim of non-disclosure within the above stated time periods the claim will be invalid. A further claim may not be made at a later date even if the document happens to be the subject of a later information demand. Accordingly it is recommended that the taxpayer or their authorised tax advisor should notify the Commissioner of a claim that a document is a tax advice document as soon as practicable after receiving an information demand.

63. The Commissioner may extend the above time periods for making a claim of non-disclosure in exceptional circumstances if requested to do so by the taxpayer (or their authorised tax advisor). Any request for such an extension must be made before the end of the time frame advised in the information demand and any extension will be granted at the discretion of the Commissioner. Any change to the time period will be notified to the taxpayer in writing. The Commissioner will (as necessary) take the following matters into account when extending the time period for making a claim of non-disclosure:

- the complexity of the situation;
- the compliance history of the taxpayer;
- issues related to the timing of the notice;
- the difficulty which the taxpayer may have in making the claim; and
- other factors generally relevant to the exercise of the relevant statutory power.

Limitations on the right to claim non-disclosure

64. If a document required to be disclosed under an information demand does not meet the requirements of being a tax advice document, that document is ineligible to be a tax advice document. In such circumstances, the information holder is required to disclose that document pursuant to the requirements of the information demand. This includes attachments (such as appendices, schedules and notes) to tax advice documents where the attachment is not eligible to be a tax advice document.

65. Examples of documents (including those that are attached to another document which is a tax advice document) that are generally not eligible to be tax advice documents include, but are not limited to:

- business and management records;
- financial statements, work papers, and notes to the financial accounts;
- letters of engagement;
- numerical calculations compiled for the purpose of calculating a taxpayer's tax liability;
- transfer pricing documentation;
- legal transaction documents such as contracts, licence agreements, loan documentation, guarantees, deeds, title documents, tax indemnity agreements and letters between the transaction parties;
- databases and spreadsheets;
- diagrams demonstrating transactions;
- documents created by the tax advisor for main purposes other than giving a taxpayer advice on the operation and effect of tax laws, such as advising on employment law, company law, securities law, other regulatory requirements, or the accounting or financial treatment of transactions, etc.

66. If the taxpayer or their tax advisor does not disclose the documents or part of documents which are not tax advice documents by the required date set out in the information demand, the taxpayer or their tax advisor may be liable for penalties as set out in Part 9. It is therefore important that care is taken to identify those documents which may be tax advice documents from those other documents or parts of documents which are not eligible to be tax advice documents.

Treatment of potential tax advice documents

67. Section 20C contains specific provisions dealing with the treatment of a potentially eligible tax advice document while the non-disclosure claim is being established.

68. The document will be regarded as being a tax advice document from the date of the information demand or discovery obligation until the earlier of:

- the date by which the taxpayer or their authorised tax advisor is required to claim the document is a tax advice document; or
- the date on which the taxpayer or their authorised tax advisor informs the Commissioner that the person is waiving the right to claim non-disclosure over the document (including where the document is provided as it is not included in a claim for non-disclosure).

69. As advised above, if a non-disclosure claim is not made within the statutory time frame the document loses its tax advice document status.

70. If the taxpayer or their authorised tax advisor claims a document is a tax advice document within the statutory time frame the document must be treated as a tax advice document from the date the Commissioner is advised of the claim until one of the following events occurs:

- the District Court, or a court or Taxation Review Authority (that the discovery obligation is in proceedings before) rules that the document is not a tax advice document;
- the taxpayer or their authorised tax advisor agrees in writing that the document is not a tax advice document;
- the taxpayer or their authorised tax advisor withdraws in writing the claim that the document is a tax advice document;
- an approved advisor group informs the Commissioner that the authorised tax advisor is or was not a member of the approved advisor group at the time that the authorised tax advisor claimed and was required to be a member of the approved advisor group.

71. While the non-disclosure claim is being considered a copy of the document is to be held in a secure place.

72. A "secure place" includes a lockable cupboard, locker or safe at the tax advisor's business premises and secure electronic storage. It can also include the non-public parts of a tax advisor's offices where access to that area is limited, and protected or controlled by the tax advisor.

Step 2: Provision of tax contextual information in statutory declaration

73. An information holder who is required to disclose information under an information demand or discovery obligation must also disclose tax contextual information relating to any document that the taxpayer or their authorised tax advisor claims to be a tax advice document, if required to do so by the Commissioner. The Commissioner may require disclosure of the tax contextual information either as part of the original information demand, discovery obligation or may require disclosure through a subsequent information demand at a later date.

74. The discretion to require disclosure of the tax contextual information will be exercised sparingly in order to minimise compliance costs, and so that the spirit of the non-disclosure right rules are not undermined. Accordingly, exercising this discretion will be limited to officers at an appropriately high level of delegated authority.

75. The Commissioner will notify the taxpayer or their authorised tax advisor if disclosure of the tax contextual information is required either as part of the original information demand or in a separate information demand. A decision to require disclosure of the tax contextual information will be made after the Commissioner has assessed the information already provided under the information demand and after considering the nature of the documents for which the non-disclosure claim has been claimed. Generally the Commissioner will require the disclosure of tax contextual information after the information demand has been issued where:

- there appears to be material gaps in the information available;
- there is an issue of credibility in respect of the information already held by Inland Revenue;

- inconsistent information already provided needs to be verified; or
- there is considerable factual complexity requiring clarification and there are no other reasonable sources for that information.

76. Where the Commissioner considers it necessary to protect the integrity of the tax system, an original information demand may require the tax contextual information to be disclosed at the same time the information demand is given. This is likely to occur:
    - in circumstances involving suspected evasion or other suspected criminal action;
    - where sections 16 or 16B are being applied;
    - where the transactions in question are particularly complex and the evidence is inconsistent, and there may be insufficient time for the Inland Revenue to properly complete the investigation within the timebar period; and/or
    - where there is a history of non-compliance by the taxpayer or associated persons.
77. The disclosure of the tax contextual information must be in a statutory declaration in the prescribed form *Tax contextual information disclosure (IR520)*.
78. The statutory declaration contained in the IR520 form must be made by an authorised tax advisor who has not been barred from making a statutory declaration. A tax advisor may be barred from making a statutory declaration if a Court has so ordered where the tax advisor has previously been convicted of an offence under one or more of the following provisions:
    - section 111 of the Crimes Act 1961 - false statements or declarations;
    - section 143(1)(b) - not supplying information when required to by tax law;
    - section 143A(1)(b) or (c) - knowingly does not provide information when required to by law or knowingly provides altered, false, incomplete or misleading information;
    - section 143B(1)(b) or (c) - knowingly not supplying information when required to by tax law, or providing altered, false, incomplete or misleading information; or
    - section 143H - obstruction.
79. Generally, the Commissioner prefers that the authorised tax advisor making the statutory declaration will be the same tax advisor or a member of the same firm which created the tax advice document for which the non-disclosure right is claimed (and where possible be the same authorised tax advisor who claimed the non-disclosure right on behalf of the taxpayer).
80. The statutory declaration must be sworn before:
    - a Solicitor of the High Court of New Zealand; or
    - a Justice of the Peace; or
    - any other person authorised by law under the Oaths and Declarations Act 1957 to take a statutory declaration but not including officers of Inland Revenue.
81. Where the information demand requires disclosure of the tax contextual information, that information, including the IR520 form, may be delivered within the time periods outlined below, together with any documents which are not tax advice documents and that are required to be disclosed under the information demand to the officer of the Department authorised by the Commissioner to receive the documents. This generally will be the officer listed in the information demand.

Type of information demand/obligation	**Due date for tax contextual information**
Access to premises for information (section 16 notice, sections 16B and 16C)	The date determined by the Commissioner when requiring the statutory declaration.
Information demand (section 17 notice)	The later of the date given by the Commissioner on the notice or 28 days after the date of the notice requiring the disclosure of the tax contextual information.
Court order for information (issued under section 17A or section 18)	The date the court requires the production of the information.
Inquiry by Commissioner (section 19)	The date the Commissioner requires the production of the information.
Discovery obligation	The date required by the discovery obligation.

82. The Commissioner may extend the above time periods in exceptional circumstances if requested to do so by the taxpayer (or their authorised tax advisor). An extension may be granted at the discretion of the Commissioner and any change to the time period will be notified to the taxpayer.

83. The Commissioner may take the following matters into account when extending the time period for providing tax contextual information:

- the complexity of the situation;
- the compliance history of the taxpayer;
- issues related to the timing of the notice;
- the difficulty which the taxpayer or their authorised tax advisor may have in providing the information; and
- other factors generally relevant to the exercise of the relevant statutory power.

Section 16 information demands and tax contextual information

84. Where the Commissioner exercises her powers under sections 16, 16B or 16C, disclosure of the tax contextual information in the information demand related to the exercise of the section 16, 16B or 16C powers will be required.

85. A taxpayer or their authorised tax advisor will need to ensure that they have met the following requirements by the relevant statutory time period(s) set out in the information demand in relation to sections 16, 16B and 16C:

- all documents required to be disclosed under the information demand which are not eligible to be tax advice documents have been provided;
- if the non-disclosure right is being claimed the Commissioner has been notified of that and the required information in the IR519 form has been provided; and
- the tax contextual information for all documents which are subject to the non-disclosure right has been provided.

Voluntarily providing eligible documents

86. Nothing in this Statement precludes a taxpayer or their authorised tax advisor from voluntarily providing documents which may be eligible to be tax advice documents. However taxpayers and their authorised tax advisors should be aware that any documents which may be eligible to be tax advice documents but which are provided voluntarily will constitute a waiver of the right to claim non-disclosure over those particular documents.

87. Nothing in this Statement precludes a taxpayer from meeting their obligations under Part 9. For example, it will commonly be the case that tax advice documents need to be disclosed to demonstrate that the taxpayer took reasonable care in taking a particular tax position.

Challenge by the Commissioner

88. The legislation provides that the Commissioner may apply to the District Court (this may be included in the course of a section 18 inquiry), or the court or authority the particular matter is before, for an order determining one or more of the following:

- whether a document is a tax advice document for the taxpayer;
- whether information provided by a taxpayer or their authorised tax advisor is tax contextual information for a tax advice document; or
- whether the taxpayer or their authorised tax advisor is required to provide a more detailed or better description of tax contextual information in relation to a document.

89. As part of an application by the Commissioner, the District Court Judge, court or authority may require disclosure to the court of the document which is the subject of the order.

Disclosure of information to approved advisor group

90. Section 81 allows the Commissioner to supply information to an approved advisor group about an action or omission by a person who is or purports to be a member of the approved advisor group where the Commissioner considers that act or omission to be a breach of the tax advisor's responsibilities in relation to the non-disclosure right.

91. The Commissioner would only consider this type of disclosure in specific circumstances such as:

- the provision of false or incomplete information in the statutory declaration required for the disclosure of tax contextual information;

- where a tax advisor has knowingly failed to disclose facts or assumptions relating to a transaction which is the subject of the tax advice document; where the tax advisor has failed to provide tax contextual information when required to do so by the Commissioner under or pursuant to an information demand.

This Operational Statement is signed on 29 June 2018.

Vanessa Montgomery
Manager, Technical Standards

QUESTIONS WE'VE BEEN ASKED

This section of the *TIB* sets out the answers to some day-to-day questions people have asked. They are published here as they may be of general interest to readers.

QB 18/10: Income tax – state schools and donation tax credits

No payments to state schools are compulsory except for optional goods and services that parents have agreed to purchase. Therefore, many payments made by parents to state schools may qualify as gifts for donation tax credit purposes. School boards and administrators need to understand which payments made by parents may qualify as gifts so schools can issue donation tax receipts.

Question

What payments by parents to state schools are gifts for donation tax credit purposes?

Answer

Payments by parents to state schools are gifts for donation tax credit purposes where the payment is voluntary and is a payment to the school:

- to assist generally with funding its costs, including the cost of delivery of the school's curriculum; or
- for a specific purpose or project to benefit the school as a whole where no material benefit or advantage is obtained in return for making the payment; or
- to assist with the school's cost of delivering individual subjects or activities forming part of the school's curriculum and in which the student may participate regardless of whether any payment is made.

Key terms

State schools are state non-integrated schools, and include partnership schools kura hourua.

Also see:

Inland Revenue

QB 16/05 Income tax – donee organisations and gifts

QB 18/11 Income tax – state integrated schools and donation tax credits

BR Pub 18/06 Goods and services tax - payments made by parents to state and state integrated schools

Ministry of Education

Circular 2018/01 Payments by parents of students in schools

Explanation

Scope of this Question We've Been Asked

1. This Question We've Been Asked (QWBA) addresses payments made by parents to state non-integrated schools and partnership schools kura hourua in New Zealand. In this QWBA state non-integrated schools are referred to as "state schools", and include partnership schools kura hourua. Any references to a state school's board of trustees should be read as including a reference to the sponsor of a partnership school kura hourua. Further, the word "parents" includes guardians and caregivers of students who also make payments to state schools.
2. This QWBA does not address payments:
   - by parents to state integrated schools or private schools in New Zealand (state integrated schools are addressed in QB 18/11 *Income tax – state integrated schools and donation tax credits*);
   - made for international students to attend state non-integrated schools; or
   - payments to entities (such as charitable trusts or parent–teacher associations) that are associated with a state non-integrated school but are separate entities from the school.
3. This QWBA refers to *Circular 2018/01 Payments by parents of students in schools* (Ministry of Education, 2018), which provides guidance on payments by parents of students in state and state integrated schools, and partnership schools kura hourua.
4. The examples from [47] illustrate how the donation tax credit rules apply for state schools.

State school statutory environment

5. In New Zealand, students attending state schools (other than international students) from the ages of 5 to 19 are entitled to free enrolment and free education. International students are generally any students who are not New Zealand citizens or residents.

6. Section 3 of the Education Act 1989 provides:

> **3 Right to free primary and secondary education**
>
> Except as provided in this Act, every person who is not an international student is entitled to free enrolment and free education at any State school or partnership school kura hourua during the period beginning on the person's fifth birthday and ending on 1 January after the person's 19th birthday.

7. The Education Act 1989 does not define what free enrolment and free education means for schools. However, it involves the delivery of the national curriculum by schools. The Education Act 1989 establishes the overall framework for the delivery of education by state schools, by publishing various curriculum statements, guidelines, and national performance measures under s 60A of the Education Act 1989. The central component of that framework is the national curriculum, which comprises the New Zealand Curriculum and Te Marautanga o Aotearoa. The national curriculum sets out a common direction for teaching and learning in New Zealand schools.

8. The board of trustees of every state school must develop a charter (or, from 2019, a four-year strategic plan and an annual implementation plan) and a detailed curriculum for its school, that align with the intent of the national curriculum and the school community's values and expectations. The board is then required to implement its school's curriculum in accordance with the priorities set out in the National Education Goals and the National Administration Guidelines.

Ministry of Education guidance in Circular 2018/01

9. The Education Act 1989 does not give any guidance on the types of payments boards of trustees of state schools may ask for from parents, but it is implicit that state schools cannot charge for something that is part of a student's statutory entitlement to free enrolment and free education. The Ministry of Education confirms this in *Circular 2018/01*.

10. According to *Circular 2018/01*, a school may ask parents for **donations** to assist with funding its costs, including the cost of delivering the school's curriculum. The donations requested may be general donations (that is, donations for an unspecified purpose) or specified donations (that is, donations for a particular purpose such as books or sports equipment). *Circular 2018/01*, advises schools that if a specified donation is requested for an activity forming part of the delivery of the school's curriculum, students cannot be excluded from participating in the activity if the parent chooses not to make all or part of the contribution.

11. Sometimes schools may offer for sale consumables, take-home items (such as items made in technology classes), stationery, clothing and optional activities that are not part of the delivery of the school's curriculum. Schools may charge for these optional consumables and activities where the parents have agreed to buy them, but parents are not obliged to buy them. Any payment for these optional things is not a donation.

12. *Circular 2018/01* also explains that schools must not pressure parents to make donations. No payments sought from parents of students attending state schools are compulsory except for charges for optional goods and services that parents have agreed to purchase. Schools cannot withhold education services, information or privileges from students if their parents choose not to make the requested donations or make only part of the requested donation.

Donation tax credit rules

13. Under the Income Tax Act 2007, a donation tax credit may be available for charitable or other public benefit gifts made by a parent to a state school if the requirements in ss LD 1 to LD 3 are met. The phrase "charitable or other public benefit gift" is defined in s LD 3(1) to mean a monetary gift of $5 or more paid to a qualifying organisation (referred to as a donee organisation).

14. Since 2008, the boards of trustees of state schools have been listed as donee organisations in s LD 3(2)(bb). Before 2008, state schools qualified as donee organisations because the advancement of education is a charitable purpose and they otherwise met the requirements of s LD 3.

15. As the boards of trustees of state schools are donee organisations a parent who makes a monetary "gift" of $5 or more to such a board can **claim** a donation tax credit of one third of the payment amount at the end of the relevant tax year, provided the parent meets the other requirements for claiming a tax credit. These requirements include the parent holding a donation tax receipt from the school. Inland Revenue processes all claims for donation tax credits, and, ultimately, it is the Commissioner who decides whether a parent is entitled to a tax credit for a payment made to a state school on the basis that she is satisfied the parent has made a qualifying charitable or other public benefit gift to the school.

Charitable or other public benefit gifts

16. While the phrase "charitable or other public benefit gift" is defined in s LD 3(1), the term "gift" is not defined in the Income Tax Act. In the absence of a statutory definition of "gift", the Commissioner considers "gift" should be given its ordinary meaning. This is consistent with the Court of Appeal's decision in *Mills v Dowdall* [1983] NZLR 154. New Zealand case law on the ordinary meaning of "gift" is limited, so the Commissioner considers it appropriate to take guidance from overseas case law.

17. It is likely the New Zealand courts (like the Canadian courts before them) will follow the approach taken by the Australian courts on the ordinary meaning of "gift". Therefore, the Commissioner considers that, for the purposes of s LD 3(1) and state schools, a "gift" is a payment by a parent to a school of money of $5 or more:

    - made voluntarily;
    - by way of benefaction; and
    - in return for which the parent receives no material benefit or advantage.

    For a more general discussion on what is a gift see *QB 16/05 Income tax – donee organisations and gifts*.

18. When deciding whether a parent's payment to a state school is a gift, the true nature of the payment is to be determined by considering the overall arrangements and transactions giving rise to the payment. The name or description given to a payment is not determinative of its true nature.

Voluntary payment

19. According to *Circular 2018/01* the only compulsory payments parents are required to make to a school are attendance dues payable to the proprietor of a state integrated school. In all schools, payment can be enforced where the parents have agreed to purchase optional goods and services from the school. Otherwise, all other payments parents may be asked to make to schools are voluntary in the sense that the school cannot compel parents to make the payments. Parents can choose whether to make requested voluntary payments in full, in part, or not at all. However, just because these payments are "voluntary" does not mean they are automatically gifts for income tax purposes.

20. To qualify as a gift, a parent's payment to a school must be made voluntarily. For gifting purposes, this means that the payment is made willingly, freely by choice and for benevolent reasons. It also means that a parent's payment must not be made under an arrangement (contractual or otherwise) where the payment is made in return for a material benefit or advantage. Similarly, a payment may not be voluntary where there is some agreement, understanding or expectation that the school is to do or provide something in return for the payment. (The link between the payment and the material benefit is discussed from [30].)

21. The absence of a contract or a legal obligation on a parent to contribute to a school does not automatically mean payments are voluntary and therefore gifts. There may be circumstances where, even though a parent has no legal obligation to make a payment to a school, the payment will still not be a gift for donation tax credit purposes. For example, where a student's participation in an activity is dependent on the parent's payment.

22. Occasionally, pressure might be applied (by the school or by other parents) on a parent to make a contribution. This pressure can create a sense of moral obligation on the parent to contribute. While a payment may be voluntary even if it is made under a sense of moral obligation, in some circumstances the Commissioner considers pressure might also be evidence that a payment is being made under an arrangement between the school and the parent where the payment is being made in return for a material benefit or advantage. In those circumstances, the payment will not be voluntary, and so will not be a gift.

Benefaction

23. The requirement that a gift is made voluntarily is connected with the concept of benefaction and the belief that gifts usually proceed from a "detached and disinterested generosity". Benefaction is the idea that a gift is made to provide an advantage to or to do good for the recipient. Benefaction is an important element of a gift in its ordinary sense; when it is absent there can be no gift (*Leary v FCT* (1980) 32 ALR 221).

24. In the context of contributions made by parents to state schools, benefaction is the idea that a parent's payment will provide an advantage to or do good for the school in some way. For example, a voluntary contribution by a parent towards the school's cost of delivering the curriculum will help the school achieve its charitable purpose of advancing education.

Material benefit or advantage in return

25. A parent's voluntary payment to a state school will not be a gift if it is made under an arrangement where the parent expects a material benefit or advantage **in return for** making the payment. It is sufficient that an understanding or expectation (clear or implicit) exists between the parent and the school that the payment is being made in return for a material benefit or advantage.

26. In *Case M128* (1990) 12 NZTC 2,825 Judge Barber held that payments by a parent for the cost of a field trip for his son to Mount Aspiring was not a gift because the payment gave the student the right to participate in the trip and was not for the common good of the school. He similarly found that other school charges were not gifts as they all conferred rights on the student, such as the right to attend camp, the right to use and own stationery and the right to own a manual.

27. The Commissioner considers a parent's payment to a state school will **not** be a "gift" where:
    - the parent's payment is made in return for a material benefit or advantage; or
    - the school is placed under an obligation to do or provide something in return for the parent making the payment.

28. A material benefit or advantage does not need to come directly from the school and does not need to be received directly by the parent who made the payment (for example, the student may receive the benefit) so long as under the arrangement the material benefit or advantage is in return for the parent making the payment.

29. A benefit or advantage will be considered "material" if it is of substance and can be valued or owned or both. (Sometimes these benefits are referred to as pecuniary or proprietary benefits.) A benefit or advantage will not be material if it is intangible and cannot be valued or owned. Non-material benefits or advantages include such things as public acknowledgement (for example, when a parent's name is printed in a school newsletter to acknowledge their gift). This is different from a material benefit such as where a parent's business is advertised in the school's newsletter in return for the parent making the payment.

Sufficient link between payment and benefit or advantage

30. Importantly, not every material benefit or advantage will necessarily disqualify a voluntary payment from being a gift. Sometimes a voluntary payment may be a gift even if the parent obtains a material benefit or advantage. This happens when the connection between the payment and the benefit is weak (for example, where a benefit will be obtained by the giver regardless of whether the gift is made). In this example, although a benefit is received, the payment cannot be said to be made **in return for** the benefit, as the benefit will be obtained anyway. The extent and strength of any link between the parent's payment and a benefit or advantage can be an important factor in determining whether a payment is a gift.

31. This point is illustrated by two Australian Board of Review decisions concerning payments made to two different ambulance services: *Case D55* 72 ATC 339 and *Case F40* 74 ATC 223. In *Case D55* the board held payments to an ambulance service were gifts, while in *Case F40* the same board considered payments to a different ambulance service were not gifts.

32. In *Case D55* the giver made payroll-giving–type payments to a free ambulance service operating in his home district. The payments were not made under a contract between the giver and the ambulance service. The giver was already entitled to a free service from the ambulance service and there was no evidence of any representation that by making the payments he would receive any material benefit or *quid pro quo* in return. Given these factors, and even though the giver was entitled to free ambulance services, the board concluded that the payments were gifts. This was because the payments were made voluntarily by the giver, not in return for the ambulance services and the payments were for what the giver considered to be a good cause. A sufficient link did not exist between the benefits to the giver and the payments to prevent the payments from being gifts.

33. In *Case F40* the ambulance service operated under different rules. A person who made a payment to the ambulance centre was entitled to receive a free treatment and transport service within the area for one year and would be eligible to be elected to the centre's committee and to vote in elections for the committee. The board held that a contract existed between the centre and the payer under which the centre had an obligation to provide free services to the payer in return for the payment. If the payment had not been made, the payer would not have been entitled to free services. A strong dependency existed between the payment and the free services, so the payment was not a gift. Unlike in *Case D55*, the payer was not entitled to the benefit of free ambulance services regardless of whether the payment was made.

34. In New Zealand, the statutory right to free education means students attending state schools are statutorily entitled to the delivery of the school's curriculum regardless of whether their parents make donations in full, in part or not at all to assist with the cost of the delivery of that curriculum, or even if no parents make donations. The Commissioner considers

that, generally, a student's statutory right to free education will mean a sufficient link does not exist between a parent's voluntary payment to assist a state school and any benefit obtained by the student in return. This is because the school is obliged to deliver the school's curriculum to the student regardless of whether the parent's payment is made, so the payment is being made to benefit the school rather than being made in return for education.

35. *Case J76* (1987) 9 NZTC 1,451 provides some support for the view that a state school student's statutory right to free education means a sufficient link does not generally exist between a parent's voluntary payment to assist the school and any benefit obtained by the student. *Case J76* concerned a claim by the objector, a parish priest, that payments he made to ensure disadvantaged children obtained appropriate schooling were gifts and he should be entitled to a rebate under s 56A(2) of the Income Tax Act 1976.

36. Judge Keane found there was no doubt that the payments were made out of charity. But he found no suggestion that the schools would have educated the children if the priest had not made the payments. Therefore, the payments placed the schools under a contractual duty to educate the children. The priest's payments were not gifts. Judge Keane's decision suggests that if the schools had had an existing obligation to educate the children, then the priest's payments might have been gifts, because they would have been made to fund the schools' charitable purposes (that is, the advancement of education). Instead, in the absence of the schools having any pre-existing obligations, the payments were held to be made in return for the schools' educational services.

37. The strength of any link between a payment and a benefit or advantage can usually be determined by considering **all** the circumstances surrounding the gift, including, in the case of state schools, a student's statutory right to free education. However, the stronger the connection between a parent's payment and any material benefit or advantage obtained in return, the less likely it is that the payment will qualify as a gift. It is also important to remember that gifts ordinarily proceed from an intention on the part of the giver to provide an advantage or to do good for the recipient – (that is, the school).

Gifting in the state school environment

General donations

38. State schools may ask parents for donations to assist generally with funding their costs, including the cost of delivering the school's curriculum. Where the donations requested are general donations (that is, donations for an unspecified purpose), the school may issue a donation tax receipt, providing the payments are made voluntarily by the parents to benefit the school.

39. The benefit parents and students get from making general donations to assist a school with its costs, including the cost of delivering its curriculum will not prevent the parent's payments from being gifts. This is because students attending state schools are entitled to free education. Therefore, parents of students at state schools are entitled to expect their children will receive the education their school has undertaken to provide regardless of whether the parent makes any general donations. As a result, the Commissioner considers an insufficient link exists between a parent's general donation and any benefit obtained, so the parent's payment is not made in return for the benefit.

Voluntary payments for specific purposes or projects

40. Sometimes parents are asked to assist schools with funding special projects for a school (for example, to assist with developing a computer lab or for books for the school library). Gifts for specific purposes or projects may not always be a contribution towards the cost of delivering the school's curriculum, so they can be different from general school donations in that regard. However, the fact a school seeks donations for a specific project will not, in itself, prevent the payment being a gift. In the Commissioner's view, a payment made for a specific purpose or project will be a gift so long as it has the attributes of a gift.

41. Further, the fact the parent or their child may be among those who ultimately benefit from a project may not disqualify the payment from being a gift if the payment is not made in return for the relevant benefit or advantage.

42. However, it is acknowledged that when schools request contributions for specific purposes rather than as general donations, this could give rise to circumstances where a parent's payment is sufficiently linked to a relevant benefit or advantage for the payment to be viewed as made in return for the benefit or advantage. The stronger the connection between a parent's payment and any material benefit or advantage obtained in return, the more likely it is that the payment will not qualify as a gift. This is particularly so where the school requests a payment for a specific purpose that benefits an individual student or a narrow group of students rather than the school as a whole.

43. Therefore, a gift made for a specific purpose may qualify for a donation tax credit even where it is not a contribution towards the cost of delivering the school's curriculum. The fact the parent or their child may be among those who ultimately benefit from a project may not disqualify the payment from being a gift. However, where the benefit obtained is more direct and more closely linked to the payment, there may be circumstances that mean the payment is not a gift for donation tax credit purposes.

Voluntary payments for individual subjects or curriculum activities

44. Where a parent makes a voluntary payment towards the school's cost of delivering an individual subject or activity that forms part of the school's curriculum for their child, that payment will be a gift only if it can be clearly established that the student has a right to participate in the subject or activity regardless of whether their parent makes a requested payment. If a student has a right to participate in the subject or activity regardless of whether their parent makes all or part of the requested payment to the school, then in the Commissioner's view the voluntary payment is made to advantage the school and is not made in return for participation.

Voluntary payments for non-curriculum activities

45. Where a parent makes a voluntary contribution towards the cost of delivering an activity or thing that does not form part of the school's curriculum, that payment will be a gift only if, in fact, it is voluntary, it is to do good for the school, and a sufficient link does not exist between the payment and the activity or the thing for the payment to be viewed as made in return for the relevant benefit. The statutory right to free education does not apply in those circumstances to weaken the link between the payment and the benefit.

46. Therefore, in many cases payments for a student's right to participate in non-curriculum activities will not be gifts. This is because those payments are made **for** the right to participate in the activities, or for the thing.

Examples

47. The following examples explain the application of the donation tax credit rules for state schools. The examples are consistent with the guidance in *Circular 2018/01*. None of the students in the examples are international students.

Example 1: Annual donation

48. Along with the first newsletter for the school year, Cindi receives a printed statement from her son's primary school showing a request for an annual donation of $125 to assist the school with its general operating costs for the year. Cindi wants to help her son's school but on top of having to buy a new school uniform she cannot afford the full requested amount so she pays $80. This is a gift for donation tax credit purposes, so the school issues Cindi with a donation tax receipt for $80.

49. Cindi's payment will be a gift for donation tax credit purposes, whether she chooses to pay:

- $125 as requested; or
- less than $125; or
- more than $125.

Example 2: Books for the library

50. Jillian has two children, Finn and Anna, at the local primary school. The school is trying to improve literacy throughout the school and has asked families if they would like to donate towards the school purchasing books for the school library. Jillian thinks it is a great idea. She particularly likes that the books will be an enduring benefit for the whole school to enjoy. Jillian happily donates $50 to the school for books for the library.

51. This is a gift for donation tax credit purposes and the school can issue Jillian with a donation tax receipt. The fact the gift is for a specific purpose (to purchase books) does not prevent the payment being a gift. Also, the fact Finn and Anna may benefit from the gift also does not prevent the payment being a gift because a sufficient link does not exist between the payment by Jillian and the benefit her children may obtain by being able to borrow books from the library.

Example 3: School stationery pack

52. At the beginning of the school year, Fiona's daughter Tui's school offers parents the choice of purchasing a stationery pack from the school or taking a stationery list and purchasing the stationery from a local store. Fiona chooses to purchase a stationery pack from the school for Tui.

53. Fiona can voluntarily choose whether to purchase the pack from the school, so the payment for the pack is not a gift to the school. It is a payment made in return for the stationery pack. The school does not issue Fiona with a donation tax receipt.

Example 4: NCEA level 2 biology contribution

54. Jack is in Year 12 at his local college and has chosen to study National Certificate of Educational Achievement (NCEA) level 2 biology. The college has requested the following voluntary payments from Jack's parents given his biology subject selection:
    - $20 to assist the school with the cost of a biology field trip to the local mud flats (attendance is a compulsory part of course requirements for the internal achievement standard); and
    - $30 for a biology work book (optional but recommended).

55. Jack's parents agree to purchase the workbook and make the requested voluntary contribution to assist the college with the cost of the field trip.

56. The school administrator issues a donation tax receipt to Jack's parents for $20. The school provides Jack with a biology workbook. The voluntary payment towards the school's field trip is a gift, but the $30 payment for the purchase of the optional workbook is not a gift.

57. The reason the contribution to assist the school with the cost of the biology field trip is a gift is because there a sufficient link does not exist between the payment and the benefit obtained by Jack. Under the Education Act 1989, Jack is entitled to free education. The field trip is part of the delivery of the school's curriculum. Jack can attend even if his parents choose not to make any or part of the requested payment. The field trip will go ahead regardless of whether Jack or any of his classmate's parents make the payment. Payments by the parents are not made in return for the biology field trip.

58. If the biology workbook was required (rather than optional) it becomes part of the delivery of the college's curriculum. In that case Jack's parents could not be compelled to purchase the workbook, but the college could ask for a voluntary contribution towards the college's cost of providing it. Jack would be entitled to use the workbook regardless of whether his parents make any voluntary contribution. Any contribution towards the cost of the workbook is a donation, so the school could issue a donation tax receipt.

Example 5: Overnight camping trip

59. Cameron is in year 5 at Mountain Ridge Primary School. Every year the school arranges an overnight camping trip to the Mountain Ridge Forest Park for its year 5 and 6 classes. The camping trip forms part of the school's curriculum and all year 5 and 6 students are expected to attend. The students travel in buses to the forest park and camp overnight, cooking their own meals and practising bush craft skills.

60. The school asks Cameron's parents for a voluntary contribution towards the cost of the camping trip. Payment is not compulsory, and Cameron's parents are free to pay all, part or none of the requested amount. Cameron can participate in the camping trip along with his year 5 and year 6 classmates regardless of whether his parents make a contribution.

61. Cameron's parents choose to make a generous contribution to the school to assist the school with the cost of the camping trip. The contribution is a gift, and the school issues a donation tax receipt to Cameron's parents.

62. The reason the contribution towards the school's overnight camping trip is a gift is because a sufficient link does not exist between the payment and the benefit obtained by Cameron. Under the Education Act 1989, Cameron is entitled to a free education. Participating in the camping trip is part of the delivery of the school's curriculum. The camping trip will go ahead regardless of whether Cameron or any of his year's parents make any payment. Payments by the parents are not made in return for the camping trip.

Example 6: High-performance sports coach

63. Roisin is a member of her secondary school's premier hockey team, which plays in the Tuesday night inter-college competition. Her coach has organised for the team to have a skills training session with a high-performance coach. All team members are expected to attend the session, and parents have been asked to contribute $30 each towards the cost of the session. Even though the training session does not form part of the delivery of the school's curriculum, the school office has helped by adding the requested amount to each team member's school account.

64. The parents' payments are in return for the training session. This payment is not a gift so the school does not issue a donation tax receipt.

Example 7: Cloud storage offer

65. High Tops Intermediate School has chosen to deliver the curriculum to its students using a software package that requires each student to have a minimum amount of cloud storage space available to them. The school has asked for voluntary contributions of $20 towards the cost of this storage space.

66. These contributions are gifts, and the school can issue a donation tax receipt to parents who choose to contribute, at whatever level.

67. The school also advises parents that they can purchase an additional amount of cloud storage space for their child (over and above the minimum required for effective curriculum delivery) for $30. This additional storage space is not needed for delivery of the curriculum, therefore the payment, if made by a parent who takes up the school's offer, is not a gift. The parent makes the payment in return for the additional storage space. The school does not issue a donation tax receipt.

References

Legislative references

Education Act 1989, ss 3, 60A
Income Tax Act 2007, ss LD 1 to LD 3
Income Tax Act 1976, s 56A(2)

Case references

Case D55 72 ATC 339 (Australian Board of Review)
Case F40 74 ATC 223 (Australian Board of Review)
Case J76 (1987) 9 NZTC 1,451 (TRA)
Case M128 (1990) 12 NZTC 2,825 (TRA)
Mills v Dowdall [1983] NZLR 154 (CA)
Leary v Federal Commissioner of Taxation (1980) 32 ALR 221

QB 18/11: Income tax – state integrated schools and donation tax credits

No payments to state integrated schools are compulsory except for attendance dues and optional goods and services that parents have agreed to purchase. Therefore, some payments made by parents to state integrated schools may qualify as gifts for donation tax credit purposes. School boards, proprietors and administrators need to understand which payments made by parents may qualify as gifts so the school can issue donation tax receipts.

Question

What payments by parents to state integrated schools are gifts for donation tax credit purposes?

Answer

Payments by parents to state integrated schools are gifts for donation tax credit purposes where the payment is voluntary and is a payment to:

- the board of trustees to assist generally with funding its costs, including the cost of delivery of the school's curriculum; or
- the board of trustees or a qualifying proprietor for a specific purpose or project to benefit the school as a whole where no material benefit or advantage is obtained in return for making the payment; or
- the board of trustees to assist with the school's cost of delivering individual subjects or activities forming part of the school's curriculum and in which the student may participate regardless of whether any payment is made; or
- a qualifying proprietor to assist the proprietor with its cost of supporting the delivery of the school's curriculum with special character.

Key terms

State integrated school: A previously private school that has been integrated into the state school system.

Proprietor: The proprietor owns (or leases) and maintains a state integrated school's land and buildings and is responsible for determining and maintaining the school's special character. A proprietor may qualify as a donee organisation if it is a not-for-profit organisation established for the charitable purpose of advancing education.

Special character: A particular or general religious or philosophical belief, as defined in a state integrated school's Deed of Integration with the Crown.

Attendance dues: Compulsory payments parents are required to pay to proprietors as a condition of their child's enrolment at the school. They are approved by the Minister of Education, and must be spent for specified purposes.

Also see:

Inland Revenue:

QB 16/05 Income tax – donee organisations and gifts

QB 18/10 Income tax – state schools and donation tax credits

BR Pub 18/06 Goods and services tax – Payments made by parents to state and state integrated schools

Ministry of Education:

Circular 2018/01 Payments by parents of students in schools

Explanation

Scope of this Question We've Been Asked

1. This Question We've Been Asked (QWBA) addresses payments parents make to boards of trustees and proprietors of state integrated schools. The word "parents" includes guardians and caregivers of students who also make payments to state integrated schools.
2. This QWBA does not address:
   - payments parents make to state non-integrated schools, partnership schools kura hourua or private schools in New Zealand. (State non-integrated schools and partnership schools kura hourua are addressed in QB 18/10 *Income tax – state schools and donation tax credits*);
   - payments made for international students to attend state integrated schools;
   - payments to entities (such as charitable trusts or parent–teacher associations) that are associated with a state integrated school but are separate entities from the school.
3. This QWBA refers to the Ministry of Education's *Circular 2018/01 Payments by parents of students in schools* (Ministry of Education, 2018), which provides guidance on payments by parents of students in state schools and state integrated schools.
4. The examples from [59] illustrate how the donation tax credit rules apply for state integrated schools.

Education with a special character

5. State integrated schools provide education within the framework of a particular or general religious or philosophical belief (referred to as the school's "special character"). A state integrated school establishes a partnership with the Crown by its Deed of Integration, which defines the special character of the school. The special character shapes the school's curriculum, enrolments, staffing processes and culture. Types of special character include such things as denominational and non-denominational Christian religions, Judaism, Islam, or the Steiner or Montessori philosophies.

6. Part 33 of the Education Act 1989 sets out the rules for state integrated schools. (Previously, these rules were in the Private Schools Conditional Integration Act 1975, which was re-enacted as an amendment to the Education Act 1989 in May 2017). Section 414(1) of the Education Act 1989 defines "education with a special character" as:

   > education within the framework of a particular or general religious or philosophical belief, and associated with observances or traditions appropriate to that belief

7. Like state schools, state integrated schools are governed by an elected board of trustees, but they differ from state schools in that they also have proprietors. Section 414 of the Education Act 1989 defines proprietor as:

   > the body corporate that—
   >
   > (a) has the primary responsibility for determining the special character of a school registered under section 35A and for supervising the maintenance of that special character; and
   >
   > (b) owns, holds in trust, or leases the land and buildings that constitute the premises of the private school or a State integrated school

8. The proprietor is a person or entity that provides and maintains the land and buildings and is responsible for determining and supporting the maintenance of the school's special character. The board of trustees of a state integrated school includes representatives of the proprietor.

State integrated school statutory environment

9. In New Zealand, students attending state integrated schools must be given free education on the same conditions as students enrolled at a state school (see s 441 of the Education Act 1989). Under the Education Act 1989, any reference to a state school includes any reference to a state integrated school (see s 414(2)).

10. Section 3 of the Education Act 1989 provides:

   > **3 Right to free primary and secondary education**
   >
   > Except as provided in this Act, every person who is not an international student is entitled to free enrolment and free education at any State school or partnership school kura hourua during the period beginning on the person's fifth birthday and ending on 1 January after the person's 19th birthday.

11. International students are generally any students who are not New Zealand citizens or residents.

12. The Education Act 1989 does not define what free education means for state integrated schools. However, it involves the delivery of the national curriculum by schools. The Education Act 1989 establishes the overall framework for the delivery of education by state integrated schools, by publishing various curriculum statements, guidelines and national performance measures under s 60A of the Education Act 1989. The central component of that framework is the national curriculum, which comprises the New Zealand Curriculum and Te Marautanga o Aotearoa. The national curriculum sets out a common direction for teaching and learning in New Zealand schools.

13. The board of trustees of every state integrated school must develop a charter (or from 2019, a four-year strategic plan and an annual implementation plan) and a detailed curriculum for its school that align with the intent of the national curriculum, the school's special character and the school community's values and expectations. The school's proprietor supervises and ensures the school's special character, as defined in its Deed of Integration, is reflected in the school's curriculum. The board of trustees is then required to implement its school's curriculum in accordance with the priorities set out in the National Education Goals, the National Administration Guidelines and the school's Deed of Integration. Therefore, in the state integrated school context free education involves the delivery of the national curriculum with special character.

Ministry of Education guidance on fund raising by state integrated schools

14. According to *Circular 2018/01* all payments requested from parents by state integrated schools (whether requested by the board of trustees or the proprietor) must be voluntary, unless the payments are attendance dues payable to the proprietor or payments for the purchase of optional goods or services that the parent has agreed to purchase.

15. The Education Act 1989 provides limited guidance on the payments proprietors may request from parents and no guidance about the types of payments boards of trustees of state integrated schools may ask for from parents. However, it is implicit that state integrated schools cannot charge for something that is part of a student's statutory entitlement to free education. The Ministry of Education confirms this in *Circular 2018/01*.

16. *Circular 2018/01* also explains that pressure must not be placed on parents to make donations. No payments sought from parents of students attending state integrated schools are compulsory except for attendance dues payable to the proprietors and charges for optional goods and services that parents have agreed to purchase. Schools cannot withhold education services, information or privileges from students if their parents choose not to make requested donations or to make only part of a requested donation.

Proprietors

17. Part 33 of the Education Act 1989 provides guidance for proprietors. Part 33 provides that the only payments proprietors of a state integrated school may require parents to pay as a condition of a child's enrolment at the school are attendance dues (see s 447(1) of the Education Act 1989). The amount of attendance dues that proprietors may charge parents is approved by the Minister of Education, and the attendance dues must be applied for specific purposes.

18. Otherwise, proprietors are permitted to conduct fund-raising activities and request voluntary financial contributions from parents in accordance with s 451 of the Education Act 1989. The Appendix to *Circular 2018/01* explains (at pages 1 and 4):

> Section 451 makes provision for proprietors to seek contributions (donations) for any purpose. Those contributions must be voluntary. Proprietors must make audited accounts of those contributions available on request to parents and other contributors.
>
> …
>
> **Fundraising by Proprietors**
>
> Under Part 33 of the Act, Proprietors may fundraise. This means Proprietors of state-integrated schools may request donations. Parents cannot be compelled, however, to pay donations or to become involved in fundraising activities.

Boards of trustees

19. Boards of trustees of a state integrated school may ask parents for donations to assist with funding its costs, including the cost of delivering the school's curriculum. In this context the "school's curriculum" is the delivery of the education the board of trustees has agreed with the Ministry of Education to provide to its students and that aligns with the intent of the national curriculum, the school's special character and the school community's values and expectations.

20. The donations requested may be general donations (that is, donations for an unspecified purpose) or specified donations (that is, donations for a particular purpose such as library books or sports equipment). In *Circular 2018/01*, schools are advised that if a specified donation is requested for an activity forming part of the delivery of the school's curriculum, students cannot be excluded from participating in the activity if the parent chooses not to make the contribution or makes only part of the contribution.

21. Sometimes schools may offer for sale consumables, take-home items (such as items made in technology classes), stationery, clothing and activities that are not part of the delivery of the school's curriculum. Schools may charge for these optional consumables and activities, but students are not obliged to buy them. Any payment for these consumables or activities is not a donation.

Donation tax credit rules

22. Under the Income Tax Act 2007, a donation tax credit may be available for charitable or other public benefit gifts made by a parent to a state integrated school, if the requirements in ss LD 1 to LD 3 are met. The phrase "charitable or other public benefit gift" is defined in s LD 3(1) to mean a monetary gift of $5 or more paid to a qualifying organisation (referred to as a donee organisation).

23. Since 2008, the boards of trustees of state integrated schools have been listed as donee organisations in s LD 3(2)(bb). Before 2008, state integrated schools qualified as donee organisations because the advancement of education is a charitable purpose and they otherwise met the requirements of s LD 3.

24. As the boards of trustees of state integrated schools are donee organisations a parent who makes a "gift" of money of $5 or more to such a board may **claim** a donation tax credit of one third of the payment amount at the end of the relevant tax year, provided the parent meets the other requirements for claiming a donation tax credit. These requirements include the parent holding a donation tax receipt from the school. Inland Revenue processes all claims for donation tax credits, and, ultimately, it is the Commissioner who decides whether a parent is entitled to a tax credit for a payment made to a state integrated school on the basis that she is satisfied the parent has made a qualifying charitable or other public benefit gift to the school.

25. A donation made to a proprietor of a state integrated school will qualify for a donation tax credit only if the proprietor is a donee organisation. The proprietors of state integrated schools may qualify as donee organisations if they are not-for-profit organisations established for the charitable purpose of advancing education.

Charitable or other public benefit gifts

26. While the phrase "charitable or other public benefit gift" is defined in s LD 3(1), the term "gift" is not defined in the Income Tax Act. In the absence of a statutory definition of "gift, the Commissioner considers "gift" should be given its ordinary meaning. This is consistent with the Court of Appeal's decision in *Mills v Dowdall* [1983] NZLR 154. New Zealand case law on the ordinary meaning of "gift" is limited, so the Commissioner considers it appropriate to take guidance from overseas case law.

27. It is likely the New Zealand courts (like the Canadian courts before them) will follow the approach taken by the Australian courts on the ordinary meaning of "gift". Therefore, the Commissioner considers that, for the purposes of s LD 3(1) and state schools, a "gift" is a payment by a parent to a school of money of $5 or more:
    - made voluntarily;
    - by way of benefaction; and
    - in return for which the parent receives no material benefit or advantage.

28. For a more general discussion on what is a gift see *QB 16/05 Income tax – donee organisations and gifts*.

29. When deciding whether a parent's payment to a state integrated school is a gift, the true nature of the payment is to be determined by considering the overall arrangements and transactions giving rise to the payment. The name or description given to a payment is not determinative of its nature.

Voluntary payment

30. As noted above, according to *Circular 2018/01* the only compulsory payments parents are required to make to state integrated schools are attendance dues payable to the proprietor and payments where the parents have agreed to purchase optional goods and services from the school. All other payments parents may be asked to make to state integrated schools are voluntary in the sense that the school cannot compel parents to make the payments. Parents can choose whether to make requested voluntary payments in full, in part, or not at all. However, just because these payments are "voluntary" does not mean they are automatically gifts for income tax purposes.

31. To qualify as a gift, a parent's payment to the board of trustees or proprietor must be made voluntarily. For gifting purposes, this means that the payment is made willingly, freely by choice and for benevolent reasons. It also means that a parent's payment must not be made under an arrangement (contractual or otherwise) where the payment is made in return for a material benefit or advantage. Similarly, a payment may not be voluntary where there is some agreement, understanding or expectation that the school or proprietor is to do or provide something in return for the payment. (The link between the payment and the material benefit is discussed from [41]).

32. The absence of a contract or a legal obligation on a parent to contribute to a school does not automatically mean payments are voluntary and, therefore, gifts. There may be circumstances where, even though a parent has no legal obligation to make a payment to a school, the payment still will not be a gift for donation tax credit purposes. For example, where a student's participation in an activity is dependent on the parent's payment.

33. Occasionally, pressure might be applied (by the school or by other parents) on a parent to make a contribution. This pressure can create a sense of moral obligation on the parent to contribute. While a payment may be voluntary even if it is made under a sense of moral obligation, in some circumstances the Commissioner considers pressure might also be evidence that a payment is being made under an arrangement between the school and the parent where the payment is being made in return for a material benefit or advantage. In those circumstances the payment will not be voluntary, so will not be a gift.

Benefaction

34. The requirement that a gift is made voluntarily is connected with the concept of benefaction and the belief that gifts usually proceed from a "detached and disinterested generosity". Benefaction is the idea that a gift is made to provide an advantage to or to do good for the recipient. Benefaction is an important element of a gift in its ordinary sense; when it is absent there can be no gift (*Leary v FCT* (1980) 32 ALR 221).

35. In the context of contributions made by parents to the board or proprietor of a state integrated school, benefaction is the idea that the parent's payment will provide an advantage to or do good for the school in some way. For example, a voluntary contribution to the proprietor to assist with the cost of building a new music studio for the school will assist the school.

Material benefit in return

36. A parent's voluntary payment to the board of trustees or proprietors of a state integrated school will not be a gift if it is made under an arrangement where the parent expects a material benefit or advantage in return for making the payment. It is sufficient that an understanding or expectation (clear or implicit) exists between the parent and the school that the payment is being made in return for a material benefit or advantage.

37. In *Case M128* (1990) 12 NZTC 2,825 Judge Barber held that payments by a parent for the cost of a field trip for his son to Mount Aspiring was not a gift because the payment gave the student the right to participate in the trip, and was not for the common good of the school. He similarly found that other school charges were not gifts as they all conferred rights on the student, such as the right to attend camp, the right to use and own stationery and the right to own a manual.

38. The Commissioner considers a parent's payment to the board of trustees or proprietor of a state integrated school will **not** be a "gift" where:

- the parent's payment is made in return for a material benefit or advantage; or
- the school is placed under an obligation to do or provide something in return for the parent making the payment.

39. A material benefit or advantage does not need to come directly from the school and does not need to be received directly by the parent who made the payment (for example, the student may receive the benefit) so long as under the arrangement the material benefit or advantage is in return for the parent making the payment.

40. A benefit or advantage will be considered "material" if it is of substance and can be valued or owned or both. (Sometimes these benefits are referred to as pecuniary or proprietary benefits.) A benefit or advantage will not be material if it is intangible and cannot be valued or owned. Non-material benefits or advantages include such things as public acknowledgement (for example, when a parent's name is printed in a school newsletter to acknowledge their gift). This is different from a material benefit such as where a parent's business is advertised in the school's newsletter in return for the parent making the payment.

Sufficient link between payment and benefit or advantage

41. Importantly, not every material benefit or advantage will necessarily disqualify a voluntary payment to the board of trustees or proprietor of a state integrated school from being a gift. Sometimes a voluntary payment may be a gift even if the parent obtains a material benefit or advantage. This happens when the connection between the payment and the benefit is weak (for example, where a benefit will be obtained by the giver regardless of whether the gift is made). In this example, although a benefit is received, the payment cannot be said to be made **in return for** the benefit, as the benefit will be obtained anyway. The extent and strength of any link between the parent's payment and a benefit or advantage can be an important factor in determining whether a payment is a gift.

42. This point is illustrated by two Australian Board of Review decisions concerning payments made to two different ambulance services: *Case D55* 72 ATC 339 and *Case F40* 74 ATC 223. In *Case D55* the board held payments to an ambulance service were gifts, while in *Case F40* the same board considered payments to a different ambulance service were not gifts.

43. In *Case D55* the giver made payroll-giving–type payments to a free ambulance service operating in his home district. The payments were not made under a contract between the giver and the ambulance service. The giver was already entitled to a free service from the ambulance service and there was no evidence of any representation that by making the payments he would receive any material benefit or *quid pro quo* in return. Given these factors, and even though the giver was entitled to free ambulance services, the board concluded that the payments were gifts. This was because the payments were made voluntarily by the giver, not in return for the ambulance services and the payments were for what the giver considered to be a good cause. A sufficient link did not exist between the benefits to the giver and the payments to prevent the payments from being gifts.

44. In *Case F40* the ambulance service operated under different rules. A person who made a payment to the ambulance centre was entitled to receive a free treatment and transport service within the area for one year and would be eligible to be elected to the centre's committee and to vote in elections for the committee. The board held a contract existed between the centre and the payer under which the centre had an obligation to provide free services to the payer in return for the payment. If the payment had not been made, the payer would not have been entitled to free services. A strong dependency existed between the payment and the free services, so the payment was not a gift. Unlike in *Case D55* the payer was not entitled to the benefit of free ambulance services regardless of whether the payment was made.

45. In New Zealand, the statutory right to free education means that students attending state integrated schools are statutorily entitled to the delivery of the school's curriculum with special character regardless of whether their parents make donations (in full, in part or not at all) to assist with the cost of the delivery of that curriculum, or even if no parents make donations. The Commissioner considers that, generally, a student's statutory right to free education with special character will mean a sufficient link does not exist between a parent's voluntary payment to assist a state integrated school and any benefit obtained by the student in return. This is because the school is obliged to deliver the school's curriculum with special character to the student regardless of whether the parent's payment is made, so the payment is being made to benefit the school rather than being made in return for the education.

46. *Case J76* (1987) 9 NZTC 1,451 provides some support for the view that a state integrated school student's statutory right to free education generally means a sufficient link does not exist between a parent's voluntary payment to assist the school and any benefit obtained by the student. *Case J76* concerned a claim by the objector, a parish priest, that payments he made to ensure that disadvantaged children obtained appropriate schooling were gifts and he should be entitled to a rebate under s 56A(2) of the Income Tax Act 1976.

47. Judge Keane found there was no doubt that the payments were made out of charity. But he found no suggestion that the schools would have educated the children if the priest had not made the payments. Therefore, the payments placed the schools under a contractual duty to educate the children. The priest's payments were not gifts. Judge Keane's decision suggests that if the schools had had an existing obligation to educate the children, then the priest's payments might have been gifts because they would have been made to fund the schools' charitable purposes (that is, the advancement of education). Instead, in the absence of the schools having any pre-existing obligations, the payments were held to be made in return for the schools' educational services.

48. The strength of any link between a payment and a benefit or advantage can usually be determined by considering **all** the circumstances surrounding the gift, including, in the case of state integrated schools, a student's statutory right to free education with special character. However, the stronger the connection between a parent's payment and any material benefit or advantage obtained in return, the less likely it is that the payment will qualify as a gift. It is also important to remember that gifts ordinarily proceed from an intention on the part of the giver to provide an advantage to or to do good for the recipient (that is, the school).

Gifting in the state integrated school environment

General donations

49. Boards of trustees of state integrated schools may ask parents for donations to assist generally with its costs, including the cost of delivering the school's curriculum. Similarly, proprietors may request contributions from parents to assist with the cost of supporting the delivery of the school's curriculum with special character. Where the donations requested by the board of trustees are general donations (that is, donations for an unspecified purpose), the school may issue a donation tax receipt, providing the payments are made voluntarily by the parents to benefit the school. Similarly, where proprietors request contributions to assist with the cost of supporting the delivery of the school's curriculum with special character, the Commissioner considers those contributions are gifts. If the proprietor is a donee organisation it may issue a donation tax receipt, providing the payments are made voluntarily by the parents to benefit the school.

50. The benefit parents and students get from making general donations to assist a school with its costs, including the cost of delivering its curriculum with special character will not prevent the parents' payments from being gifts. This is because students attending a state integrated school have a statutory right to free education with special character. Therefore, parents of students attending a state integrated school can expect their children to receive an education with special character regardless of whether the parent makes any general donations. As a result, the Commissioner considers an insufficient link exists between a parent's general donation and any benefit obtained, so the parent's payment is not made in return for the benefit.

Voluntary payments for specific purposes or projects

51. Sometimes parents are asked to assist schools with funding special projects for a school (for example, to assist with developing a computer lab or for books for the school library). Gifts for specific purposes or projects may not always be a contribution towards the cost of delivering the school's curriculum, so they can be different from general school donations in that regard. However, the fact a school seeks donations for a specific project will not, in itself, prevent the payment being a gift. In the Commissioner's view, a payment made for a specific purpose or project will be a gift so long as it has the attributes of a gift.

52. Further, the fact the parent or their child may be among those who ultimately benefit from a project may not disqualify the payment from being a gift, if the payment is not made in return for the relevant benefit or advantage.

53. However, it is acknowledged that when schools request contributions for specific purposes rather than as general donations, this could give rise to circumstances where a parent's payment is sufficiently linked to a relevant benefit or advantage for the payment to be viewed as made **in return for** the benefit or advantage. The stronger the connection between a parent's payment and any material benefit or advantage obtained in return, the more likely it is that the payment will not qualify as a gift. This is particularly so where the school requests a payment for a specific purpose that benefits an individual student or a narrow group of students rather than the school as a whole.

54. Therefore, a gift made for a specific purpose may qualify for a donation tax credit even where it is not a contribution towards the cost of delivering the school's curriculum. The fact the parent or their child may be among those who ultimately benefit from a project may not disqualify the payment from being a gift. However, where the benefit obtained is more direct and more closely linked to the payment, there may be circumstances that mean the payment is not a gift for donation tax credit purposes.

55. Proprietors may request building contributions to assist with the cost of upgrading and maintaining the school's buildings and facilities, providing infrastructure and preserving the special heritage of the school. Contributions may be set aside for long-term capital developments. In the Commissioner's view, generally, contributions to proprietors to assist with funding building costs will be gifts. It is unlikely a sufficient link exists between any benefit obtained by the student and the parent's donation. This is because, usually, school buildings will be enjoyed by the wider school community as a whole and over many generations. This makes it hard to identify a sufficient link between a parent's payment and any benefit or advantage obtained by their child.

Voluntary payments for individual subjects or activities

56. Where a parent makes a voluntary contribution towards the school's cost of delivering an individual subject or activity forming part of the school's curriculum with special character, that payment will be a gift only if it can be clearly established that the student has a right to participate in the subject or activity regardless of whether their parent makes all or part of the requested payment. If a student has a right to participate in the subject or activity regardless of whether their parent makes a requested payment to the school, then in the Commissioner's view the voluntary payment is made to advantage the school and is not made in return for participation.

Payments for non-curriculum activities

57. Where a parent makes a voluntary contribution to the board or proprietor of a state integrated school to assist with the cost of delivering an activity or thing that does not form part of the school's curriculum, that payment will be a gift only if, in fact, it is voluntary, it is to do good for the school, and a sufficient link does not exist between the payment and the activity or the thing for the payment to be viewed as made in return for the relevant benefit. The statutory right to free education does not apply in those circumstances to weaken the link between the payment and the benefit.

58. Therefore, in many cases payments for a student's right to participate in non-curriculum activities will not be gifts. This is because those payments are made **for** the right to participate in the activities, or for the thing.

Examples

59. The following examples explain the application of the donation tax credit rules for state integrated schools. The examples are consistent with the guidance in *Circular 2018/01*. None of the students in the examples are international students.

Example 1: Annual donation to the board of trustees

60. Along with the first newsletter for the school year, Charlotte receives a printed statement from her son's state integrated primary school showing a request for an annual donation of $350 to assist the board of trustees with its general operating costs for the year. Charlotte wants to help her son's school but on top of having to buy a new school uniform she cannot afford the full requested amount so she pays $200. This is a gift for donation tax credit purposes, so the school issues Charlotte with a donation tax receipt for $200.

61. Charlotte's payment will be a gift for donation tax credit purposes, whether she chooses to pay:

- $350 as requested; or
- less than $350; or
- more than $350.

Example 2: Books for the library

62. Thomas has two children, Dermot and Bill, at the local church state integrated primary school. The school is trying to improve literacy throughout the school and has asked families if they would like to donate towards the school purchasing books for the school library. Thomas thinks it is a great idea. He particularly likes the idea that the books will be an enduring benefit for the whole school to enjoy. Thomas happily donates $50 to the school for books.

63. This is a gift for donation tax credit purposes, so the school can issue Thomas with a donation tax receipt. The fact the gift is for a specific purpose (to purchase books) does not prevent the payment being a gift. Also, the fact Dermot and Bill may benefit from the gift also does not prevent the payment being a gift because a sufficient link does not exist between the payment by Thomas and the benefit his children may obtain by being able to borrow books from the library.

Example 3: School stationery pack

64. At the beginning of the school year, Julie's daughter Aroha's school, a state integrated primary school, offers parents the choice of purchasing a stationery pack from the school or taking a stationery list and purchasing the stationery from a local store. Julie chooses to purchase a stationery pack from the school for Aroha.

65. Julie can voluntarily choose to purchase the pack from the school, so the payment for the pack is not a gift to the school. It is a payment made in return for a stationery pack. The school does not issue Julie with a donation tax receipt.

Example 4: NCEA level 2 biology contribution

66. Cameron is in year 12 at his state integrated college and has chosen to study National Certificate of Educational Achievement (NCEA) level 2 biology. The college has requested the following voluntary payments from Cameron's parents in respect of his biology subject selection:
   - $20 to assist the college with the cost of the biology field trip to mud flats (attendance is a compulsory part of the course requirements for the internal achievement standard); and
   - $30 for a biology work book (optional but recommended).

67. Cameron's parents agree to purchase the workbook and make the requested payment to the college to assist with the cost of the field trip.

68. The school administrator issues a donation tax receipt to Cameron's parents for $20. The college provides Cameron with a biology workbook. The voluntary payment towards the college's field trip is a gift, but the $30 payment for the optional workbook is not a gift.

69. The reason the contribution to assist the school with the cost of the field trip is a gift is because a sufficient link does not exist between the payment and the benefit obtained by Cameron. Under the Education Act 1989, Cameron is entitled to free education. The field trip is part of the delivery of the college's curriculum. Cameron can attend even if his parents choose not to make any or part of the requested payment. The field trip will go ahead regardless of whether Cameron's parents or any of his classmate's parents make the payment. Payments by the parents are not made in return for the biology field trip.

Example 5: High-performance sports coach

70. Krish is a member of his state integrated secondary school's premier hockey team which plays in the Tuesday night inter-college competition. His coach has organised for the team to have a skills training session with a high-performance coach. All team members are expected to attend the session, and parents have been asked to contribute $80 each towards the cost of the session. Even though the training session does not form part of the delivery of the school's curriculum with special character, the school office has helped by adding the requested amount to each team member's school account.

71. The parents' payments are in return for the training session. This payment is not a gift so the school does not issue a donation tax receipt.

Example 6: Special character contribution

72. Edward's state integrated school undertakes to provide students with a Christian education. The school's proprietor (a donee organisation) asks each family for an annual $100 voluntary contribution towards the cost of chaplaincy services, religious education and pastoral support.

73. Because the voluntary payment relates to the delivery of the school's curriculum with special character, as defined in the school's Deed of Integration, the payment is a gift for donation tax credit purposes, so the proprietor can issue Edward's parents with a donation tax receipt for $100. This is on the basis that Edward is statutorily entitled to an education with special character regardless of whether his parents choose to make the payment or even if no parents make the payment.

74. The school also asks for a $25 voluntary contribution towards the cost of providing a religious education workbook. This workbook is compulsory and comprises part of the delivery of the school's curriculum. Edward will receive the workbook regardless of whether his parents make the voluntary contribution. The workbook stays at school and is not taken home.

75. The contribution towards the cost of the workbook is a donation, so the school can issue a donation tax receipt. If the workbook had been optional and not part of the delivery of the curriculum, then the school could have charged Edward's parents for the cost of the workbook if they agreed to purchase it.

References

Legislative references

Education Act 1989, ss 3, 60A, Part 33, ss 414, 441, 447(1), 451
Income Tax Act 2007, ss LD 1 to LD 3
Income Tax Act 1976, s 56A(2)
Private Schools Conditional Integration Act 1975

Case references

Case D55 72 ATC 339 (Australian Board of Review)
Case F40 74 ATC 223 (Australian Board of Review)
Case J76 (1987) 9 NZTC 1,451
Case M128 (1990) 12 NZTC 2,825
Leary v FCT (1980) 32 ALR 221
Mills v Dowdall [1983] NZLR 154 (CA)

Other references

Ministry of Education, *Circular 2018/01 Payments by parents of students in schools*

QB 18/12: Are war pensions paid under the Dutch ABVP Scheme exempt from tax?

As part of our review of Public Information Bulletins, this QWBA confirms PIB 168-17 "War pensions — Section 61(10) Income Tax Act 1976", which stated that pensions under the Dutch (Benefit Act for Victims of Persecution 1940-1945) Scheme are tax exempt.

Key provisions

Section CW 28(1)(b) of the Income Tax Act 2007. All section references are to the Income Tax Act 2007.

Question

Are war pensions paid under the Dutch ABVP Scheme exempt from tax?

Answer

Yes. War pensions (as well as allowances) paid under the Dutch ABVP Scheme are exempt income and are not taxed in New Zealand.

Key terms

The Dutch ABVP Scheme, short for the Dutch (Benefit Act for Victims of Persecution 1940-1945) Scheme, provides financial support to Dutch nationals suffering permanent physical or psychological harm as a result of persecution during World War II.

Explanation

1. The Dutch AVBP Scheme, otherwise known as the Dutch (Benefit Act for Victims of Persecution 1940-1945) Scheme, provides financial support to Dutch nationals suffering permanent physical or psychological harm as a result of persecution during World War II. Under the Dutch ABVP Scheme, recipients are entitled to a monthly benefit (a pension) guaranteeing them a certain level of income. Some recipients may also be entitled to an allowance for certain costs, such as medical treatment.
2. Financial support is also available for partners and minor orphans of deceased victims of persecution.
3. Under s CW 28(1)(b), a pension or an allowance granted in New Zealand or overseas by any government relating to any war is exempt from tax. Because the monthly benefit and allowances paid under the Dutch ABVP Scheme will be a pension or an allowance granted by a government and relating to a war, these amounts will be exempt income under s CW 28(1)(b) and not taxed in New Zealand.

QB 18/13: Income Tax – What is the tax treatment of allowances paid and benefits provided to farm workers?

This Question We've Been Asked (QWBA) considers the income tax treatment of allowances or benefits paid or provided to employees in a farming context. This QWBA consolidates, updates and replaces items previously published by the Commissioner. It will be of interest to those paying or receiving allowances in the farming sector.

Question

What is the tax treatment of allowances and benefits paid or provided to farm workers?

Answer

Reimbursing allowances an employer pays for expenses that the employee incurs or is likely to incur in connection with their employment can generally be paid tax-free. However, a reimbursing allowance of a capital or private nature is taxable as employment income to the employee and subject to PAYE.

Benefit allowances an employer pays to an employee are taxable as employment income to the employee and subject to PAYE.

The expenditure an employer incurs on providing reimbursing allowances or benefit allowances is deductible to the employer, provided the employee's salary or wages are deductible.

Non-cash benefits an employer provides to an employee may be subject to fringe benefit tax payable by the employer. Expenditure incurred in providing non-cash benefits to an employee is deductible to the employer, as is any fringe benefit tax paid.

Key terms

Farm worker: an "employee" as defined in s YA 1 of the Income Tax Act 2007.

For some purposes this definition includes independent contractors who receive "schedular payments" (that is, contractors subject to withholding tax under Schedule 4).

Reimbursing allowance: an amount an employer pays to an employee as a regular or one-off payment that is related to expenditure the employee is likely to incur or has incurred in connection with the employee's employment or service. These allowances are generally not taxable.

Benefit allowance: an amount an employer pays to an employee to compensate the employee for the conditions of their service, such as using a dangerous piece of equipment, working in a dangerous or dirty environment or working in a remote location. These allowances are generally taxable.

Key provisions

Sections CE 1, CW 17 and CX 2 of the Income Tax Act 2007

Explanation

Scope of this Question We've Been Asked

1. This QWBA relates to "farm workers" who meet the definition of an "employee" in s YA 1 of the Income Tax Act 2007. An employee is a person who receives, or is entitled to receive, a PAYE income payment. A PAYE income payment includes salary or wages paid to permanent and casual employees.
2. A PAYE income payment also includes a schedular payment subject to withholding tax made to contract workers. A schedular payment is defined in s RD 8 as a payment of a class set out in schedule 4 to the Act. Schedule 4 includes payments made for work or services relating to primary production (see part C of the schedule). Part C includes farming and cultivation contract work, shearing, droving, forestry or bush work and the work described in ss DO 1 and DO 2. Sections DO 1 and DO 2 describe various types of farm-related work including weed and pest destruction, flood or erosion repair, scrub clearing and fencing.
3. A contractor is not an employee in the current context if they hold a Certificate of Exemption issued under s 24M of the Tax Administration Act 1994. This is because the definition of "schedular payment" excludes any payments covered by an exemption certificate. The definition also excludes payments for services a company provides unless the company is an "agricultural, horticultural, or viticultural company". Such a company is defined in the Act as, effectively, a company involved in supplying labour in orchards, vineyards or market gardens.
4. Accordingly, a "farm worker" in this QWBA includes **employees** and **some contract workers**.
5. The term "farm workers" in this QWBA does not include employees with an indirect or direct financial interest in the business of their employer (for example, shareholder employees or partners in a partnership). This is because additional tax considerations may arise for these types of employees under other provisions of the Act not considered in this QWBA.

What is the tax treatment of allowances paid to employees?

Meaning of allowance

6. An allowance is a payment of an agreed amount by an employer to an employee. It is paid on a regular basis (such as daily or weekly) or when certain events happen. It is taxable to the employee as employment income under s CE 1(1)(a) unless an exemption applies.

7. The two main types of allowances are reimbursing allowances and benefit allowances.

Reimbursing allowances

8. In this context the QWBA is only concerned with "employees" who are subject to the employment limitation.
A reimbursing allowance is an allowance an employer pays to an employee for expenses that an employee incurs or is likely to incur in connection with their employment. A reimbursing allowance need not be an exact reimbursement of the employee's expenses but it should be a reasonable amount.

9. Some reimbursing allowances may be paid tax-free to an employee under s CW 17. For this to apply, the allowance must reimburse the employee for expenses that the employee incurs or is likely to incur in connection with their employment. Under s CW 17(2B), the expenses will be treated as incurred in connection with an employee's employment, if it is a necessary expense incurred in doing the job from which they earn income.

10. Further, the expenses must be of a type that the employee could have been allowed a deduction for against their income but for the employment limitation in s DA 2(4). Employees cannot usually deduct expenses incurred in deriving their employment income because of the employment limitation. However, s CW 17(2) suspends the employment limitation for the purpose of determining whether the reimbursing allowance is exempt income of the employee.

11. Effectively, this means a reimbursing allowance cannot be paid tax-free to an employee if it reimburses the employee for expenses that would not have been deductible for a business taxpayer. The main limitations that might apply to prevent certain expenses from being deductible (and any corresponding reimbursing allowance paid tax-free) are the **capital** limitation in s DA 2(1) and the **private** limitation in s DA 2(2).

12. The capital limitation prevents deductions for capital expenses. Therefore, if any reimbursing allowance reimburses the purchase or replacement of a capital asset it cannot be treated as tax-free (for example, an allowance for the purchase of a motor bike rather than for its running expenses). There are two exceptions; firstly, under s CW 17(4), the relevant expenses reimbursed tax-free can include an amount for depreciation. This means if the reimbursing allowance includes an amount for depreciation of an asset, then that amount would be treated as deductible if the asset is used for work purposes. This is because s DA 4 provides that the capital limitation does not apply to an amount of depreciation loss. Secondly, subject to some limitations, the capital costs of low value assets may be deducted in full as depreciation under s EE 38. Items of low value under this provision must have cost $500 or less. This means an allowance could reimburse the capital costs of low value assets tax-free.

13. The private limitation prevents deductions for private or domestic expenses. "Private" expenditure is expenditure that relates to an individual living as a member of society. Examples of private expenditure are food, clothing and shelter. "Domestic" expenditure is expenditure that relates to the household or family. Examples of this include the cost of a home telephone or an internet connection or other expenditure related to running a household.

14. An example of an allowance subject to the private limitation is one provided to help meet the cost of boarding school-aged children away from the farm. While the expenditure may be prompted by a farm worker's employment in a remote location, the costs associated with the provision of basic needs such as the education of children is expenditure of a private or domestic nature. The employee would not be able to deduct the costs, despite the employment limitation, because of the private limitation.

15. The private limitation may also arise where farm equipment or machinery has both a business use and a private or domestic use. For instance, farm vehicles may be used for work purposes and private purposes. An apportionment is required for any part of the allowance that relates to expenditure incurred for the private or domestic use. In such cases the portion of the allowance relating to the expenditure incurred for business use would be exempt and not taxable. The portion of the allowance relating to the expenditure incurred for the private use would be taxable in the hands of the employee as employment income (and subject to PAYE). However, the allowance may be adjusted to reimburse for only the business use and remain exempt.

16. Contractors are included in the definition of "employee" if they receive a schedular payment. Unlike employees, contractors can (in most cases) deduct expenses. Being able to deduct expenses makes exempt allowances unnecessary.

The Commissioner understands that the usual practice is for most employers to pay contractors a single contract price and not to pay separate reimbursement allowances. The outcome is essentially the same as if they were paid an exempt allowance because although they receive a single contract amount subject to withholding tax, the expenses will be deductible to the contractor.

Expenses a reimbursing allowance may cover

17. Examples of the kinds of reimbursing allowances that may be paid to farm workers and the type of expenses they might reimburse are listed in the table at [36]. This is not an exhaustive list, and the items are exempt only to the extent that the capital or private limitations do not apply. In all cases, the onus is on the employer to justify treating the allowance as a tax-free reimbursing allowance.

Estimates of expenses

18. In setting the allowance amount, the employer may estimate the total amount of expenditure an employee is likely to incur. Section CW 17(3) allows employers to make a "reasonable estimate" of the amount of expenditure likely to be incurred by an employee or a group of employees. The onus is on the employer to establish the estimate is reasonable.

19. A reasonable estimate is one that has some basis. For example, the estimate might be based on historical data, industry standards or employee survey information. Employers must retain sufficient information about how the estimate was calculated to substantiate the allowance amount. Employers should review their estimates periodically to ensure they remain "reasonable".

Benefit allowances

20. A benefit allowance is an allowance an employer pays to compensate an employee for the conditions of their service, such as using a dangerous piece of equipment, working in a dangerous or dirty environment, or working in a remote location. Another example of a benefit allowance is a cash allowance paid in lieu of the employer providing stores and rations.

21. These types of allowances have been described as "benefit allowances" because they give a financial benefit to the employee rather than to compensate the employee for expenses they incur or are likely to incur in carrying out their employment duties. Unlike a reimbursing allowance, a benefit allowance is taxable to the employee as employment income under s CE 1(1)(a) and subject to PAYE. This is because the benefit allowance does not qualify for an exemption under s CW 17. However, s CW 17CB may exempt a reimbursement allowance for work-related meals where the employee is required to travel for work.

22. If the allowance paid is a mixture of a reimbursing allowance and a benefit allowance, then only that part of the total allowance that is a reimbursing allowance that meets s CW 17 can be paid tax-free.

What is the tax treatment of non-cash benefits provided to employees?

23. Under s CX 2, a "fringe benefit" is a "benefit" that an "employer" provides to an "employee" (which includes contract workers who receive schedular payments) in connection with their employment and is:
    - a benefit specified in ss CX 6, CX 9, CX 10, or CX 12 to CX 16; or
    - an unclassified benefit under s CX 37.

24. Also, some benefits are excluded from being fringe benefits by specific provisions in subpart CX. Notably CX 4 prevents a benefit that is assessable income begin taxed again as a fringe benefit.

25. The provision of food (stores and rations) is a non-cash benefit that may be provided to farm workers. The Commissioner's view is that the provision of food is a "benefit" to the employees. It provides an economic advantage to the employees because it gives them benefits (food) to which they would otherwise not be entitled. Food includes goods produced on the employer's premises such as eggs, vegetables and meat.

26. The provision of food is not one of the benefits listed in ss CX 6, CX 9, CX 10, and CX 12 to CX 16. However, it may still be an "unclassified benefit" under s CX 37. Section CX 37 applies to benefits that an employer provides to an employee in connection with their employment that are not included or are excluded by a specific provision.

27. The only potentially relevant exclusion is in s CX 23, which deals with benefits the employee uses or consumes on the employer's premises. Food consumed on the employer's premises is excluded from being a fringe benefit by s CX 23(1)), so will not be subject to FBT. The meaning of employer's premises is set out in s CX 23(2). Of relevance to farm workers is that the employer's premises do not include premises an employee occupies for residential purposes (s CX 23(2)(c)). Whether food provided to employees is consumed on the employer's premises is a question of fact in each case.

28. This means if the food is provided in connection with an employee's employment and it is not excluded by a specific provision, then the benefit will be a "fringe benefit" as an unclassified benefit. As a result, the employer may be liable for FBT as calculated under subpart RD.

29. However, s RD 45 limits the employer's FBT liability when providing unclassified benefits to situations where the taxable value of all unclassified benefits provided exceed certain thresholds.

- Where the employer pays FBT quarterly, the employer is liable for FBT only if:
  - the total taxable value of all unclassified benefits provided in the quarter **to the employee** is more than $300; or
  - the total taxable value of all unclassified benefits provided in the last four quarters (including the current quarter) **to all employees** is more than $22,500.
- Where the employer pays FBT annually or on an income year basis, the employer is liable to pay FBT only if:
  - the total taxable value of all unclassified benefits provided in the tax year or income year **to the employee** is more than $1,200; or
  - the total taxable value of all unclassified benefits provided in the tax year or income year **to all employees** is more than $22,500.

30. The above figures are based on all unclassified benefits the employer provided in the relevant period, not just the provision of food. The figures are based on the "taxable value" of the fringe benefits provided. Section RD 54 provides that the taxable value of a fringe benefit is its value. For unclassified benefits comprising food, the relevant value of the benefit is that given by s RD 40(1) which applies to goods. The value (and taxable value) of the food will be the:

- market value where the employer manufactured, produced or processed the goods (which may occur in a farm setting);
- cost to the employer where the employer acquired the goods when dealing at arm's length with the supplier.

31. If an employee contributes an amount towards the fringe benefit the taxable value is reduced by the amount of the contribution.

32. In the case of goods produced by the employer, the value may be reduced if the market value is greater than the amount the employer would have received for selling the goods under normal sale conditions to an arm's length customer (s RD 40(2)).

33. In the case where cost applies, this is the GST-exclusive cost if the employer is a registered person and able to claim an input tax deduction for the goods (s RD 40(3)).

Can the employer deduct allowances or the cost of providing non-cash benefits?

34. A person is allowed a deduction for an amount of expenditure or loss to the extent that it is incurred by them in the course of carrying on a business for the purpose of deriving assessable income (s DA 1). In most cases, salary and wage costs will be deductible because they will satisfy the test in s DA 1 and none of the general limitations will apply. The payment of an allowance or the provision of a benefit in connection with an employee's employment is a business cost just like the employee's basic salary or wages. Therefore, provided the costs of an employee's basic salary or wages are deductible, then, generally, the costs of paying reimbursing or benefit allowances or providing non-cash benefits will also be deductible.

35. The costs incurred in providing a fringe benefit may also be deducted if the general permission is met and none of the general limitations applies. Also, if the employer is liable to pay any FBT, the FBT itself is a deductible expense.

Examples of allowances

36. The following table lists examples of the types of allowances paid to employees. The amounts specified in the withdrawn items listed in this item no longer apply. The reimbursement allowances in the table are **exempt only to the extent that they do not reimburse private expenses or capital expenses (subject to the low value asset rule (that is, they are below the $500 limit))**. Employee allowances should be deductible to the employer where the employee's salary or wages are deductible.

Category	Payment or benefit provided	Type of allowance	Tax treatment	
			Employee	Employer
Working dogs	Allowance for food, registration or vet bills	Reimbursing allowance	Exempt	Deductible
Horses	Allowance for food, saddlery and accessories (less than $500), saddlery repairs, vet or farrier's bills	Reimbursing allowance	Exempt	Deductible
Motor bikes and quad bikes	Allowance for depreciation, interest, fuel, tyres (less than $500), servicing or repairs	Reimbursing allowance	Exempt	Deductible
Protective clothing	Allowance for purchase (less than $500) of protective clothing such as boots, chaps, leggings, gloves, and hearing or eye protection	Reimbursing allowance	Exempt	Deductible
Wet weather gear	Allowance for purchase (less than $500) of wet weather gear, such as waterproof coats, hats and leggings	Reimbursing allowance	Exempt	Deductible
Shearing equipment	Allowance for acquisition (less than $500) of hand-pieces or shearing equipment, repairs and maintenance and depreciation of equipment	Reimbursing allowance	Exempt	Deductible
Boarding school fees	School boarding away allowance	Benefit allowance	Taxable	Deductible
Travel costs	Reimbursement of work travel	Reimbursing allowance	Exempt	Deductible
Rations and stores	Provisions of stores and rations, meat or farm produce	Non-cash benefit	Not assessable	FBT (subject to exemptions)
	Payment in lieu of stores and rations	Benefit allowance	Taxable	Deductible
Remote location	Allowance for working in a remote location	Benefit allowance	Taxable	Deductible
Dangerous or dirty conditions	Allowance for working in a dangerous or dirty environment	Benefit allowance	Taxable	Deductible

37. The following example uses sheep farming as its basis because this relates the most closely to the allowances in the items now withdrawn. It is included solely to assist in explaining the application of the law as set out above. The same principles would apply to farm workers on other types of farms or other primary production sectors.

Example

Frank is a sheep farmer in a remote area. The following people work at various times on Frank's farm:

- Mike, the farm manager;
- Pete and Jake, full-time live-in farm hands;
- a shearing gang employed by Sharp Shearing Services Ltd with which Frank has a contract for the provision of shearing services. The shearing gang is from another district and because of the distance and remoteness of the farm they stay in the shearers' quarters for the duration of the job.

Mike, his partner and their two children live in the manager's house on the farm. Because of the remote location of the farm, the children attend boarding school. Frank pays Mike an allowance every term to assist with boarding school costs.

Mike is also paid the following amounts regularly as part of his salary:

- an allowance to reimburse Mike for the costs (depreciation, interest, fuel, tyres, and servicing and repairs) he is likely to incur in using his own quad bike;
- an allowance for Mike to provide his own wet weather gear;
- a remote living allowance of $50 per week.

Pete and Jake live on the farm in separate staff quarters provided by Frank. On work days, Frank provides them breakfast that has been prepared and is consumed in Frank's kitchen. From time to time, Frank gives them meat for the freezer that they store and consume in their own quarters.

Sharp Shearing Services Ltd pays each employee an allowance to reimburse them for the costs they are likely to incur in using their shearing gear for work depending on the job they do. The allowances cover repairs and maintenance of hand-pieces, and the replacement of combs and cutters and for the employees to provide their own protective clothing. Sharp Shearing Services also pays its employees a daily allowance in lieu of providing stores or rations when the employees are on site.

It is accepted that any reimbursement allowances are paid in connection with the relevant employee's employment and, with the exception of Mike's remote living allowance, has been based on an amount incurred or a reasonable estimate. The $50 per week remote living allowance was negotiated as a condition of Mike's employment.

Implications for Mike

The reimbursing allowances paid to Mike to reimburse him for the costs he is likely to incur in using his quad bike for work and for providing wet weather gear are exempt from tax under s CW 17(2). This exemption is because these expenses are expenses that would have been deductible to Mike if the employment limitation did not exist. In the case of the wet weather gear, the conclusion that s CW 17 applies to treat this allowance as exempt income assumes that if any part of the allowance was for the capital cost to acquire the gear, the acquisition costs would have been deductible as a depreciation allowance under the low value asset provision s EE 38.

The allowance paid to assist Mike with the costs of his children attending boarding school is a benefit allowance because it provides Mike with a benefit in reducing the boarding school costs paid by him. Expenditure on boarding school fees for his children is of a private or domestic nature. It is taxable to Mike as employment income under s CE 1(1)(a) and subject to PAYE.

The remote living allowance paid to Mike is also a benefit allowance because it provides him with a benefit by reducing his private or domestic expenditure.

Therefore, it is taxable as employment income under s CE 1(1)(a) and subject to PAYE.

Implications for Pete and Jake

The food Frank provides Pete and Jake for breakfast is not a fringe benefit because the exclusion for benefits provided on an employer's premises applies (s CX 23).

The meat for the freezer is a fringe benefit and the exclusion in s CX 23 does not apply. The taxable value can be worked out using s RD 40(1) and will be the meat's market value.

Implications for the shearing gang

The reimbursing allowance paid to each member of the shearing gang to reimburse them for the costs of providing their own shearing gear is exempt from tax under s CW 17. This exemption is because these expenses are expenses that would have been deductible to them if the employment limitation did not exist. In the case of protective clothing, the conclusion that s CW 17 applies to treat these allowances as exempt income assumes that if any part of the allowance was for the capital cost to acquire the clothing, the acquisition costs would have been deductible as a depreciation allowance under the low value asset provision s EE 38. The allowance in lieu of rations paid to the gang is also exempt from tax. Generally such allowances would not satisfy s CW 17(2) because of the private limitation. However, s CW 17CB(1) allows exempt meal allowances to be paid for short periods where the employment duties of an employee require them to travel and work away. In this case the shearers are working away in another district and staying in shearers' quarters so can be paid an exempt meal allowance to the extent that they receive an allowance rather than food.

Implications for Frank

Frank is not liable for FBT for the food he provides to Pete and Jake.

All the allowances paid to Mike and the costs of providing food to Pete and Jake are deductible to Frank because they are paid in connection with their respective employment. They are business expenses that satisfy the test in s DA 1.

Sharp Shearing Services

The reimbursing allowances paid to the shearing gang are all deductible to Sharp Shearing Services because they are paid in connection with the employment of the company's employees. Accordingly, they are business expenses that satisfy the nexus test in s DA 1.

References

Subject references

Allowances
Benefit allowance
Certificate of exemption
Employee
Farm worker
Fringe Benefit
Reimbursing allowance

Legislative references

Income Tax Act 2007: ss CE 1, CW 17, CX 2, CX 6, CX 9, CX 10, CX 12 to CX 16, CX 23, CX 37, DA 1, DA 2, DO1, DO 2, EE 38, subpart RD, RD 8, RD 40, RD 45, RD 54, YA 1 ("agricultural, horticultural, or viticultural company", "employee", "PAYE income payment", "scheduler payment"), Sch 4

Tax Administration Act 1994: s 24M, 91AAT

Other references

"Allowances – shearers and shed hands", *Public Information Bulletin* No 92 (December 1977): 2

"Allowances for shepherds, musterers and drovers", *Public Information Bulletin* No 40 (May/June 1967): 8

"Cost of keep of farm employees", *Public Information Bulletin* No 171 (March 1988): 1

"CS 16/02: Determining 'market rental value' of employer-provided accommodation", *Commissioner's Statement* (24 November 2016)

"CS 12/01: "Income tax treatment of accommodation payments, employer-provided accommodation and accommodation allowances", *Commissioner's Statement* (6 December 2012)

"Farming supplement 'No 2' – allowances to farm employees – tax position explained", *Public Information Bulletin* No 25 (August 1965): 7

"Some farm employees living in remote areas not to pay tax on school boarding allowances", *Public Information Bulletin* No 25 (August 1965): 11

"Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014", *Tax Information Bulletin* Vol 26, No 7 (August 2014): 35

Items withdrawn and replaced

This QWBA withdraws and replaces the Commissioner's view on the tax treatment of the types of allowances referred to in the following items (except those concerning accommodation):

- "How Allowances Received By Farm Employees Are Taxed" Public Information Bulletin No 19, (February 1965):9.
- "Farming Supplement 'No 2' – Allowances to Farm Employees – Tax Position Explained", Public Information Bulletin No 25, (August 1965):7•
- "Some Farm Employees Living in Remote Areas Not to Pay Tax on School Boarding Allowances", Public Information Bulletin No 25 (August 1965):11.
- "Allowances for Shepherds, Musterers and Drovers", Public Information Bulletin No 40, (May/June 1967):8.
- "Allowances – Shearers and Shed Hands", PIB No 92, (December 1977):2.
- "Cost of Keep of Farm Employees", Public Information Bulletin 171, (March 1988):1.

The allowances referred to in the items listed above cover cash allowances paid to certain farm employees:

- to reimburse them for expenses incurred in providing their own dogs, horses, saddlery or hand pieces;
- in lieu of the employer providing food ("stores and rations");
- to reimburse employees' travelling expenses; or
- to reimburse employee's costs associated with boarding school-age children off the farm.

This QWBA also replaces the above items that covered the provision of non-cash benefits of food or stores and rations. It also deals with the fringe benefit tax (FBT) implications since FBT did not exist when the items were published.

This QWBA does not consider the aspects of the PIB items dealing with free board or lodgings and accommodation provided to farm workers. The Commissioner's position relating to employees and accommodation issues is covered in:

- "CS 16/02: Determining 'market rental value' of employer-provided accommodation", Commissioner's Statement (24 November 2016); and
- "CS 12/01: Income tax treatment of accommodation payments, employer-provided accommodation and accommodation allowances", Commissioner's Statement (6 December 2012).

CS 12/01 is being updated to reflect changes contained in the Taxation (Annual Rates, Employee Allowances, and Remedial Matters) Act 2014, which are detailed in *Tax Information Bulletin*, Vol 26, No 7 (August 2014).

LEGISLATION AND DETERMINATIONS

This section of the *TIB* covers items such as recent tax legislation and depreciation determinations, livestock values and changes in FBT and GST interest rates.

Determination FDR 2018/02 – Use of fair dividend rate method for a type of attributing interest in a foreign investment fund (Two Trees Global Macro Fund)

Reference

This determination is made under section 91AAO(1)(a) of the Tax Administration Act 1994. This power has been delegated by the Commissioner of Inland Revenue to the position of Technical Specialist , under section 7 of the Tax Administration Act 1994.

Discussion (which does not form part of the determination)

Units in the Two Trees Global Macro Fund ("Two Trees Fund"), to which this determination applies, are attributing interests in a foreign investment fund ("FIF") for New Zealand resident investors.

The investments held by the Two Trees Fund may consist predominantly of financial arrangements providing funds to a person. In addition, some investors may hedge their attributing interests in the Two Trees Fund back to New Zealand dollars. Therefore, section EX 46(10)(cb) of the Income Tax Act 2007 could apply to prevent those investors from using the fair dividend rate method in the absence of a determination under section 91AAO of the Tax Administration Act 1994.

Notwithstanding that the Two Trees Fund may have assets predominantly comprising financial arrangements and the presence of the hedging arrangements, the overall arrangement contains sufficient risk so that it is not akin to a New Zealand dollar-denominated debt instrument. Accordingly, I consider it is appropriate for resident investors to use the fair dividend rate method to calculate FIF income from their attributing interest in the Two Trees Fund.

Scope of determination

This determination applies to units held by New Zealand resident investors in the Two Trees Fund.

The Two Trees Fund achieves its investment objectives by taking long and short positions across global equity indices, bonds, commodities, currencies and volatility products, as well as making other investments. Exposure to these markets is primarily achieved through the use of exchange traded futures or over the counter derivatives such as currency forward contracts.

New Zealand resident investors may hedge their attributing interests back to New Zealand dollars.

This determination is made subject to the following conditions:

1) The investment in the Two Trees Fund is not part of an overall arrangement that seeks to provide the New Zealand resident investor with a return that is equivalent to an effective New Zealand dollar denominated interest exposure.
2) The absolute value of the Two Trees Fund's notional derivative exposure must not fall to 20% or less of its Net Asset Value for a continuous period of 45 days. Should this occur, the determination ceases to apply from the first day of the following quarter.

Interpretation

In this determination unless the context otherwise requires:

"Fair dividend rate method" means the fair dividend rate method under section YA 1 of the Income Tax Act 2007;

"Financial arrangement" means financial arrangement under section EW 3 of the Income Tax Act 2007;

"Foreign investment fund" means foreign investment fund under section YA 1 of the Income Tax Act 2007;

"Two Trees Fund" means an Australian Unit Trust known at the date of this determination as the Two Trees Global Macro Fund.

Determination

This determination applies to an attributing interest in a FIF, being a direct income interest in the Two Trees Fund. This is a type of attributing interest for which the investor may use the fair dividend rate method to calculate FIF income from the interest.

Application Date

This determination applies for the 2019 and subsequent income years.However, under section 91AAO(3B) of the Tax Administration Act 1994, this determination also applies for an income year beginning before the date of this determination for a person who invests in the Two Trees Fund and who chooses that the determination applies for that income year.

Dated this 13th day of June 2018.

Haydn Clark
Technical Specialist

General Determination DEP103: Tax Depreciation Rate for skin therapy machines

Note to this determination

The Commissioner has recently been asked to consider what depreciation rate should apply for skin therapy machines used for beauty treatments. The beauty treatments include hair removal, reducing winkles, freckles, vascular lesions and pigmentation problems.

The asset uses intense light pulse ("IPL") treatment supplemented by a Radio Frequency ("RF") emitting mode, which radiates the follicles or skin cells with a shortwave or microwave radio frequency. In the RF mode, it is effectively operating as a diathermy machine (Diathermy is deep treatment of tissue by heat applied through RF or microwaves). The machine may include a handpiece which emits the light and/or RF that is waved over the skin and has a sapphire plate that touches the skin which is refrigerated by means of a circulating coolant to prevent overheating and burning.

Determination DEP103: Tax Depreciation Rates General Determination Number 103

This determination may be cited as "Determination DEP103 Tax Depreciation Rates General Determination Number DEP103: Skin therapy machines used for beauty treatments".

1. Application

This determination applies to taxpayers who own items of depreciable property of the kind listed in the table below:

This determination applies for the 2017/18 and subsequent income years.

2. Determination

Pursuant to section 91AAF of the Tax Administration Act 1994, the general determination will apply to the kind of items of depreciable property listed in the table below by:

- Adding into the "Medical and Medical Laboratory" and "Shops" industry categories, the new asset class, estimated useful life, and general diminishing value and straight-line depreciation rates listed below:

Asset class	Estimated useful life (years)	DV rate (%)	SL rate (%)
IPL, Laser, Ultrasound or RF emitting skin treatment or depilation equipment.	8	25	17.5

3. Interpretation

In this determination, unless the context otherwise requires, words and terms have the same meaning as in the Income Tax Act 2007 and the Tax Administration Act 1994.

This determination is signed by me on the 14th day of June 2018.

Vanessa Montgomery
Manager, Technical Standards, OCTC

LEGAL DECISIONS – CASE NOTES

This section of the *TIB* sets out brief notes of recent tax decisions made by the Taxation Review Authority, the High Court, Court of Appeal, and the Supreme Court.

We've given full references to each case, including the citation details where it has already been reported. Details of the relevant Act and section will help you to quickly identify the legislation at issue. Short case summaries and keywords deliver the bare essentials for busy readers. The notes also outline the principal facts and grounds for the decision.

These case reviews do not set out Inland Revenue policy, nor do they represent our attitude to the decision. These are purely brief factual reviews of decisions for the general interest of our readers.

Entitlement to tax sparing credits under the double tax agreement between New Zealand and China - leave to appeal to the Supreme Court was denied

Case	Lin v Commissioner of Inland Revenue [2018] NZSC 54
Decision date	20 June 2018
Act(s)	Double Taxation Relief (China) Order 1986 Art 23; Senior Courts Act 2016 s 74
Keywords	leave to appeal, double tax agreement, Controlled Foreign Company, general or public importance, general commercial significance, miscarriage of justice

Summary

The Applicant, Patty Tzu Chou Lin, sought leave to appeal a judgment of the Court of Appeal, *Commissioner of Inland Revenue v Lin* [2018] NZCA 38 (Harrison, Cooper and Asher JJ) ("*CIR v Lin*") to the Supreme Court. Leave was denied. *CIR v Lin* dealt with an issue of interpretation of the double tax agreement between New Zealand and the People's Republic of China (Double Taxation Relief (China) Order 1986) ("the NZ/China DTA").

Impact

This case involves the threshold criteria for leave to appeal as set out in s 74 of the Senior Courts Act 2016. The Supreme Court may be less inclined to grant leave where a matter involves outdated law.

Facts

The Applicant had a 30 per cent interest in five Controlled Foreign Companies ("CFCs") which were tax residents of China. The income of the CFCs in China was attributed to the Applicant for New Zealand tax purposes under the CFC regime. China provided tax concessions to the CFCs, which meant that they were exempt from paying Chinese tax.

Article 23(2)(a) of the NZ/China DTA provides that Chinese tax paid in respect of income derived by a resident in New Zealand from sources in China (with some exceptions) is allowed as a credit against New Zealand tax payable in respect of that income by the New Zealand tax resident. Article 23(3) allows tax spared by the Chinese authorities as a credit against New Zealand tax payable by the New Zealand resident.

The Commissioner calculated the Applicant's tax liability on the basis that a credit was provided for tax actually paid in China, but no credit was given for tax spared in China.

The Applicant challenged the Commissioner's assessment to the High Court, which decided that the Applicant was entitled to a credit in New Zealand for tax spared in China, interpreting art 23(3) on the basis that it had to be read in the light of the wording of art 23(2)(a) so that the two provisions could be read consistently. The High Court held that that this interpretation was underscored by evidence about the way in which double tax agreements are negotiated, the research done by each country into the other's tax systems and policy and the irresistible inference that both parties would have known at the time of entering into the NZ/China DTA that New Zealand intended to implement a CFC regime. The High Court also considered that the interpretation of art 23(3) respected the purpose of the tax sparing provision in the NZ/China DTA to encourage investment in China by ensuring that the benefit of the Chinese tax concessions remained with investors, rather than accruing to the benefit of the New Zealand tax system.

The Commissioner appealed to the Court of Appeal, which held that art 23's meaning was clear, and thus there was no necessity to resort to extrinsic materials for assistance in its interpretation. It considered that art 23(3) dealt with tax that would have been payable in China by a resident in New Zealand. It did not deal with tax that would have been payable in China by a CFC, in which a New Zealand resident has an interest, thus causing the income of the CFC to be attributed to the New Zealand resident under the CFC regime.

Decision

The Supreme Court held that the significance of the Applicant's case was substantially affected by the change to the CFC regime in 2009, which required the attribution to a New Zealand shareholder of a CFC of the passive income of the CFC, but not the active income (the events of the Applicant's case occurred before 2009). This meant that it was unlikely that a CFC would ever benefit from a tax sparing provision in relation to income attributed to it in New Zealand.

The Supreme Court also said that the case was affected by the ongoing negotiation of a new NZ/China DTA. The Supreme Court noted that it was anticipated that even if the new DTA were to allow for tax sparing provisions, it would make clear one way or the other what credit should be available to a New Zealand tax resident.

The Supreme Court did not grant leave to appeal as it saw these two developments as strong indications that the Applicant's arguments were not points of sufficient importance to justify the grant of leave for a further appeal. The Supreme Court also did not see any appearance of a miscarriage of justice if leave was not granted.

Dr Muir's application to set aside Bankruptcy Notice dismissed

Case	Commissioner of Inland Revenue v Garry Albert Muir [2018] NZHC 1407
Decision date	22 June 2018
Act(s)	Insolvency Act 2006
Keywords	Bankruptcy Notice, Inherent Jurisdiction

Summary

The High Court entered summary judgment (recently upheld on appeal) against the Judgment Debtor (Dr Muir) in favour of the Commissioner for unpaid taxes, interest and penalties totalling $8,179,830.94 (*Commissioner of Inland Revenue v Muir* [2017] NZHC 1413 upheld on appeal, *Muir v Commissioner of Inland Revenue* [2018] NZCA 129). The Commissioner issued a bankruptcy notice against Dr Muir on the basis of the summary judgment. These proceedings related to Dr Muir's applications seeking to set aside the bankruptcy notice or adjournment of proceedings by virtue of the High Court's inherent jurisdiction. The High Court dismissed Dr Muir's applications and awarded costs to the Commissioner.

Impact

The exercise of the High Court's jurisdiction should proceed on a principle basis and not merely for convenience or expediency. Adjournment of bankruptcy proceedings is unlikely where judgment has not been stayed and remains outstanding.

Facts

Dr Muir was the architect of the Trinity Tax Scheme. Given the protracted nature of the Trinity dispute, the Court identified four relevant stages in the litigation history as a) the Supreme Court decision of *Ben Nevis* finding the Trinity scheme a tax avoidance arrangement (*Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289 at [148]), b) subsequent attempts by Dr Muir to challenge his personal tax assessments c) enforcement proceedings, being the summary judgment determination of Associate Judge Bell, upheld on appeal and d) these current bankruptcy proceedings.

The Court of Appeal recently upheld Associate Judge Bell's decision entering summary judgment (*Muir v Commissioner of Inland Revenue* [2018] NZCA 129), to which Dr Muir has sought leave of the Supreme Court to appeal. Dr Muir also sought to recall the Court of Appeal's decision however, that application was dismissed. Dr Muir's appeals of the decisions of Toogood and Jagose JJ were recently heard together in the Court of Appeal where judgment is still reserved. It is those two Court of Appeal decisions that Dr Muir says are outstanding tax challenges under pt 8A of the Tax Administration Act 1994.

Decision

Dr Muir's applications were dismissed and the Commissioner was awarded costs. The Court found no exceptional circumstances or principled basis for exercising its inherent jurisdiction to set aside the notice or adjourn the proceedings. The Court was not satisfied with counsel's explanation as to why Dr Muir had not sought or obtained a stay of execution of the underlying summary judgment and noted that it was bound by the decision of the Court of Appeal in upholding judgment.

Mr Hucker, Dr Muir's counsel, explained there was a real concern with the safety of the underlying judgment, given the tax challenges on foot and on appeal, as well as leave being sought from the Supreme Court against the Court of Appeal's decision upholding judgment. However, the Court did not accept this, Associate Judge Andrew noting at [31]:

> To do so would put [the Court] in the invidious and untenable position of having to make an assessment of whether there is any credible basis for the application for leave to the Supreme Court, in circumstances where I am bound to conclude that the Court of Appeal was correct.

Furthermore, the Court did not accept Mr Hucker's submission that an adjournment of these proceedings until the Supreme Court leave application had been determined was a practical and sensible solution, noting that the exercise of the Court's inherent jurisdiction should not proceed on grounds of convenience and expediency but on a principled basis.

The Court concluded that the challenge to the underlying summary judgment was not a cross claim for the purposes of s 17 of the Insolvency Act 2006, that the Court should uphold the principle of finality of litigation, noting Dr Muir had already sorely tested that principle and "a line must now surely be drawn" (at [33](b)), and that there was no serious injustice to Dr Muir that might satisfy the granting of an adjournment. The Court recognised that as a consequence of its decision not to grant an adjournment, Dr Muir had committed an act of bankruptcy, however, this was not enough to constitute an exceptional circumstance which might justify the exercise of the Court's jurisdiction.

The Court noted that if the Supreme Court did grant leave to appeal, then Dr Muir could seek a halt of any adjudication proceedings pursuant to s 42 of the Insolvency Act 2006.

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Office of the Chief Tax Counsel

The Office of the Chief Tax Counsel (OCTC) produces a number of statements and rulings, such as interpretation statements, binding public rulings and determinations, aimed at explaining how tax law affects taxpayers and their agents. The OCTC also contributes to the "Questions we've been asked" and "Your opportunity to comment" sections where taxpayers and their agents can comment on proposed statements and rulings.

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