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TAX INFORMATION Bulletin

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Inland Revenue
Te Tari Taake

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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** (search keywords: public consultation).

Email your submissions to us at **public.consultation@ird.govt.nz** or post them to:

Public Consultation
Tax Counsel Office
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.

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This determination applies to an attributing interest in a foreign investment fund, being a direct income interest in Class Q shares in ISAM Systematic Trend. This is a type of attributing interest for which the investor may use the fair dividend rate method to calculate foreign investment fund income from the interest.

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Any investment by a New Zealand resident investor in units in the Russell Investments Multi Strategy Volatility Fund is a type of attributing interest for which the investor may use the Fair Dividend Rate method to calculate Foreign Investment Fund income from the interest.

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This determination provides employers with the option of applying certain percentages to make an allocation between business use and private use of telecommunications tools and usage plans. The option will reduce business compliance costs.

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Public rulings

BR Pub 19/05: Income tax – treatment of alteration to rights attached to shares under section CB 4; BR Pub 19/06: Income tax – treatment of a disposal of shares with altered rights under section CB 4 20

The rulings concern an arrangement where a shareholder holds shares in a company and the shares were acquired for the purpose of disposal. They conclude that an alteration of share rights does not result in a disposal of personal property for the purposes of s CB 4, and the time of acquisition of the shares where the rights attached to them are altered after acquisition is the time the shares were acquired before the alteration.

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Interpretation statement

IS 19/04 - Income tax - distributions from foreign trusts 28

This interpretation statement discusses the tax treatment of amounts of money and property received by NZ residents from overseas, including by inheritance, that are potentially distributions from trusts. It covers how to determine if the amounts actually come from a trust (especially when another country has no law of trusts, or the law is different to NZ), whether anything is beneficiary income or a taxable distribution from a foreign trust and when and how the ordering rules in s HC 16 might mean they are treated as taxable distributions when they might not otherwise appear to be. It also considers the law of administration of deceased estates to help determine at what point a trust might arise to make distributions taxable.

Questions we've been asked

QB 19/15: If property held in a trust is rented out by a beneficiary of the trust for short-stay accommodation, who should declare the income, and what deductions can be claimed? 59

This Question We've Been Asked is part of a series of guidance on the income tax and GST consequences of providing short-stay accommodation through peer-to-peer websites such as Airbnb, Bookabach and Holiday Houses. It explains how the income tax rules apply if property held in a trust is rented out by a beneficiary of the trust.

QB 19/16: If property held in a trust is rented out by the trustees for short-stay accommodation, who should declare the income, and what deductions can be claimed? 65

This Question We've Been Asked is part of a series of guidance on the income tax and GST consequences of providing short-stay accommodation through peer-to-peer websites such as Airbnb, Bookabach and Holiday Houses. It explains how the income tax rules apply if property held in a trust is rented out by the trustees.

Standard practice statement

SPS 19/05 – options for relief from child support debt 73

This statement sets out the Commissioner's practice for providing relief when the immediate payment of an overdue child support or domestic maintenance obligation is not possible. The relief is provided in the form of an agreement to pay the debt in instalments; writing off penalties in certain situations; or in limited circumstances, writing off part or all of the child support debt.

Operational statement

OS 19/05: Employer-provided travel from home to a distant workplace – income tax (PAYE) and fringe benefit tax 84

This statement is intended to clarify and simplify the tax rules around employer-provided travel to distant workplaces - for example, a person who works in Wellington but lives in Auckland, or who may travel greater distances in working from home or at multiple workplaces.

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Legal decisions - case notes

High Court upholds TRA decision regarding Income Tax, GST and PAYE assessments and TAA ss 108 and 108A time bar 94

This is an appeal from a decision of the Taxation Review Authority ("TRA") regarding Mr Dowden's challenge to the Commissioner of Inland Revenue's ("Commissioner") PAYE, GST and INC assessments for tax periods between January 2004 and May 2012.

These assessments concerned several businesses run by Mr Dowden, including Safeguard Security ("Safeguard"). Mr Dowden claimed to have transferred his interest in Safeguard to his former partner, Ms Jackson, in December 2003. Mr Dowden's case was that Ms Jackson was liable for tax relating to Safeguard between January 2004 and December 2011.

The TRA upheld the Commissioner's assessments. The TRA held that Mr Dowden had not ceased to trade as Safeguard from January 2004 to December 2011 and also that the Commissioner was not bound by the limitation periods in ss 108 and 108A of the TAA.

Commissioner successful in donations GST case 95

This proceeding was a tax challenge in relation to reassessments made for six GST periods (from the tax year ended 31 March 2012 to the tax year ended 31 March 2015) to include payments that the disputant, CD Trust, has treated as not being subject to GST. The Taxation Review Authority ("the Authority") found for the Commissioner of Inland Revenue ("the Commissioner") and upheld the reassessments (during the preparation for the hearing the Commissioner's investigator identified that there were errors in the calculations underlying the assessments and recalculated what the correct amount of the assessments should be. The Taxation Review Authority varied the assessments accordingly pursuant to s 138P of the TAA.)

Court of Appeal dismisses appeal of application for judicial review of child support assessment 96

The Court of Appeal dismissed P's appeal and accepted the Commissioner of Inland Revenue ("CIR") had acted correctly in changing P's child support entitlement to nil.

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 2019/01 - Use of fair dividend rate method for a type of attributing interest in a foreign investment fund (ISAM Systematic Trend – Class Q shares)

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)

Class Q shares in ISAM Systematic Trend, to which this determination applies, are attributing interests in a foreign investment fund for New Zealand resident investors.

ISAM Systematic Trend holds directly or indirectly assets of which 80% or more are financial arrangements providing funds to a person. In addition, some New Zealand resident investors hedge their attributing interests in Class Q shares in ISAM Systematic Trend back to New Zealand dollars. Therefore, section EX 46(10)(cb) of the Income Tax Act 2007 would 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.

I consider that it is appropriate for New Zealand resident investors to use the fair dividend rate method to calculate foreign investment fund income from their attributing interests in Class Q shares in ISAM Systematic Trend. Although ISAM Systematic Trend directly or indirectly invests in assets predominantly comprising financial arrangements and New Zealand resident investors may enter into New Zealand dollar hedging arrangements, the overall arrangement contains sufficient risk so that it is not similar to a New Zealand dollar-denominated debt investment.

Scope of determination

This determination applies to Class Q shares held by New Zealand resident investors in ISAM Systematic Trend.

The ISAM Systematic Trend's investment objective is to grow the value of its assets, providing returns with low correlations to the stock and bond markets through the implementation of systematic trading models. ISAM Systematic Trend achieves its investment objectives by primarily investing in ISAM Systematic Trend Master. ISAM Systematic Trend Master trades primarily in global futures, swaps and forward contracts including with respect to stock indices, interest rates, currencies, energy commodities, agriculture and metals, as well as in over-the-counter spot foreign exchange and metals transactions.

This determination is made subject to the following conditions:

1) The investment in Class Q shares in ISAM Systematic Trend is not part of an overall arrangement that provides 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 ISAM Systematic Trend'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;

"ISAM Systematic Trend" means a Cayman Islands exempted company incorporated on 9 February 2010 known at the date of this determination as ISAM Systematic Trend;

"ISAM Systematic Trend Master" means a Cayman Islands exempted company incorporated on 9 February 2010 known at the date of this determination as ISAM Systematic Master; and

"The investor" means the person who has a share in ISAM Systematic Trend.

Determination

This determination applies to an attributing interest in a foreign investment fund, being a direct income interest in Class Q shares in ISAM Systematic Trend. This is a type of attributing interest for which the investor may use the fair dividend rate method to calculate foreign investment fund income from the interest.

Application Date

This determination applies for the 2020 and subsequent income years.

However, under section 91AAO(3B) of the Tax Administration Act 1994, this determination does not apply for a person and an income year beginning before the date of the determination unless the person chooses that the determination apply for the income year.

Dated this 29th day of November 2019.

Haydn Clark
Technical Specialist

Determination FDR 2019/02 – Use of fair dividend rate method for a type of attributing interest in a foreign investment fund (Russell Investments Multi Strategy Volatility 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)

Shares in the Russell Investments Multi Strategy Volatility Fund ("Russell MSV 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 Russell MSV Fund consist predominantly of financial arrangements providing funds to a person. In addition, some New Zealand resident investors hedge their attributing interests in the Russell MSV Fund back to New Zealand dollars. Therefore, section EX 46(10)(cb) of the Income Tax Act 2007 would 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.

I consider that it is appropriate for New Zealand resident investors to use the fair dividend rate method to calculate FIF income from their attributing interest in the Russell MSV Fund. Although the Russell MSV Fund invests in assets predominantly comprising financial arrangements and New Zealand resident investors may enter into related New Zealand dollar hedging arrangements, the overall arrangement contains sufficient risk so that it is not akin to a New Zealand dollar-denominated debt investment.

Scope of determination

This determination applies to shares held by New Zealand resident investors in the Russell MSV Fund.

The Russell MSV Fund achieves its investment objectives by investing in global equity indices and volatility indices through derivative instruments (exchange traded or over-the-counter and including futures and options) with the aim of removing directional or market exposure and for hedging or efficient portfolio management purposes. For the purposes of covering the derivative positions, the Russell MSV Fund also invests in cash and cash equivalents (including money market instruments, cash deposits, commercial paper and certificates of deposit).

This determination is made subject to the following conditions:

1) The investment in the Russell MSV Fund is not part of an overall arrangement that provides 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 Russell MSV 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;

"Russell MSV Fund" means the Russell Investments Multi Strategy Volatility Fund, being a sub-fund of an Irish company incorporated on 10 November 2004 known at the date of this determination as Russell Investment Company IV plc.

Determination

This determination applies to an attributing interest in a foreign investment fund, being a direct income interest in the Russell MSV Fund. This is a type of attributing interest for which the investor may use the fair dividend rate method to calculate foreign investment fund income from the interest.

Application Date

This determination applies for the 2020 and subsequent income years.

However, under section 91AAO(3B) of the Tax Administration Act 1994, this determination does not apply for a person and an income year beginning before the date of the determination unless the person chooses that the determination apply for the income year.

Dated this 28th day of November 2019.

John Trezise
Technical Specialist

Determination EE001: Employee use of telecommunications tools and usage plans in their employment

Reimbursements or reimbursing allowances in relation to employee use of telecommunications tools and usage plans in their employment are taxable and subject to PAYE unless specifically exempt.

Section CW 17 of the Income Tax Act 2007 allows reimbursements or reimbursing allowances to be exempt to the extent that an employee would be allowed a deduction if they incurred the expenditure and the employment limitation did not exist. Evidence is required to demonstrate a 'nexus' between incurring the expenditure and deriving income.

Under s CW 17(2) a reimbursement may be exempt or under s CW 17(3) a reasonable estimate of the amount of expenditure may be exempt. In this context a reasonable estimate is one that has some objective basis. For example, the estimate might be based on actual historical data or employee survey information. Employers must retain sufficient information about how the estimate was determined to substantiate the amount.

This Determination provides employers with the option of applying certain percentages to make an allocation between business use and private use for usage plans related to telecommunications tools based on the level of business use. There is also a de minimis level of payment that may be treated as exempt income.

As a means of providing flexibility and reducing compliance costs this Determination allows lesser requirements for the provision of evidence when applying the percentages or the de minimis class. The requirements may involve signed declarations from employees in lieu of other evidence of use, an employment policy to establish an obligation to use telecommunications tools and in the case of the de minimis class there is no evidence requirement.

The option to use this Determination will reduce business compliance costs.

Determination

This Determination is made under s 91AAT of the Tax Administration Act 1994.

This Determination applies to the arrangements described and in circumstances where employees use their own telecommunications tools in their employment and also use the tools for private use. It may also apply where the employer provides payments in relation to usage plans only. Employers reimburse employees or provide reimbursing allowances which involve estimates being made. This Determination can be relied on for the required apportionment.

This Determination relates to the following arrangements, which comprise three classes: Class A, Class B and the De Minimis Class.

Class A: Principally business use, covers situations where:

- an employer enters into an arrangement with the employee whereby the employee will provide their own telecommunications tools and usage plan, or the arrangement involves the employee using their own usage plan; and
- the employee incurs the cost of the telecommunications tools and the usage plan or the cost of the usage plan alone and there is reimbursement; or
- a reimbursing allowance represents a reasonable estimate of the likely expenditure to be incurred by the employee; and
- the telecommunications tools and usage plan are principally used by the employee in their employment, and the employee also uses the tools and usage plan or usage plan alone for private use; and
- there may be an amount relating to depreciation loss.

Class B: Principally private use, covers situations where:

- an employer enters into an arrangement with the employee whereby the employee will provide their own telecommunications tools and usage plan, or the arrangement involves the employee using their own usage plan; and
- the employee incurs the cost of the telecommunications tools and the usage plan or the cost of the usage plan alone and there is reimbursement; or
- a reimbursing allowance represents a reasonable estimate of the likely expenditure to be incurred by the employee; and
- the employee is required to use telecommunications tools and usage plan in their employment based on a business reason and also uses the tools and usage plan or usage plan alone for private use; and
- there may be an amount relating to depreciation loss.

The De Minimis Class covers situations where:

- an employer enters into an arrangement with the employee whereby the employee will provide their own telecommunications tools and usage plan, or the arrangement involves the employee using their own usage plan; and
- the employee incurs the cost of the telecommunications tools and the usage plan or the cost of the usage plan alone and there is reimbursement; or
- a reimbursing allowance represents a reasonable estimate of the likely expenditure to be incurred by the employee; and
- the employee is required to use telecommunications tools and a usage plan in their employment based on a business reason and also uses the tools and usage plan for private use; and
- there is a payment of no more than $5 per week per employee, amounting to no more than $265 per year per employee, as a reimbursement or a reimbursing allowance in relation to the use of telecommunications tools and a usage plan or the cost of the usage plan alone.

Class A

For Class A cases, employers can treat 75% of the amount paid (total bill amount) either by reimbursement or by a reimbursing allowance for usage plans, as exempt income of the employee. The extent to which the payment is taxable is 25%. If the employer pays 75% of the total bill as a reimbursement or reimbursing allowance, then the whole amount paid is exempt.

Depreciation loss is calculated using the Commissioner's rates for the items.

Class B

For Class B cases, employers can treat 25% of the amount paid (total bill amount) either by reimbursement or by a reimbursing allowance for usage plans, as exempt income of the employee. The extent to which the payment is taxable is 75%. If the employer pays 25% of the total bill as an reimbursement or reimbursing allowance, then the whole amount paid is exempt.

Depreciation loss is calculated using the Commissioner's rates for the items.

De Minimis Class

A payment up to $5 per week, amounting to no more than $265 per year, per employee, as reimbursement or a reimbursing allowance in relation to telecommunication tools and a usage plan can be treated as exempt income of the employee. This is in circumstances where the employee uses telecommunications tools in employment and incurs expenditure.

Limitations on the scope of this Determination

Additional and supplementary telecommunications tools

If the employer provides telecommunications tools, then the employer should not also be paying a reimbursing allowance, which is exempt income, for use of the employee's own telecommunications tools of that type. However, an employer who provides employees with laptops can also have a bring your own device ("BYOD") plan for cell phones or home internet connections.

Additional remuneration or salary sacrifice

This Determination does not apply if the amount paid is materially more than the actual plan costs or if there is evidence of the amounts being taken into account in remuneration levels so that a salary sacrifice arrangement exists.

Section CW 17(2C) does not permit a Determination under s 91AAT of the Tax Administration Act 1994 to apply to salary sacrifice arrangements. The inclusion of a telecommunications benefit in a salary statement to document the reimbursing allowance does not by itself indicate a salary sacrifice arrangement.

Fringe benefit tax (FBT)

This Determination does not apply where there is no employment income under the arrangement, that is, where the employer provides the telecommunications tool and pays for the usage. In such circumstances there may be FBT implications. It is noted that s CX 21 provides an exemption for business tools.

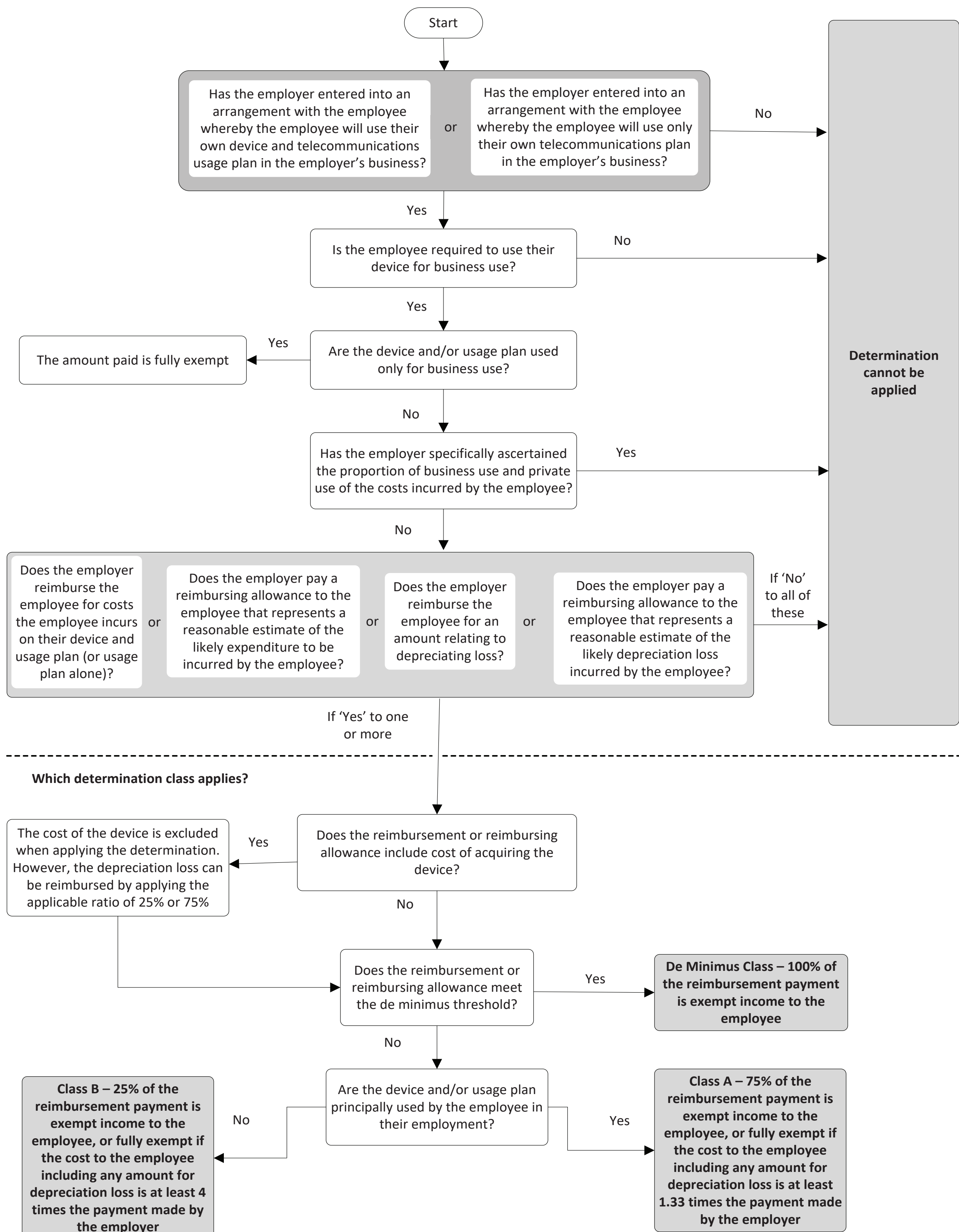
Determination is not binding on employer or employee

This Determination is not binding on the employer or the employee. If the employer or employee has evidence to demonstrate that, in their particular circumstance, some other apportionment is appropriate under s CW 17, the taxpayer may apply that apportionment.

This Determination is signed by me on the 20th day of December 2019.

Tony Munt
National Advisor - Technical Standards
Inland Revenue

Does this Determination apply?



Examples

The following nine examples explain the application of this Determination.

Example 1: Class A – Reimbursing allowance

An employee brings their own telecommunications tool to work and uses it in the course of their work. The telecommunications tool is principally used for work. In recognition of that, the employer pays a reimbursing allowance of the total monthly account of $60 per month to the employee. A portion of this payment ($45) can be treated as exempt income to the employee.

Under Class A, a 75% portion of the reimbursing allowance ($45) can be treated as exempt income to the employee. This Determination (for Class A) can be relied on in lieu of establishing the apportionment of usage.

Example 2: Depreciation

An employer has an optional BYOD policy. Employees who opt into the policy must return their employer-provided laptop and use their own laptop and associated equipment instead. Under this policy, employees must use a laptop that meets certain specifications. The employee must also purchase a mouse, keyboard and docking station to use at their workplace.

This arrangement is within Class A. The employer estimates that the average cost of a laptop that meets the required specifications and associated equipment is $1,500. The cost of this device and equipment per year is subject to a depreciation calculation made using the Commissioner's rates for the items. The employee can receive an amount calculated as depreciation loss (75% of that amount) annually as exempt income.

Example 3: Class B – Reimbursing allowance

An employee uses their home internet connection to do work for their employer, and the employer pays the employee a monthly reimbursing allowance of $60. It is understood that the reimbursing allowance is sufficient to cover both business use and private use, on the basis that it covers the total monthly account. The employee is required to use the home internet connection in their employment, but employment is not the principal use. There is some actual business use.

Under Class B, a 25% portion of the reimbursing allowance ($15) can be treated as exempt income to the employee. This Determination (for Class B) can be relied on in lieu of establishing the apportionment of usage.

Example 4: Reimbursement equal to or below business use percentage

An employer makes a monthly reimbursement payment of $25 to the employee. The home internet plan costs the employee $100 per month. The employer has evidence that the $25 reimbursement will cover monthly business use because business use amounts to at least 25%.

The monthly payment by the employer is equal to the business use percentage, so it is unnecessary to make a private use apportionment. The amount would be fully exempt under s CW 17.

Example 5: De minimis payment

An employer makes a monthly reimbursement payment of $20 to the employee. The employee must use their telecommunications tool in their employment based on a business reason and also uses the tool for private use. The payment is exempt income given it does not exceed the de minimis threshold of a payment up to $5 per week, amounting to no more than $265 per year.

Example 6: Second mobile phone

An employer provides a mobile phone for work purposes that is also available for private use. The employer reimburses or pays an reimbursing allowance for a second mobile phone for the employee. No additional facts indicate that the employee needs two phones for business purposes such as specifically needing separate phone numbers.

This Determination cannot be relied on in relation to the usage plan for the second mobile phone. The reimbursement or reimbursing allowance amount is likely to be employment income and not exempt.

Example 7: Salary sacrifice

An employer provides an amount of $1,000 per month for telecommunications tools as part of a salary package. The employee spends $100 per month on the internet (usage) plan.

This Determination cannot be relied on. The amount is employment income to the extent it relates to private use.

Example 8: Employee needs to be contacted at any time

An employee needs to be able to be contacted at any time to deal with work related matters. While the level of usage of the plan is less than 50% these facts still meet the principal use test. Class A applies and employers can treat 75% of the amount reimbursed or provided as an allowance as exempt income of the employee. If the employer paid the employee 75% or less of the total cost of the telecommunications tool the full reimbursement or reimbursing allowance would be exempt.

Example 9: Leave of absence

An employee has been assessed as receiving a Class A reimbursement. The employee receives a reimbursing allowance of $100 per month, of which $75 is tax exempt. The employee takes 6 weeks annual leave, during which the employee is not contactable for work purposes. As this is a temporary arrangement, any reimbursing allowance payments during the annual leave period remain 75% tax exempt.

Commentary (which does not form part of this Determination)

Purpose of Determination

1.1 Section CW 17 provides an exemption for certain payments to or made on behalf of an employee. The payments are in connection with an employee's employment or service and are for the employee's job-related expenditure. Often this expenditure might also have a private element. Under s CW 17, apportionment is required for this private element.

1.2 This Determination allows the employer to use the relevant percentage for the taxable portion of the payment to the employee, if the requirements set out in this Determination are met and the employer considers that it is preferable not to commit resource to establishing the actual percentage.

1.3 This Determination applies where the payment covers both business use and private use and the proportion is not ascertained.

Other options

1.4 Employers do not have to apply this Determination. Section CW 17 provides the basis to apportion when this Determination is not applied.

Arrangement

1.5 Many employers have a policy of agreeing to or allowing employees to bring their own telecommunications tools to work for business use, or agreeing to the business use of the employee's usage plan and telecommunications tools. There also may be an understanding that the employee will use the tools or usage plan away from work for business purposes. This has the benefits of convenience, flexibility, increased productivity and cost savings. It also results in reimbursement or reimbursing allowances paid to the employee in relation to the costs of the telecommunications tools and usage plan. There may be a depreciation loss in using these devices. The acquisition cost of any telecommunications tool is not itself a depreciation loss.

1.6 This Determination relates to an arrangement whereby an employer reimburses an employee or employees for the cost of usage plans for telecommunications tools, or the employer reasonably estimates the amount of expenditure and pays a reimbursing allowance. There may also be payments relating to depreciation loss.

1.7 This Determination applies to a variety of arrangements. They may be described as BYOD plans, whereby the employer and employee agree on a reimbursement or a reimbursing allowance for the employee because the employee uses their own telecommunications tools for work.

Arrangements vary and the usage plan may include the supply of telecommunications tools

1.8 The arrangements include variations where the usage plan also involves the supply of a telecommunications tool as part of the plan. The arrangements may vary as to what particular telecommunications tools and usage plans are included. They may vary as to whether there is a reimbursement or a reimbursing allowance in relation to an on-going service plan.

1.9 This Determination operates to allow a percentage of any costs relating to a usage plan or depreciation loss as exempt income. There is also a de minimis acceptable level of payment.

Usage plan only

1.10 The arrangement includes the employer providing the telecommunications tools and then reimbursing the employee for the cost of the employee's usage plan or estimating the amount of reimbursement.

Fringe benefit tax implications are not covered

1.11 FBT implications are not covered by this Determination.

Payment can be made in different ways

1.12 Payment could be made to an employee in a variety of ways. There could be a reimbursing allowance or an exact reimbursement of costs. This Determination applies to these types of payment that cover both business use and private use. Private use could involve allowing household use.

1.13 This Determination does not provide a percentage or reasonable estimate for expenditure on account of an employee.

Employment requirement

1.14 In all cases, the payment is made because the telecommunications tools are required for the employee to do their job. In this respect, the telecommunications tools:

- are used when the employee is performing an obligation required by their employment or service;
- the employee derives employment income through the performance of the obligation;
- the expenditure is necessary in the performance of the obligation.

If payment only meets cost of business use, amount would be fully exempt

1.15 If the reimbursement or a reimbursing allowance can be evidenced as being an amount that does not exceed the actual or reasonable estimate of business use then it would be fully exempt under s CW 17. Depreciation loss would be added to other costs. For example a monthly value for depreciation loss would be added to monthly usage plan costs to establish the total cost for the employee. A reimbursement, including the depreciation loss, that did not exceed the estimate of business use would be fully exempt under s CW 17.

De minimis allowance

1.16 There is also a de minimis allowance when a reimbursement or a reimbursing allowance is no more than $5 per week, or $265 per year, per employee. This level of expenditure is unlikely to involve private use. In such cases, the reimbursing allowance or reimbursement will be exempt income. If this level of expenditure is not exceeded, there is no requirement to hold any evidence in support of the expenditure.

Acquisition cost of telecommunications tools is not covered; an amount of depreciation loss is covered

1.17 The telecommunications tools are likely to be capital assets, and the initial payment for these would not be expenditure on account under s CW 17 because they would be subject to the capital limitation in s DA 2(1). Telecommunications tools are identifiable assets of an enduring benefit. Therefore, the initial cost of the telecommunications tool is excluded when applying this Determination. The usage plan in some cases may include any cost for the telecommunications tools and the cost is effectively paid off over the minimum sign up period. In these cases there is no need to consider depreciation further as the full cost of the usage plan is subject to the relevant percentage for exempt income under Class A or Class B.

1.18 This Determination can include an amount that represents an amount for depreciation of the telecommunications tool. Section CW 17(4) states that for the purposes of s CW 17 expenditure, the expenditure can include an amount of depreciation loss. If the telecommunications tool costs $500 or less, the amount of the depreciation loss is the cost of the tool (see s EE 38).

1.19 Employers may estimate the cost of telecommunications tools for the purpose of depreciation, and then apply the applicable ratio to the estimated depreciation loss. The estimate should be based on the depreciation rates the Commissioner has set.

Class A, Class B and the De Minimis Class are covered

1.20 This Determination covers three classes: Class A, Class B, and the De Minimis Class.

1.21 Under the classes an employer can make a payment or reimbursement in relation to the telecommunication tools and the usage plan or the cost of the usage plan alone.

Class A – telecommunications tools are principally used in employment

1.22 Class A covers arrangements where the telecommunications tools are principally used in employment.

Meaning of "principally used"

1.23 Principally used', the basis for Class A arrangements, means the main or primary use of the telecommunications tools in these arrangements is for use in employment.

Reasonable judgement can be exercised

1.24 As is the case when making an apportionment under s CW17 reasonable judgement must be exercised as to the level of business use and there would be some reasonable evidential basis based on time spent or a staff survey.

1.25 However, it may be difficult to determine the level of use precisely and this Determination is intended to allow less than precise estimation. The employer may rely on some evidence of time spent, or for the purposes of this Determination, an employer may in the absence of any other evidence choose to obtain a signed declaration from an employee that telecommunications tools will be principally used in employment.

1.26 It is expected that the situation would be reviewed periodically to check that the level of use remains the same. A review once every two years would be adequate. If an employer has obtained a signed declaration from an employee that telecommunications tools will be principally used in employment then a review is only required if there has been a material change to the employee's circumstances.

1.27 In some cases, the importance of the employee having access to the telecommunications tools might mean that principal use is established. For example, an employee might need to be available at all times for calls. This factor on its own, does not mean there is principal use of the telecommunications tools for employment purposes. In some cases, data or expected usage could indicate a less than 50% usage, but the importance of availability might be a factor resulting in the principal use test being met.

Implications

1.28 Employers can treat 75% of the amount paid either by reimbursement or by reimbursing allowance for usage plans and depreciation loss (if any) as exempt income of the employee. If employers pay 75% of the total usage charge as reimbursement or allowance, then the whole amount paid by the employer will be exempt.

1.29 If the employer pays a fixed amount per month the employer could obtain a declaration from the employee that the employee's costs are at least 1.33 times the amount of the reimbursing allowance paid. The whole amount paid by the employer will be exempt.

Class B – arrangements where telecommunications tools are required, but not principally used for employment

1.30 Class B covers arrangements where the telecommunications tools are still required for employment, but the tools are not principally used for employment. There must be an employment reason for the use of the telecommunications tools.

1.31 Class B provides a second-tier option. This enables a reduction in the compliance costs involved in the active measurement of use. An employment reason still exists for the use of the telecommunications tools. Employers apply a lesser percentage for exempt income of 25%.

Employment policy is sufficient to show employment-use obligation

1.32 Class B is intended to cover arrangements where there is an employment reason and an obligation for the employee to use the tools, but private use is predominant. An established employment policy related to the use of the tools would be sufficient to establish the obligation. It is expected that there would be actual business use of the tools over time. Access to telecommunications tools is needed, but employment use is not the principal use.

Implications

1.33 Employers can treat 25% of the amount paid either by reimbursement or by reimbursing allowance for usage plans and depreciation loss (if any) as exempt income of the employee. If employers pay 25% of the total usage charge as reimbursement or reimbursing allowance, then the whole amount will be exempt.

1.34 If the employer pays a fixed amount per month, the employer could obtain a declaration from the employee that the employee's costs are at least four times the amount of the reimbursing allowance paid. The whole amount paid by the employer is exempt.

De Minimis Class – minimum payment treated as exempt income

1.35 The De Minimis Class allows for a payment of up to $5 per week, or up to $265 per year, per employee as reimbursement or reimbursing allowance for the cost of a usage plan to be treated as exempt income.

No records necessary

1.36 It is not necessary to support this de minimis level of reimbursement or reimbursing allowance with records.

Implications

1.37 Employers can treat a minor payment as exempt.

Interpretation

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

Unless the context otherwise requires:

- "business use" means use in connection with an employee's employment or service;
- "depreciation loss" means an amount calculated under s CW 17(4). Depreciation loss is calculated using the Commissioner's rates for the items and, if claimed, is counted as part of the $265 per year in relation to de minimis;
- "employee" does not include an independent contractor;
- "principally used" means the main or primary use;
- "reimbursing allowance" is an allowance paid by an employer for expenses that an employee incurs or is likely to incur in connection with their employment. A reimbursing allowance is not necessarily an exact reimbursement of expenditure and may involve an estimate;
- "required to use" means an obligation and a business reason to use;
- "telecommunications tools" includes, telephones, mobile phones, tablets, laptops and personal computers;
- "usage plans" means internet connection, service plans or usage plans in relation to telecommunications tools.

Determination CFC 2019/05: Non-attributing active insurance CFC status (TOWER Insurance Limited)

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

A person has no attributed CFC income or loss from a CFC under sections CQ 2 and DN 2 of the Income Tax Act 2007 if the CFC is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007 because the requirements of sections CQ 2(1)(h) and DN 2(1)(h) are not satisfied.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC is a non-attributing active CFC if it is an insurer that meets the requirements of section 91AAQ of the Tax Administration Act 1994 and the Commissioner makes a determination under that section. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because insurance income is otherwise treated as passive income and an attributable amount under section EX 20B(3) of the Income Tax Act 2007.

Section 91AAQ(1)(a) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of a CFC, if the CFC satisfies subsection (2). Pursuant to section 91AAQ(1)(a) and (6), TOWER Insurance Limited has made an application for a determination in respect of the CFC set out below. TOWER Insurance Limited has a 30 September balance date.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the CFC satisfies the requirements set out in section 91AAQ(2) of the Tax Administration Act 1994 and is accordingly a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of the determination

The CFC to which this determination applies is:

Name	Jurisdiction
TOWER Insurance (Vanuatu) Limited	Vanuatu

Interpretation

In this document, unless the context otherwise requires –

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a "controlled foreign company" as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994, I hereby determine that the above CFC is a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2020 and 2021 income years.

This determination is signed by me this 5th day of December 2019.

Sonya Duncan
Group Lead – Customer Compliance

Determination CFC 2019/04: Non-attributing active insurance CFC status (TOWER Insurance Limited)

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

A person has no attributed CFC income or loss from a CFC under sections CQ 2 and DN 2 of the Income Tax Act 2007 if the CFC is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007 because the requirements of sections CQ 2(1)(h) and DN 2(1)(h) are not satisfied.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC is a non-attributing active CFC if it is an insurer that meets the requirements of section 91AAQ of the Tax Administration Act 1994 and the Commissioner makes a determination under that section. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because insurance income is otherwise treated as passive income and an attributable amount under section EX 20B(3) of the Income Tax Act 2007.

Section 91AAQ(1)(a) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of a CFC, if the CFC satisfies subsection (2). Pursuant to section 91AAQ(1)(a) and (7), TOWER Insurance Limited has made an application to extend an earlier determination in respect of the CFC set out below. TOWER Insurance Limited has a 30 September balance date.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the CFC satisfies the requirements set out in section 91AAQ(2) of the Tax Administration Act 1994 and is accordingly a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of the determination

The CFC to which this determination applies is:

Name	Jurisdiction
National Pacific Insurance (Tonga) Limited	Tonga

Interpretation

In this document, unless the context otherwise requires –

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a "controlled foreign company" as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994, I hereby determine that the above CFC is a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2020 and 2021 income years.

This determination is signed by me this 5th day of December 2019.

Sonya Duncan
Group Lead – Customer Compliance

Determination CFC 2019/03: Non-attributing active insurance CFC status (TOWER Insurance Limited)

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

A person has no attributed CFC income or loss from a CFC under sections CQ 2 and DN 2 of the Income Tax Act 2007 if the CFC is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007 because the requirements of sections CQ 2(1)(h) and DN 2(1)(h) are not satisfied.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC is a non-attributing active CFC if it is an insurer that meets the requirements of section 91AAQ of the Tax Administration Act 1994 and the Commissioner makes a determination under that section. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because insurance income is otherwise treated as passive income and an attributable amount under section EX 20B(3) of the Income Tax Act 2007.

Section 91AAQ(1)(b) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of the members of a group of CFCs, if the members satisfy subsection (3). Pursuant to section 91AAQ(1)(b) and (7), TOWER Insurance Limited has made an application to extend an earlier determination in respect of the members of the group of CFCs set out below. TOWER Insurance Limited has a 30 September balance date.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the members of the group of CFCs satisfy the requirements set out in section 91AAQ(3) of the Tax Administration Act 1994 and are accordingly non-attributing active CFCs for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of the determination

The CFC to which this determination applies is:

Name	Jurisdiction
National Insurance Company (Holdings) Limited	Fiji
TOWER Insurance (Fiji) Limited	Fiji
Southern Pacific Insurance Company (Fiji) Limited	Fiji

Interpretation

In this document, unless the context otherwise requires –

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a Controlled Foreign Company as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994, I hereby determine that the above CFCs are non-attributing active CFCs for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2020 and 2021 income years.

This determination is signed by me this 5th day of December 2019.

Sonya Duncan
Group Lead – Customer Compliance

Determination CFC 2019/02: Non-attributing active insurance CFC status (TOWER Insurance Limited)

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

A person has no attributed CFC income or loss from a CFC under sections CQ 2 and DN 2 of the Income Tax Act 2007 if the CFC is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007 because the requirements of sections CQ 2(1)(h) and DN 2(1)(h) are not satisfied.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC is a non-attributing active CFC if it is an insurer that meets the requirements of section 91AAQ of the Tax Administration Act 1994 and the Commissioner makes a determination under that section. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because insurance income is otherwise treated as passive income and an attributable amount under section EX 20B(3) of the Income Tax Act 2007.

Section 91AAQ(1)(a) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of a CFC, if the CFC satisfies subsection (2). Pursuant to section 91AAQ(1)(a) and (7), TOWER Insurance Limited has made an application to extend an earlier determination in respect of the CFC set out below. TOWER Insurance Limited has a 30 September balance date.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the CFC satisfies the requirements set out in section 91AAQ(2) of the Tax Administration Act 1994 and is accordingly a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of the determination

The CFC to which this determination applies is:

Name	Jurisdiction
TOWER Insurance (PNG) Limited	Papua New Guinea

Interpretation

In this document, unless the context otherwise requires –

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a "controlled foreign company" as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994, I hereby determine that the above CFC is a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2020 and 2021 income years.

This determination is signed by me this 5th day of December 2019.

Sonya Duncan
Group Lead – Customer Compliance

Determination CFC 2019/01: Non-attributing active insurance CFC status (TOWER Insurance Limited)

Reference

This determination is made under section 91AAQ of the Tax Administration Act 1994.

Explanation (which does not form part of the determination)

A person has no attributed CFC income or loss from a CFC under sections CQ 2 and DN 2 of the Income Tax Act 2007 if the CFC is a non-attributing active CFC under section EX 21B of the Income Tax Act 2007 because the requirements of sections CQ 2(1)(h) and DN 2(1)(h) are not satisfied.

Section EX 21B(3) of the Income Tax Act 2007 provides that a CFC is a non-attributing active CFC if it is an insurer that meets the requirements of section 91AAQ of the Tax Administration Act 1994 and the Commissioner makes a determination under that section. In the absence of such a determination, a CFC carrying on an insurance business is unlikely to be a non-attributing active CFC, because insurance income is otherwise treated as passive income and an attributable amount under section EX 20B(3) of the Income Tax Act 2007.

Section 91AAQ(1)(a) of the Tax Administration Act 1994 allows a person to apply to the Commissioner for such a determination in respect of a CFC, if the CFC satisfies subsection (2). Pursuant to section 91AAQ(1)(a) and (7), TOWER Insurance Limited has made an application to extend an earlier determination in respect of the CFC set out below. TOWER Insurance Limited has a 30 September balance date.

It has been determined, having regard to the matters set out in subsections (4) and (5) of section 91AAQ of the Tax Administration Act 1994, that the CFC satisfies the requirements set out in section 91AAQ(2) of the Tax Administration Act 1994 and is accordingly a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Scope of the determination

The CFC to which this determination applies is:

Name	Jurisdiction
TOWER Insurance (Cook Islands) Limited	Cook Islands

Interpretation

In this document, unless the context otherwise requires –

"Attributed CFC income or loss" means attributed CFC income under section CQ 2 or attributed CFC loss under section DN 2 of the Income Tax Act 2007.

"CFC" means a "controlled foreign company" as defined in section YA 1 of the Income Tax Act 2007.

"Non-attributing active CFC" means a non-attributing active CFC under section EX 21B of the Income Tax Act 2007.

Determination

Pursuant to section 91AAQ of the Tax Administration Act 1994, I hereby determine that the above CFC is a non-attributing active CFC for the purposes of section EX 21B of the Income Tax Act 2007.

Application date

This determination applies for the 2020 and 2021 income years.

This determination is signed by me this 5th day of December 2019.

Sonya Duncan
Group Lead – Customer Compliance

BINDING 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 19/05: Income tax – treatment of alteration to rights attached to shares under section CB 4

This is a reissue of BR Pub 17/04. For more information about the earlier publication of this Public Ruling see the Commentary to this Ruling.

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

Taxation Law

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

This Ruling is about how s CB 4 applies to the Arrangement.

The Arrangement to which this Ruling applies

The Arrangement is where a shareholder holds shares in a company and the shares were acquired for the purpose of disposal. Subsequently, the rights attached to the shares are altered and the following apply:

- The shares are in a company registered under the Companies Act 1993.
- The alteration is not structured as a cancellation and issue of shares.

For the avoidance of doubt, the Arrangement does not include an arrangement where s BG 1 applies to void the arrangement.

How the taxation law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

- The alteration of rights attached to the shares does not result in a disposal of personal property for the purposes of s CB 4.

The period or tax year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on 1 April 2020.

This Ruling is signed by me on 5 December 2019.

Susan Price
Director, Public Rulings

BR Pub 19/06: Income tax – treatment of a disposal of shares with altered rights under section CB 4

This is a reissue of BR Pub 17/05. For more information about the earlier publication of this Public Ruling see the Commentary to this Ruling.

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

Taxation law

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

This Ruling is about how s CB 4 applies to the Arrangement.

The Arrangement to which this Ruling applies

The Arrangement is where a shareholder holds shares in a company and the shares were acquired for the purpose of disposal. Subsequently, the rights attached to the shares are altered and the following apply:

- The shares are in a company registered under the Companies Act 1993.
- The alteration is not structured as a cancellation and issue of shares.
- After the alteration, the shareholder disposes of some or all of their shares with altered rights.

For the avoidance of doubt, the Arrangement does not include an arrangement where s BG 1 applies to void the arrangement.

How the taxation law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

- Section CB 4 applies to the disposal of shares with altered rights.
- The time of acquisition of a share with altered rights held on revenue account is the time the share was acquired before the alteration.

The period or tax year for which this Ruling applies

This Ruling will apply for an indefinite period beginning on 1 April 2020.

This Ruling is signed by me on 5 December 2019.

Susan Price
Director, Public Rulings

Commentary on public rulings BR Pub 19/05 and BR Pub 19/06

This commentary is not a legally binding statement. The commentary is intended to help readers understand and apply the conclusions reached in Public Rulings BR Pub 19/05 and BR Pub 19/06 ("the Rulings").

Legislative references are to the Income Tax Act 2007 unless otherwise stated. References to the CA 1993 are to the Companies Act 1993.

Summary

1. The Rulings consider two situations. The situations represent two points in time at which s CB 4 could apply when share rights are altered, namely when the:
   - rights are altered; and
   - shares with altered rights are disposed of.
2. Whether s CB 4 applies in these situations depends on whether the shares with altered rights are the same property as the shares before the alteration.

3. A basis sometimes put forward for shares with fundamentally altered rights being different property is the contractual doctrine of rescission. In the case of alterations provided for in the terms on which the shares were issued, the alteration would be pursuant to the original contract, so the contractual doctrine of rescission would not apply. For the contractual doctrine of rescission to be relevant in other cases, there must be a contract. This makes the nature of a share, and whether share rights are conferred by contract, relevant in determining whether shares with altered rights are the same property as the shares before the alteration. It is also relevant to consider the rules in the Companies Act 1993 (CA 1993) for the issue and cancellation of shares and the altering of share rights.
4. The Commissioner considers that shares with altered rights are the same property as the shares before the alteration for the purposes of s CB 4 for four reasons:
    - The rights and obligations comprising a share are not conferred by contract, so the contractual doctrine of rescission is not relevant.
    - Based on the rules in the CA 1993 for the issue and cancellation of shares and the altering of share rights, there is no cancellation and issue of shares by implication when share rights alter.
    - When share rights alter, at no point does a shareholder lose control of their shares and have only a right to receive shares, such as may be the case when shares are cancelled and new shares are issued.
    - Altering share rights does not involve property moving from the company to the shareholders. The alteration merely alters the shareholders' existing rights against the company.
5. Accordingly, the alteration of rights attached to shares (share rights) does not result in a disposal of any shares for the purposes of s CB 4. The shares continue in existence with altered rights. The Commissioner considers that this will be the case whether there is a minor change, or a complete change of class.
6. When a shareholder who acquired the shares on revenue account before the alteration disposes of the shares after the alteration, s CB 4 will apply to the disposal. This is because the shares with altered rights are the same property as the shares before the alteration. Therefore, the time of acquisition of the shares with altered rights is the time the shares were acquired before the alteration.
7. While an alteration of share rights will not result in a disposal of a share, it may have an effect on shareholder continuity.
8. If a change in the rights attached to a share is effected by cancelling the old share and issuing a new share, there will be a disposal for the purposes of s CB 4 when the share is cancelled.

Background

9. BR Pub 19/05 and BR Pub 19/06 are reissues of BR Pub 17/04 and BR Pub 17/05, respectively. There are no changes to the Commissioner's view of the application of s CB 4 to the Arrangement.

Application of the legislation

10. Under s CB 4, an amount that a person derives from disposing of personal property is income of the person if they acquired the property for the purpose of disposing of it:

    CB 4 Personal property acquired for purpose of disposal

    An amount that a person derives from disposing of personal property is income of the person if they acquired the property for the purpose of disposing of it.
11. Shares are a type of personal property: s 35 of the CA 1993.
12. Shares confer rights on shareholders: s 36(1) of the CA 1993. The rights can be altered by the constitution of the company, if any, or the terms on which the shares were issued: s 36(2) of the CA 1993. Altering share rights may be referred to as alterations, share reclassifications or share reorganisations.
13. Questions arise as to the application of s CB 4 where share rights alter and when a shareholder disposes of shares with altered rights. The Rulings consider two points in time at which s CB 4 could apply when share rights are altered, namely when the:
    - rights are altered;
    - shares with altered rights are disposed of.
14. Whether s CB 4 applies in these situations depends on whether the shares with altered rights are the same property as the shares before the alteration.

Can the shares with altered rights be regarded as the same property as the shares before the alteration?

15. Two broad requirements of s CB 4 must be satisfied. If these requirements are met, an amount that the person derives from disposing of the personal property is income of the person. The first requirement is that a person acquires personal property for the purpose of disposing of it. The second requirement is that the person disposes of the personal property.
16. The grammatical construction of s CB 4 shows that the property disposed of must be the same property as that acquired. When share rights alter, the question arises whether the shares are the same property as the shares before the alteration. The answer to this question will also assist in determining the time of acquisition of the shares with altered rights for the purposes of s CB 4. In determining whether the shares with altered rights are the same property as the shares before the alteration, it is helpful to ask two questions:
    - What is the nature of a share?
    - Are shares disposed of when rights attached to them alter?

What is the nature of a share?

17. Section 36(1) of the CA 1993 sets out the basic rights and powers that attach to shares. The basic rights and powers include the right for the shareholder to vote at a meeting of the company on any resolution, the right to an equal share in dividends authorised by the board, and the right to an equal share in the distribution of surplus assets of the company. The rights may be negated, altered or added to by the constitution of the company, if there is one, or under the terms on which the shares were issued: s 36(2) of the CA 1993.
18. A company may issue different classes of shares: s 37(2) of the CA 1993. "Class" means a class of shares having identical rights, privileges, limitations and conditions attached to them: s 116(1) of the CA 1993.
19. It is generally accepted that a share is a bundle of rights and obligations between the shareholders and the company: *Borland's Trustee v Steel Brothers & Co Ltd* [1901] 1 Ch 279; *Bradbury v English Sewing Cotton Ltd* [1923] AC 744 (HL); *IRC v Laird Group plc* [2003] UKHL 54. This was confirmed by the New Zealand Court of Appeal in *Robertson v Bicknell* [2002] BCL 408 (CA). In *Robertson* at [23], the Court also confirmed that the nature of the property in a share is the interest of a person in the company, that interest comprising various rights and obligations.
20. A shareholder does not have a proprietary right or interest in the assets of a company. A shareholder has been said to be entitled to a proportion of the company's share capital, with reference to which the shareholder has certain rights: *Archibald Howie v Commr of Stamp Duties (NSW)* (1948) 77 CLR 143 at 156.
21. The property comprising a share encompasses all of the rights and obligations attached to the share. A shareholder does not own each share right as a separate piece of property: *In re Alex Russell (deceased)* [1968] VR 285 at 299.
22. Previously, under the Companies Act 1955 (CA 1955), the memorandum and articles of a company were deemed to be a contract between the company and its shareholders: s 34 of the CA 1955. However, the CA 1993 replaced the contractual model in the CA 1955: *Maori Development Corp Ltd v Power Beat International Ltd* [1995] 2 NZLR 568 (HC). The relationship between a company and its shareholders is now statutory: ss 31 and 38 of the CA 1993.
23. Obiter dicta in some cases decided under the CA 1993 suggest the relationship between a company and its shareholders remains a contractual one: *Ord v Calan Healthcare Properties Ltd* [2004] 2 NZLR 122 (HC); T*odd Petroleum Mining Co Ltd v Shell (Petroleum Mining) Co Ltd* (2005) 2 NZCCLR 266 (HC); *Herzog v Hertli* (HC Blenheim CIV-2007-406-251, 23 March 2009); *Manak v Hutt & City Taxis Ltd* [2009] NZCCLR 36 (HC). However, in *Maori Development Corp*, s 31 of the CA 1993 was specifically referred to and considered. Blanchard J said, at 574, that the contractual model in the CA 1955 had been replaced by the statutory statement in s 31 of the CA 1993.
24. Blanchard J's view is supported by statements made by the New Zealand Law Commission on the form and content of a new Companies Act in *Company Law Reform and Restatement* (NZLC R9, New Zealand Law Commission, Wellington, June 1989). In that report, at 1, the Commission said that one of the most significant proposed reforms was to redefine "the distribution of power within the company by direct operation of statute rather than by a deemed contract". The Commission said, at 19, that "[t]he standard constitution, and any modification of it, should confer rights directly and not, as the [CA 1955] provides, by deeming the constitutional documents to be a contract". Also, the Explanatory Note to the Companies Bill introduced on 21 September 1990 stated, at ii, that a purpose of the Bill was to redefine "the distribution of power within the company by direct operation of statute rather than by a deemed contract".

25. The change from the contractual model of the CA 1955 is important. This is because under the contractual model, fundamentally altering the share rights may have amounted to rescission of a contract and the entering into of a new one and, by implication, a cancellation of the shares and the issue of new ones. This would not have been the case, though, if the alteration arose from the terms of the shares themselves or the articles of association of the company (or constitution in the case of the CA 1993). However, given the statutory basis of shares under the CA 1993, the contractual doctrine of rescission is not relevant. Whether the shares are cancelled and new ones are issued depends on the operation of the CA 1993 and the company's constitution, if any.
26. The Commissioner considers that the relationship between a company and its shareholders is statutory. The Commissioner has previously considered the nature of shares: "Public Rulings BR Pub 16/05: Income tax – Treatment of a subdivision of shares under section CB 4 and BR Pub 16/06: Income tax – Treatment of a disposal of subdivided shares under s CB 4", *Tax Information Bulletin* Vol 28, No 5 (June 2016): 3-5. The Commentary on BR Pub 16/05 and BR Pub 16/06 states that it is generally accepted that a share is a bundle of rights and obligations conferred under a contract between the shareholders and the company. To the extent that the Commentary on BR Pub 16/05 and BR Pub 16/06 suggests the relationship between a company and its shareholders is contractual, it is incorrect. The Commentary to these Public Rulings (BR Pub 19/05 and BR Pub 19/06) should be relied on as setting out the Commissioner's view on the nature of a share and the relationship between a company and its shareholders.

Are shares disposed of when the rights attached to them alter?

27. "Dispose" is not defined in s YA 1 for the purposes of s CB 4 (it is defined for the purposes of other sections in the Act, but these definitions do not assist in this inquiry). The courts have held that, speaking generally, "disposed of" covers all forms of alienation and carries connotations of sale, assignment, or transfer of the property: *FCT v Wade* (1951) 84 CLR 105; *Lyttelton Port Co Ltd v CIR* (1996) 17 NZTC 12,556 (HC). "Disposition" has been said to mean "a ridding oneself of the right or interest": *Coles Myer Ltd v Commr of State Revenue (Vic)* 98 ATC 4537 (VSCA) at 4,546. As a result, the Commissioner considers that "disposing" of property must involve the alienation or ridding of that property by the disposer.
28. If there is a cancellation and issue of shares by implication when share rights alter, then that would indicate that shares have been disposed of and that the shares with altered rights are different property from the shares before the alteration.
29. The CA 1993 provides comprehensive rules for the issue and cancellation of shares, and the altering of share rights.
30. Section 36(2) of the CA 1993 provides that the rights and powers attached to shares may be negated, altered or added to by the constitution of the company or in accordance with the terms on which the shares were issued. A company is not required to have a constitution, although it may adopt one by special resolution: ss 26 and 32 of the CA 1993. If a company does not have a constitution, the company, its board and each of its directors and shareholders have the rights, powers, duties and obligations set out in the CA 1993: s 28 of the CA 1993. If a company does not have a constitution, the rights attached to its shares can be altered only in accordance with the terms on which the shares were issued.
31. Sections 117 and 118 of the CA 1993 provide certain rules regarding the alteration of shareholder rights. Section 117(1) of the CA 1993 provides that a company must not take action that affects share rights unless that action has been approved by shareholders whose rights are affected. Section 118 of the CA 1993 gives dissenting shareholders the right to require the company to purchase their shares.
32. The issue of shares is dealt with in ss 41–51 of the CA 1993. The issue of shares has been described as the whole process whereby unissued shares are applied for, allotted and, finally, registered: *National Westminster Bank plc v IRC* [1994] 3 All ER 1 (HL). Section 42 of the CA 1993 provides that, subject to the CA 1993 and the constitution of the company, if any, a company may issue shares at any time, to any person and in any number it thinks fit. On the face of it, this is a very broad power. However, the right to issue shares is subject to requirements in other provisions of the CA 1993, such as the registration of notice of a share issue and the obtaining of shareholder approval in certain circumstances: ss 43 and 44 of the CA 1993. Section 107(2) of the CA 1993 provides that shares may be issued otherwise than in accordance with some of these requirements, if all entitled persons agree or concur. Section 51 provides that a share is issued when the name of the holder is entered on the share register.
33. Sections 58–67 of the CA 1993 deal with the acquisition by a company of its own shares and their deemed cancellation. Section 59 provides that a company may acquire its own shares if permitted by its constitution, if any. Generally, any shares so acquired are deemed to be cancelled immediately on acquisition: s 66 of the CA 1993. A company must comply with procedural requirements when acquiring its own shares, such as meeting a solvency test and registration of a notice of the acquisition: ss 58 and 59 of the CA 1993.

34. Sections 68–75 of the CA 1993 deal with the redemption of shares and their deemed cancellation. Section 68 provides that shares are redeemable if:
    - the constitution of the company makes provision for the issue of redeemable shares, and
    - the constitution or the terms of issue of the shares makes provision for the redemption of the shares for a consideration that is specified or calculated by a formula or suitably qualified person.
35. Shares that a company redeems are deemed to be cancelled immediately on redemption: s 73 of the CA 1993. A company must comply with procedural requirements when redeeming shares, such as board resolutions and meeting a solvency test in certain circumstances: ss 69 and 70 of the CA 1993.
36. The separate rules in the CA 1993 for the issue and cancellation of shares, and the altering of share rights, make it seem unlikely that an alteration of share rights by the company's constitution, if any, or the terms on which the shares are issued will involve the cancellation and issue of shares by implication.
37. Further, s 83 of the CA 1993 provides for a statement of rights to be given to shareholders, on request. Section 83(2) provides that the company does not have to provide a shareholder with such a statement in certain circumstances, including if a statement has been provided within the previous six months and:
    - the shareholder has not acquired or disposed of shares since the previous statement was provided (s 83(2)(b) of the CA 1993); and
    - the rights attached to shares of the company have not been altered since the previous statement was provided (s 83(2)(c) of the CA 1993).
38. The relevance of s 83(2) of the CA 1993 is the distinction that Parliament has drawn between the acquisition of shares and the alteration of share rights. It is apparent from s 83(2) of the CA 1993 that Parliament regarded the acquisition of shares and the alteration to share rights as different things.
39. Based on the rules in the CA 1993 for the issue and cancellation of shares and the altering of share rights, the Commissioner considers that there is no cancellation and issue of shares by implication when share rights alter. This will be the case whether there is a minor change, or a complete change of class.
40. There are other indications that shares are not disposed of when share rights alter. One such indication is that when share rights alter there is no point at which a shareholder loses control of their shares and has only a right to receive shares, such as may be the case when shares are cancelled and new shares are issued.
41. Another is that altering share rights does not involve property moving from the company to the shareholders. The alteration merely alters the shareholders' existing rights against the company: *Robertson v FCT* (1952) 86 CLR 463.

Conclusion

42. The Commissioner considers that shares with altered rights are the same property as the shares before the alteration for the purposes of s CB 4 for four reasons:
    - The rights and obligations comprising a share are not conferred by contract, so the contractual doctrine of rescission is not relevant.
    - Based on the separate rules in the CA 1993 for the issue and cancellation of shares and the altering of share rights, there is no cancellation and issue of shares by implication when share rights alter.
    - When share rights alter there is no point at which a shareholder loses control of their shares and has only a right to receive shares, such as may be the case when shares are cancelled and new shares are issued.
    - Altering share rights does not involve property moving from the company to the shareholders. The alteration merely alters the shareholders' existing rights against the company.
43. This conclusion is consistent with Interpretation Statement "Available subscribed capital – Consequences of deemed reregistration", *Tax Information Bulletin* Vol 10, No 7 (July 1998): 8, which considers the consequences of share reclassifications on available subscribed capital.
44. While the altered shares will be the same property, it is noted that any change to the "voting rights" (defined in s YC 2) attached to shares may affect shareholder continuity for the purposes of determining whether losses and imputation credits can be carried forward. It is also noted that s GB 34 (ICA arrangements for carrying amounts forward) may apply in some circumstances if voting rights are altered.

Does s CB 4 apply at the time share rights are altered?

45. When share rights alter, the Commissioner considers that the shareholder does not alienate, rid themselves of, or otherwise lose control of their shares. Shares with altered rights are the same property as the shares before the alteration. Given this, the Commissioner considers s CB 4 does not apply at the time share rights are altered.

Does s CB 4 apply at the time shares with altered rights are disposed of?

46. An amount derived by a person on the disposal of shares with altered rights, where the shares were acquired before the alteration for the purpose of disposal, will be income of the person under s CB 4. Conversely, s CB 4 will not apply to an amount derived by a person on the disposal of the shares where the shares were not acquired before the alteration for the purpose of disposal. This is because the shares held by the person after the rights attached to the shares have been altered are the same property as the shares held by the person before the alteration.

What is the time of acquisition for shares with altered rights held on revenue account?

47. Given that the shares with altered rights are the same property as the shares before the alteration, the Commissioner considers that the time of acquisition of the shares with altered rights is the time the shares were acquired before the alteration.

Examples

48. The following examples are included to help explain the application of the law.

Example 1 — shares acquired for the purpose of disposal

49. On 15 May 2018, Shani purchased 1,000 shares in Red Packaging Ltd (RPL) for $10 per share. Shani acquired the shares for the purpose of disposing of them. Therefore, Shani holds these shares on revenue account.

50. The directors of RPL decide to create a new class of share with preferential rights to dividends and limited voting rights. The rights attached to half of RPL's issued shares will be altered to create the new class of share. Five hundred of Shani's shares will have their rights altered and become part of the new class of shares. The alteration has been approved by interested shareholders.

51. The alteration occurs on 30 July 2019. Shani's shares are not formally cancelled or redeemed; nor are any new shares issued. Section CB 4 will not apply at this time because Shani has not disposed of anything.

52. On 15 August 2019, Shani sells all of her shares in RPL for $15,000. At this point, the requirements of s CB 4 have been met. Shani has derived an amount from the disposal of property that she acquired for the purpose of disposal. As a result, Shani will have derived income of $15,000 on the sale of the shares. She will be allowed a deduction of $10,000 under s DB 23 for the cost of the shares in RPL, this being the amount she incurred when the shares were acquired on 15 May 2019.

Example 2 — shares not acquired for purpose of disposal

53. On 10 April 2018, Blue Ltd purchased 100 shares in Orange Transport Ltd (OTL) as a long-term investment. The shares carry preferential rights to dividends and have limited voting rights. The directors of OTL proposed that the rights attached to the shares be altered on 1 June 2019 so as to attract ordinary rights to dividends and full voting rights. Blue Ltd is among the majority of shareholders who vote in favour of the alteration. The shares are not formally cancelled or redeemed; nor are any new shares issued. Section CB 4 will not apply on 1 June 2019 when the share rights alter because Blue Ltd has not disposed of anything.

54. On 1 October 2019, due to a change in investment strategy, Blue Ltd decides to sell its shares in OTL. Section CB 4 will not apply to the amount that Blue Ltd derives on the disposal of its shares in OTL. This is because, even though Blue Ltd voted in favour of the alteration to share rights, the shares with altered rights are the same property as the shares before the alteration. When Blue Ltd acquired the shares on 10 April 2018, it did not have a purpose of disposing of them.

References

Subject references

Alteration of rights attached to shares
Cancellation and issue of shares
Disposal
Personal property
Shares

Legislative references

Companies Act 1955, s 34
Companies Act 1993, ss 26-28, 31, 32, 35-38, 41-51, 58-75, 83, 107, 116-119
Income Tax Act 2007, s CB 4

Case references

Alex Russell (deceased), In re [1968] VR 285
Archibald Howie v Commr of Stamp Duties (NSW) (1948) 77 CLR 143
Borland's Trustee v Steel Brothers & Co Ltd [1901] 1 Ch 279
Bradbury v English Sewing Cotton Ltd [1923] AC 744 (HL)
Coles Myer Ltd v Commr of State Revenue (Vic) 98 ATC 4537 (VSCA)
FCT v Wade (1951) 84 CLR 105
Herzog v Hertli (HC Blenheim CIV-2007-406-251, 23 March 2009)
IR Commrs v Laird Group plc [2003] UKHL 54
Lyttelton Port Co Ltd v CIR (1996) 17 NZTC 12,556 (HC)
Manak v Hutt & City Taxis Ltd [2009] NZCCLR 36 (HC)
Maori Development Corp Ltd v Power Beat International Ltd [1995] 2 NZLR 568 (HC)
National Westminster Bank plc v IRC [1994] 3 All ER 1 (HL)
Ord v Calan Healthcare Properties Ltd [2004] 2 NZLR 122 (HC)
Robertson v Bicknell [2002] BCL 408 (CA)
Robertson v FCT (1952) 86 CLR 463
Todd Petroleum Mining Co Ltd v Shell (Petroleum Mining) Co Ltd (2005) 2 NZCCLR 266 (HC)

Other references

Company Law Reform and Restatement (NZLC R9, New Zealand Law Commission, Wellington, 1989)
Interpretation Statement "Available subscribed capital – Consequences of deemed reregistration", *Tax Information Bulletin* Vol 10, No 7 (July 1998): 8
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"Public Ruling – BR Pub 17/04 and 17/05: Income tax – treatment of alteration to rights attached to shares under section CB 4", *Tax Information Bulletin* Vol 29, No 5 (June 2017): 8-15

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 19/04: Income tax – distributions from foreign trusts

All legislative references are to the Income Tax Act 2007 unless otherwise stated. Relevant legislative provisions are reproduced in Appendix B to this Interpretation Statement.

Scope of this statement

1. This Interpretation Statement considers the income tax treatment of amounts of money or property transferred to New Zealand resident taxpayers by a person overseas, including through inheritance. It addresses how to determine whether the person who transfers the money or property is a trustee of a trust and when a taxpayer will have derived either beneficiary income or a taxable distribution from a foreign trust.

Key terms

2. This item discusses issues using several terms that may be unfamiliar to some readers. The following brief glossary is intended to assist by describing a few of these terms in a general way:

   Administrators are appointed by the court to administer an estate.

   Assent describes what occurs at the point of administration of an estate when, either expressly or by implication, personal representatives accept that estate property can be distributed or should be held on trust.

   Bare trust is a trust where the trustee has no duties to perform (aside from guarding the property) beyond transferring trust property to a beneficiary when required to do so. A bare trust is treated in the same way as a nominee for tax purposes.

   Beneficiary income is income derived by a trustee but vested in or paid to a beneficiary in the same year or soon after.

   Civil law countries have legal systems based on Roman civil law or law other than English law.

   Common law countries are countries where the legal system is based on English law rather than Roman civil law or other law.

   Corpus is the value (at the time of settlement) of property settled on a trust.

   Executors are appointed by a testator (a person who makes a will) to carry out the instructions in the will.

   Foreign trust means a trust that has had no New Zealand resident settlor.

   Non-discretionary trust is a trust where trustees have no discretion as to various matters for distributions to beneficiaries.

   Ordering rules are the rules in s HC 16 that specify what various elements of a distribution are to be treated as consisting of and in what order.

   Personal representatives are executors or administrators.

   Settlor is someone who transfers value to a trustee.

   Taxable distributions are transfers of value to beneficiaries by trustees of foreign and non-complying trusts other than of things listed in s HC 15 (such as beneficiary income and corpus).

   Trust is not a description of an entity but a description of an obligation on someone to hold property for beneficiaries or objects (as discussed in this item).

   Trustee income is income derived by a trustee that is not beneficiary income.

Summary

3. New Zealand residents are generally liable to income tax on income derived from sources in New Zealand and worldwide. Their assessable income includes money or property transferred to them by someone offshore as "beneficiary income" or a "taxable distribution from a foreign trust".

4. Both concepts require that the money or property comes from a "trust" as that term is interpreted for New Zealand tax law purposes. It follows that the person transferring must have held the money or property according to arrangements where the essential features of a trust under New Zealand law are present. The money or property must have been held by the person as trust property with an equitable obligation to deal with it for the benefit of a person or charitable object. Whether such an obligation exists turns on there being circumstances that give rise to something that would be within the concept of a trust were the issue to be decided under New Zealand law. Wherever in the world property is situated, if the legal basis on which it is owned or controlled and the surrounding circumstances are such that there are obligations that New Zealand law would recognise as trust obligations, then there is a trust. This is the case whether the law of another country would recognise the situation as a trust or not and whether the trust law of another country is the same as trust law here or not (see [30]-[32]).

5. Where a trust exists (unless it is a "bare" trust – see [188] to [195] below), a distribution from it will be "beneficiary income" if it is current year income derived by trustees but paid to a beneficiary in the income year (or within the extended time period provided by s HC 6(1B)).

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

7. A transfer to a person as beneficiary of a foreign trust is a taxable distribution (unless it is current year income) if it is not within an exception in s HC 15(4) (such as for corpus and certain capital gains). However, the ordering rules in s HC 16 (see [143]) may apply and may override what would normally be the character of components of the distribution based on the terms of the trust or the description given of the distribution by the trust. To apply the ordering rules, good financial records for the trust are required, and the onus will be on the beneficiary to obtain that information.

8. An important exception to the requirement to apply the ordering rules is for distributions from non-discretionary trusts created by will or arising after intestacy (see [145]).

9. Where the money or property transferred to a resident is an inheritance, it may be subject to tax if a foreign trust arises following administration of the deceased's estate. This is unlikely to be the case (although it is possible) where the deceased was in a country that does not have the concept of a trust as part of its law. Where an inheritance does not come from a trust, there can still be New Zealand tax consequences for income that may be treated as derived by the inheritor from date of death because the law in the country concerned provides for immediate succession on death.

10. For estate administration in countries with legal systems like New Zealand's, once personal representatives have ascertained the property available for distribution (residue), they either transfer it to beneficiaries or they vest it in someone acting in the capacity of trustee. Until they have assented to such transfer or vesting, the personal representatives have the legal and beneficial interests in the property comprising the estate and any trust provided for in the terms of a will (a testamentary trust) or under the rules governing an intestacy will not arise.

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

12. A bare trust may mark the interval between assent and any beneficiary under the will taking legal title. Where a trust following assent is a bare trust, there is effectively no trust for tax purposes.

13. In contrast, testamentary trusts can take the form of express trusts, life interests and minority interests (see [41]-[43]) and will not be bare trusts.

14. When a trust arises from a deceased estate offshore, as for other foreign trusts outside the context of deceased estates, amounts subsequently distributed to beneficiaries in New Zealand may be beneficiary income or taxable distributions. Such amounts derived by an individual will not have income tax deducted at source and so will not be "reportable income" included as pre-populated income information for the automatically calculated assessments made and included in the individual's tax return each year. It will need to be included separately as "other income" in the individual's tax return.

Introduction

15. In general terms, under New Zealand's approach to taxation, residents are taxable on their worldwide income, and non-residents are taxed on New Zealand-sourced income: s BD 1(5).
16. Beneficiary income and taxable distributions from foreign trusts are income of a New Zealand tax resident. Determining whether money or property transferred to a resident is subject to tax as beneficiary income or a taxable distribution is often not simple. It requires consideration of all the circumstances of the transfer to the resident and the possible application of rules (ordering rules) that can override what might appear otherwise to be the nature of the transfer.
17. Thought should be given to the possibility of income from a trust being derived whenever money or property has been transferred to a New Zealand tax resident by someone who is a non-resident. Trust income can arise wherever in the world the money or property may be situated and in a wide variety of trust arrangements. For example, taxable amounts might be received from a trust established by a relative who has never had any connection to New Zealand, or they might come from a trust settled offshore before a resident migrated to New Zealand. Trust income may arise when it is not immediately obvious that an amount has come from a trust.
18. Sometimes the result can be tax on distributions of assets from the overseas estate of a deceased person to a beneficiary of the estate. It does not necessarily follow from money or property being inherited and received from someone overseas that there is no tax liability. It also makes no difference that something might be described as a "gift" or a "bequest".
19. Whether an amount is taxable can be difficult to determine and may depend on information that is hard for taxpayers to obtain. The tax treatment of amounts can depend on activity by the trustees since the trust began, and inadequate records of this activity can have the consequence of a distribution being treated as taxable (s HC 15(7) – see [147]). Further, the introduction of Common Reporting Standard and Automatic Exchange of Information arrangements means Inland Revenue is likely to have more information than it had in the past about amounts that are transferred to New Zealand tax residents from offshore trusts. The Commissioner, therefore, considers the guidance in this Interpretation Statement will be both useful and timely.
20. Note that this Interpretation Statement is not specifically concerned with trusts that might be affected by the foreign trust registration and disclosure requirements introduced early in 2017 (s 59B of the Tax Administration Act 1994 and s HC 26 of the Income Tax Act are the main provisions), which are often referred to as "New Zealand foreign trusts". They are a subset of foreign trusts that have a non-resident settlor, have at least one New Zealand resident trustee and enjoy an exemption from tax on foreign-sourced trustee income under s HC 26. The connection to New Zealand of most of this subset of trusts is simply having trustees here, so few are likely to make distributions to New Zealand residents. However, a distribution by such a trust to a New Zealand resident is covered by the discussion in this Interpretation Statement.

Discussion

Taxing beneficiary income and taxable distributions

21. This Interpretation Statement concerns the tax rules that apply when a New Zealand tax resident inherits or receives a distribution of money or property from someone overseas.
22. The money or property may be in New Zealand or in another country but if the transfer of money or property is from a trust, a potential tax liability arises for the New Zealand resident.
23. The tax rules applicable are discussed in more detail in Appendix A, but the tax liability will arise because the resident derives income in the form of beneficiary income or a taxable distribution.
24. Whether amounts are beneficiary income or taxable distributions depends on establishing whether the money or property comes from a trust.

Whether an arrangement is a "trust"

25. It will not always be clear that money or property is transferred from a trust.
26. Often, there will be a trust deed and an acknowledgement by the person who transfers property that they are transferring as a trustee. This acknowledgment will usually indicate the existence of a trust and the making of a distribution by a trust.
27. However, there may be circumstances creating doubt that the transfer is from a "trust". For instance, some countries (such as civil law jurisdictions like France and Germany) do not have the legal concept of a trust. Also, some countries do not have the same laws concerning the establishment and validity of trusts or the administration of estates as we have in New Zealand.

28. Situations like this make it important to understand what is meant by the word "trust".

29. Where the issue is whether money or property transferred to New Zealand residents by trusts should be treated as income, the starting point will be the application of the trust rules in the tax legislation. These rules apply where a "trust" exists. The question is the interpretation to be given to the word "trust" in the legislation.

30. For reasons set out in more detail in Appendix A (see [101]-[134]), it is considered that the word "trust" in tax law has the meaning that it has under New Zealand general law. This meaning is that a trust is not an entity but a description of an equitable obligation the law imposes on a person holding property to deal with that property in a certain way; namely, for the benefit of beneficiaries or a charitable purpose. Circumstances will be found to give rise to a trust only where there is such a person (the trustee(s)), property that can be the subject of the trust, someone (one or more beneficiaries) for whose benefit the property is held and where the law imposes the required obligation. It is an objective exercise to determine whether a trust exists and a court is likely to take account of the provisions of the Trusts Act 2019 which is intended to align with common law and equity while not being a code.

31. Money or property transferred to a New Zealand resident will, therefore, come from a trust when there exists an arrangement, the true nature of which is that the person transferring had a fiduciary obligation to hold property for the benefit of a person or an object. Whether such an obligation exists, turns on there being circumstances that give rise to something that has the essential features of a trust under New Zealand law; namely that a person (trustee) holds trust property and has an equitable obligation to deal with the property for the benefit of the beneficiaries or for a charitable purpose. Wherever in the world property is situated, if the legal basis on which it is owned or controlled and the surrounding circumstances are such that there are obligations that New Zealand law would recognise as trust obligations, then a trust exists for tax legislation purposes.

32. Under the laws of countries like Australia, the United Kingdom and Canada, what amounts to a trust is very similar to the position in New Zealand. However, a trust may exist whether the law of another country would recognise the arrangement as a trust or not and whether the trust law of another country is the same as trust law here or not. The law of trusts varies between countries, so where the circumstances are such that they would give rise to a trust that is valid in another country under that country's law but that arrangement would not be a trust under New Zealand law, the trust rules will not apply. It is also possible that an arrangement may be considered a trust for New Zealand tax purposes and not be considered a trust under the laws of another country. This may be the case despite the concept of trusts not even being part of the law of such a country, as is the case for civil law countries.

Deceased estates – when an inheritance will be a distribution from a trust

33. A New Zealand resident inheriting money or property on the death of someone overseas will often not have a tax liability for having derived beneficiary income or a taxable distribution from a trust. There may be several reasons for this.

34. First, no part of an inheritance may be a distribution from a trust because the administration of the estate does not give rise to a trust that includes the money or property in question. Or, secondly, as discussed from [190], money or property often ends up being held on a "bare trust" that will not be recognised as a trust for tax purposes. In that situation, income generated by the property while held on bare trust will be treated as income of the beneficiary, but the transfer of the property itself will not give rise to a tax liability under the trust rules.

35. Further, and even if the inheritance is received from a trust arising in the administration of a deceased estate, it may not be a taxable distribution when the trust rules are applied. Perhaps the ordering rules do not apply or, if they do apply, the ordering rules do not require the distribution to be treated as taxable.

36. However, an express trust may be provided for in a will or contingencies may give rise to a trust in some circumstances. Such a trust arising in the administration of the estate of a deceased person overseas means a possible tax liability for a person receiving a distribution.

37. A trust arising in the administration of an estate is a trust that the trust rules apply to in the same way as any other trust. It follows that when a New Zealand tax resident receives or becomes entitled to money or property from an executor or administrator (personal representative) of a non-resident deceased person's estate, an important question is whether the personal representative is distributing as a trustee of a trust.

38. Just as when any property is transferred by someone overseas to someone in New Zealand, it is important to identify whether the circumstances are such that the estate property is held on a trust, whether this is a foreign trust and whether the distribution is a taxable distribution or beneficiary income.

39. As to whether the estate is held on trust, that will be when the legal basis on which what is distributed is owned or controlled and the surrounding circumstances are such that there are obligations that New Zealand law would recognise as trust obligations.

40. In the context of deceased estates, whether a trust exists will turn on the basis on which the personal representatives in question hold the estate and make the distribution. Estate administration laws can determine that basis, so whether circumstances exist that they would give rise to a trust under New Zealand law will depend to some extent on what the estate administration laws of the other country are.

41. In New Zealand, on a person's death, personal representatives acting in that capacity have the legal and beneficial interest in the estate property and do not hold the estate on trust for heirs. For reasons discussed in Appendix A (see from [155]), in New Zealand a trust arises in the administration of an estate only once the personal representatives have given "assent" in relation to the property. An equitable obligation amounting to a trust, therefore, arises only following assent by the personal representatives to the property in question being held on trust by a trustee or trustees. Such assent can be express or inferred from the circumstances.

42. Even then, unless distributions are from trusts expressly provided for in a will, they may be by personal representatives holding on a "bare trust" (discussed from [190]) and will not be taxable distributions for that reason.

43. Common law countries such as Australia, the United Kingdom and Canada are likely to have similar estate administration laws to those in New Zealand. Trusts are, therefore, also not likely to arise until assent of personal representatives where an estate is administered in those countries. In situations such as heirs not being of age or a will providing for a life interest before distribution of property to heirs, where delays in distribution follow assent by personal representatives and property is not held on a bare trust, subsequent transfer to beneficiaries in New Zealand may be a taxable distribution.

44. Uncertainty around when the role of a personal representative becomes the role of a trustee will make the tax law difficult to apply in many situations. When a trust arises depends on the time of assent. That may not be easy to determine because there is no requirement (or general practice) to formally and expressly assent. It will often be a matter of inference from the circumstances. Once assent has occurred, estate property that continues to be held undistributed will be held on trust, with potential tax consequences if the trust is not a bare trust (see from [196]).

45. Distributions from estates of residents of civil law countries such as France, Germany and Switzerland are less likely to be from trusts. The general position in such countries is that heirs directly succeed to property on death and have a legal interest from that time. Personal representatives do not distribute anything to heirs that they do not already own. That does not mean the heirs can have no tax liability, they can still have New Zealand tax to pay on any income derived from their share of the estate. For example, interest from loans or rent from rental properties would be derived by the heirs as owners from the date of death. This may raise compliance (plus interest and possible penalty) issues in practice as heirs may not be aware of the details of their income until much later. Also, possible application of double tax agreements and foreign tax credits would be relevant to calculation of the tax liability. However, distributions will not be beneficiary income or taxable distributions from a trust unless the circumstances otherwise give rise to a trust.

46. In summary, a New Zealand tax resident will not derive anything that will be beneficiary income or a taxable distribution from a foreign trust unless:
    - for common law countries, administration of an estate has at least reached the stage that personal representatives have assented to the property being held on trust; or
    - for civil law countries, something has happened to the property before transfer to the resident that New Zealand law would consider gives rise to a trust (for instance, the property was transferred to someone in another country (a common law country) to hold on trust for the resident in New Zealand - a distribution made direct to the resident would not be a distribution from a trust).

Examples

47. The following seven examples help to explain the application of the law. Some of the discussion is based on the analysis covered in Appendix A, which follows the examples.

Example 1: Whether there is a trust – United States "trustee" sends money to New Zealand tax resident

48. Adam is a wealthy United States (US) citizen. Five years ago, he set up a "living trust", a common estate planning method in the US. He appointed himself trustee, and the trust deed recorded that the trust was revocable during his lifetime but would become irrevocable on his death. Until then, income from the property, if distributed, must be paid to him and nobody else. The property must be held in the trust, but he is able to have it transferred to him if he chooses or to any other person. Further, one provision in the trust deed allows Adam to absolve himself as trustee from any breaches of trust.

49. As trustee, and without breaching the income distribution clause, he sends some money to his son Orson who lives in New Zealand. The money is intended to be used by Orson to set up a business here. Orson wonders if the money is taxable in New Zealand.

50. Orson is a New Zealand tax resident, and there has been a transfer of value to him. However, he would, arguably, not derive a taxable distribution from a foreign trust. This is because the money may not have come from a trust. While Orson's father's revocable trust is a valid trust for the purposes of US law (although looked through for US tax purposes), the law of New Zealand would not necessarily recognise it as a valid trust. While Adam is alive, the essential features of a trust under New Zealand law are not present. This is not because the arrangement is "revocable" by Adam. Under New Zealand law, a valid trust can include one that may be brought to an end at any time. Instead, the important consideration on these facts is that, as trustee, Adam can effectively make a final distribution of all property held, he cannot effectively be called to account, and he did not intend to create a trust that would divest himself of the property in his lifetime.

51. The amount Orson received would be treated for New Zealand tax purposes as a gift, from his father in the US, from amounts that would have previously been taxed in the US to his father, if they were taxable there. Nothing in the facts suggests the amount is of an income character and subject to New Zealand tax in Orson's hands.

Example 2: Whether there is a trust – property held in Switzerland transferred to New Zealand tax resident

52. Carl has lived in Switzerland all his life and has accumulated several properties that he decides to dispose of. One is an apartment in Zurich that he wants to keep in the family, so he transfers it to his brother Roger and they sign an agreement that Roger is responsible for maintaining it and meeting outgoings and can live in it or rent it out in the meantime but would transfer the apartment and any accumulated rental income to Carl's daughter Ursula when she turns 25. In the event of Ursula dying before she turns 25, Roger is to give the apartment and accumulated rental income to his own children.

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

54. The tax treatment of this for Ursula will depend on whether the arrangement between Carl and Roger has the essential features of a trust under the law of trusts in New Zealand. The full factual details would be needed to decide, but at first sight the obligations that Roger is under appear to be obligations that would be regarded in New Zealand as fiduciary in nature and there would be a trust under New Zealand general law, despite the arrangement being likely to be considered a contract under Swiss law.

55. Assuming the arrangement is a trust for New Zealand tax purposes, the ordering rules in s HC 16 would apply because although it is likely to be a non-discretionary trust, it was not created by will or on intestacy. Roger has kept very good records of his time owning the apartment, so the ordering rules would treat any current year rental income as beneficiary income (because it is income derived by the trustee and paid to Ursula), the apartment itself as corpus or capital gains (and so excluded by s HC 15(4) from being a taxable distribution) and the accumulated rental income as a taxable distribution (being income Roger, as trustee, derived in earlier income years).

56. Tax credits are potentially available for tax paid by Roger (if paid by deduction ie at source and not if paid by Roger as legal owner) in Switzerland to reduce Ursula's tax liability on current year income. Art 22(1) of the double tax agreement (DTA) with Switzerland would seem to permit a credit for Swiss tax paid by deduction or by Ursula against New Zealand tax payable on the rental income distributed as beneficiary income or derived after title is transferred to her. The mechanism is via the domestic provisions such as ss LJ 1 and LJ 2. There is however no express recognition of fiscally transparent vehicles in the DTA with Switzerland so if Roger was assessed for Swiss tax then arguably it would not be treated as Ursula's tax liability under that DTA.

57. No tax credits would be available for tax paid on Roger's accumulation of rental income for previous years as a trustee. This would be treated as a taxable distribution if distributed in a lump sum to Ursula after her transitional resident status had ended. Under s LJ 6 only any tax equivalent to Non-Resident Withholding Tax deducted in Switzerland from a taxable distribution would be available as a credit in New Zealand.

58. If the arrangement is not a trust, the transfer of the apartment and any rental income accumulated by Roger before Ursula turned 25 would likely not be treated as income in New Zealand. These two items would essentially be treated in the same manner as gifts. Because the facts do not suggest Roger is an agent for Ursula at any stage, current year rental income derived before Ursula was 25 would also not be taxable in New Zealand.

Example 3: Ordering rules

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

60. In 2010, Mary moves to Australia. In 2012, Elizabeth moves to New Zealand, becoming resident here. Using the discretion given in the trust deed for the trust, in 2018 the trustees transfer the portfolio and accumulated income to Mary in Australia and the house to Elizabeth in New Zealand.

61. Although it is a discretionary trust, the trust is not a testamentary trust or created on intestacy so the tax treatment of the distribution for Elizabeth in New Zealand is going to depend on the application of the ordering rules in s HC 16. This means that Elizabeth will not be able to treat the distribution of the house to her as all being corpus and capital gains but must take account of the components of the investment portfolio. A proportion of the accumulated income in the portfolio would need to be treated under s HC 16(2) as income that the trustee derived and would be a taxable distribution under s HC 15(4).

62. For how the proportion should be calculated, see examples 21–23 and associated commentary in *Interpretation Statement IS 18/01: Taxation of Trusts – Income Tax* (IS 18/01, Inland Revenue 2018).

Example 4: Overseas will trusts

63. David moved to New Zealand from Australia with his mother when he was 12. His parents had separated, and David was their only child. David's father Joe was killed in a mining accident when David was 18. Joe's will left David a specific legacy of a sum of money and a direction that a trust be created with the balance of his residuary estate (mostly comprising commercial properties in Perth) to be held by the trustee, accumulating rents and reinvesting until David turned 21.

64. David has now turned 21, and the trustee has sold the properties and sent everything to David in New Zealand.

65. Assuming the law of administration of estates in Australia not to be materially different to the law in New Zealand, the only tax implications for David when he receives the specific legacy will arise from the fact that the money in question effectively moved from Joe to David at the time of Joe's death (under the "relation back" principle). If Joe invested the money in Australia before sending it to David, income may have been derived that would be taxable to David in New Zealand. If not, it could be argued a bare trust briefly existed with the executors' assent inferred. However, the transfer of the specific legacy will not be recognised as a trust distribution for New Zealand tax purposes.

66. The distribution from the testamentary trust created from the residuary estate, on the other hand, is likely to have tax implications for David under the trust rules. Current year investment income of the trustee distributed to David will be beneficiary income. The trust will be a foreign trust because Joe has never lived in New Zealand and he is the only person who has ever settled anything on the trust. The ordering rules in s HC 16 do not apply, assuming the trust meets the requirements to be a non-discretionary trust. Therefore, the income treatment will be determined by the relevant deed or the trustees' determination. Accumulated rental and investment returns will be a taxable distribution, but the proceeds of sale of the properties will not, being excluded under s HC 15(4) as either corpus or capital gains.

Example 5: Deceased in a civil law country

67. Thomas has lived in Germany for most of his life. His only son Joseph moved to New Zealand in 2005. When his wife died in 2010, Thomas made a will leaving all his property to Joseph.

68. When Thomas passes away in 2016, Joseph travels to Germany and discusses Thomas's estate with the executor, Erich, a professional financial advisor in Berlin. Erich suggests it would be consistent with Thomas's wishes that Joseph does not take the inheritance to New Zealand straight away but keeps it overseas. Erich's advice is to appoint a company in the Cayman Islands to hold the estate on trust for Joseph's family until the trustee determines they need it.

69. Circumstances change and five years later Joseph's family is now short of money. The trust is wound up and everything is distributed to Joseph and his wife.

70. The tax effects of this for Joseph and his wife are very likely to be that they have derived beneficiary income and taxable distributions. Joseph may also not have been aware that, as a New Zealand resident settlor, he had an obligation to meet the trustee company's New Zealand tax obligations on trustee income (s HC 25) and to disclose under s 59(1) of the TAA the particulars of the trust. Further, amounts distributed that are taxable distributions will not be from a foreign trust, instead they are likely to be from a non-complying trust, meaning a greater tax liability for them. Although Joseph inherited the estate from a deceased person in Germany, a civil law country without trusts and where Joseph directly succeeded to the estate on Thomas's death, Joseph then settled on the Cayman Islands trust assets that had vested in him before the settlement. Joseph is a New Zealand tax resident, so the trust would be a non-complying trust and not a foreign trust (although an election to be a complying trust may be possible – see [8.33] of IS 18/01 and proposed amendments to s HC 33 in the Taxation (Kiwisaver, Student Loans, and Remedial Matters) Bill 2019). The same outcomes could be expected if Joseph had inherited the estate from a deceased person from a common law country.

Example 6: Non-discretionary will trust

71. Cindy moves to New Zealand in 2005 from Canada. Her parents die in a car accident in 2012 leaving wills under which their executors are instructed to establish a non-discretionary trust to hold their estate for their seven children, six of whom have remained living in Canada.

72. In 2018, Cindy receives a substantial payment from the trustees following the sale of some Canadian shares that were part of the estate at the time of her parents' death. The trustees sign a formal resolution to the effect that the proceeds of sale should be distributed to the beneficiaries.

73. Because it is a non-discretionary will trust, the ordering rules in s HC 16 do not apply, and the trustee resolution will determine the tax effect for Cindy. This means there is no taxable distribution to Cindy because the proceeds will be both corpus of the trusts established under the parents' wills and profits from realisation of capital assets (assuming the shares had increased in value since they were settled on the trusts).

Example 7: Discretionary will trust – ordering rules and the importance of records

74. As in Example 6, Cindy's parents die and leave wills, but this time the executors are instructed to establish discretionary trusts.

75. In 2018, Cindy asks the trustees for funds to support her daughter who is about to go to university. The trustees decide to sell some of the New Zealand shares and distribute the proceeds to Cindy. They sign a formal resolution to this effect.

76. In this case, the result of the application of the ordering rules in s HC 16(2) may be that Cindy has received a taxable distribution. For this not to be the case, the records of the trust would need to show that there had been no income derived by the trustees in the current or earlier years that had not been distributed to beneficiaries earlier or at the same time. This is despite the distribution by the trustees being intended to be of corpus and capital gains.

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

Appendix A – Detailed analysis of applicable tax rules for distributions from foreign trusts

78. This appendix contains detailed analysis about the tax rules that apply when a New Zealand tax resident inherits or receives a distribution of money or property from someone overseas. A tax liability will arise because the resident derives income in the form of beneficiary income or a taxable distribution. Whether amounts are beneficiary income or taxable distributions depends on establishing whether the money or property comes from a trust.

79. All legislative references are to the Income Tax Act 2007 (the Act) unless otherwise stated. Relevant legislative provisions are reproduced in Appendix B.

Tax for New Zealand residents generally

80. This Interpretation Statement is concerned with the tax rules that apply to a New Zealand tax resident. The Commissioner's views on the test for whether somebody is tax resident in New Zealand are set out in *Interpretation Statement IS 16/03: Tax Residence* (IS 16/03, Inland Revenue, 2016).

81. A tax resident of New Zealand is generally liable to income tax in New Zealand on income derived from sources in New Zealand and worldwide. An exception exists for exempt income and excluded income (although excluded income can be taxable under other provisions such as taxable distributions from non-complying trusts: s BF 1(b)). However, for a New Zealand tax resident, if an amount is income, it will not generally make a difference to taxability that it comes from overseas.

82. Further, an amount may be income derived by a New Zealand resident regardless of whether the amount itself ever comes to New Zealand.

83. This principle of taxing the worldwide income of New Zealand tax residents includes income from trusts established overseas.

Taxation of income from trusts – overview

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

85. Trustee income is income derived by trustees that is not beneficiary income. Whether an amount derived by a trustee is trustee income or beneficiary income depends (broadly speaking) on whether the amount is income retained by the trustees (trustee income) or income transferred to beneficiaries soon after being derived (beneficiary income).

86. New Zealand tax residents (other than "transitional residents") are taxable on beneficiary income from all trusts, whether the trustees derived the income from New Zealand or offshore. For transitional residents, foreign sourced beneficiary income is exempt income, that is, not taxable.

87. The trust rules classify trusts as complying trusts, non-complying trusts or foreign trusts. These classifications are relevant to determining whether distributions of amounts other than beneficiary income are taxable to New Zealand tax residents.

88. Distributions to beneficiaries of complying trusts, other than of beneficiary income, are not taxable income of a beneficiary.

89. Distributions to beneficiaries of foreign trusts, other than of beneficiary income, corpus (value contributed to the trust fund) or certain capital profits, are called taxable distributions. They are taxable income of the beneficiaries when derived, as is any beneficiary income. These distributions from foreign trusts (both taxable distributions and beneficiary income) are the focus of this Interpretation Statement.

90. In most cases, a trust is a foreign trust where no settlor (that is, anyone contributing value to the trust fund) has been resident in New Zealand at any time since a settlement was first made on the trust. In some circumstances trusts can be complying trusts as well as foreign trusts (such "dual status" trusts, are discussed from [8.47] of IS 18/01) and distributions from such trusts are not treated as taxable distributions.

91. Any trust other than a complying trust or a foreign trust is a non-complying trust. Beneficiary income from non-complying trusts is taxable, and distributions to beneficiaries, other than of beneficiary income and corpus, are also taxable distributions and are taxed at a penalty tax rate of 45%. Distributions from non-complying trusts are not the subject of this Interpretation Statement.

92. With some exceptions (see [145]), "ordering rules" override the nominal nature of distributions from foreign and non-complying trusts that would otherwise apply based on the trust deeds or the exercise of the trustees' discretion. These are discussed in more detail from [144], but the ordering rules determine whether a distribution is treated, for tax purposes, as a distribution of income or capital gains of current or previous years or of corpus. They, therefore, determine whether

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a distribution will be a taxable distribution or not. For instance, the ordering rules mean current income is deemed to be distributed first, then retained income, capital gains and, lastly, corpus. This is regardless of what is stated in the trust minutes or records.

93. If the records of a foreign or non-complying trust do not allow for an accurate determination of the elements of a distribution (that is, current and previous years' income or capital gains and the corpus), the distribution is treated as being entirely a taxable distribution.

94. A New Zealand resident beneficiary who receives beneficiary income or a taxable distribution from a foreign trust, including in some cases from an overseas estate, is required to complete a disclosure on Inland Revenue form IR307 Schedule of Beneficiary's Estate or Trust Income for the income year in which they derive the distribution.

Taxing beneficiary income and taxable distributions

95. This Interpretation Statement is concerned with money or property that is distributed or transferred to a New Zealand tax resident (other than through a sale or purchase or other transaction where the resident gives something in return).

96. The money or property does not have to be in New Zealand. It can be located offshore, for example in a bank account in the United Kingdom or in the form of a holiday home in Australia.

97. Sections CV 13, HC 17 and HC 18 make beneficiary income and taxable distributions derived through foreign trusts "income".

98. Under s CV 13, an amount derived is income if it is beneficiary income or a taxable distribution from a foreign trust:

> **An amount derived by a person is income of the person if it is—**
>
> (a) **beneficiary income** to which sections HC 6 (Beneficiary income) and HC 17 (Amounts derived as beneficiary income) apply; or
>
> (b) a settlement on trust of property of the kind described in section HC 7(3) (Trustee income); or
>
> (c) **a taxable distribution from a foreign trust** to which section HC 18 (Taxable distributions from foreign trusts) applies. [Emphasis added].

99. Sections HC 17 and HC 18 confirm that beneficiary income and taxable distributions are income in the year they are derived.

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

Whether an arrangement is a "trust"

101. The word trust is not defined in the Act (other than in a limited definition in relation to superannuation schemes and unit trusts).

102. Section 5(1) of the Interpretation Act 1999 stipulates how statutes are to be interpreted:

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

103. The Supreme Court in *Commerce Commission v Fonterra Co-operative Group Ltd* [2007] NZSC 36, [2007] 3 NZLR 767 at [22] commented on this:

> [22] It is necessary to bear in mind that s 5 of the Interpretation Act 1999 makes text and purpose the key drivers of statutory interpretation. The meaning of an enactment must be ascertained from its text and in the light of its purpose. Even if the meaning of the text may appear plain in isolation of purpose, that meaning should always be cross checked against purpose in order to observe the dual requirements of s 5. In determining purpose the Court must obviously have regard to both the immediate and the general legislative context. Of relevance too may be the social, commercial or other objective of the enactment.

104. In relation to the text, an important thing to consider is the natural and ordinary meaning of "trust". The *Oxford English* Dictionary *Online* (accessed 10 December 2018) gives a few meanings but the only one that seems apt is the "law" meaning:

> an arrangement whereby a person (a trustee) holds property as its nominal owner for the good of one or more beneficiaries. A body of trustees.

105. The Trusts Act 2019 (the Trusts Act), which comes into force, for most purposes, from 30 January 2021, has a definition with more depth. This definition is regarded as consistent with the common law as it is currently but is not a codification of it.

106. Section 12 specifies that, among other things, an "express trust" is a "trust" that must have the characteristics set out in s 14. These are:

    (a) it is a fiduciary relationship in which a trustee holds or deals with trust property for the benefit of the beneficiaries or for a permitted purpose; and

    (b) the trustee is accountable for the way the trustee carries out the duties imposed on the trustee by law.

107. To be covered by section 12, an arrangement must be a "trust", an undefined term in the Trusts Act. Also, although section 12 defines an "express trust" , it is only "for the purposes of [the Trusts Act]". The consequence of this is that the provisions in the rest of the Trusts Act will not generally apply to arrangements that do not meet the definition of "express trust". Therefore, such arrangements may still be trusts if they would be recognised as trusts under law other than the Trusts Act. In ss 5(8) and (9), the Trusts Act makes clear that it does not codify trust law and that common law and equity rules can still apply if they are consistent with the Trusts Act and other enactments don't require otherwise.

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

109. *Law of Trusts (NZ)* (online ed, LexisNexis NZ, accessed 4 June 2019) contains the following definition (at [1.4]):

    A trust has been defined as "an equitable obligation under which a person ('the Trustee') having the control of property is bound to deal with that property either:

    (a) for the benefit of definite persons (of whom the trustee may be one) and any one of whom may enforce that obligation; or

    (b) for some object or purpose permitted by law." (*Garrow and Kelly's Law of Trusts and Trustees* 7th ed, LexisNexis, Wellington, 2013) at [1.1])

    Trusts can arise in the following ways (*Garrow and Kelly* at [2.5])

    - **An express trust**

      A person (the settlor) creates an obligation during his or her lifetime. This is often done by the execution of a deed which names the settlor, trustees and beneficiaries and directs how the trust is to be administered.

    - **An implied or presumed trust**

      The intention to create a trust has not been expressed but is implied or presumed from the circumstances. This includes resulting trusts where property is transferred to trustees for a specific purpose and when the purpose is fulfilled there is a surplus left over. The trustees then hold this surplus for the creator of the trust.

    - **The operation of law**

      For example, constructive trusts, or in the case of an intestacy under the Administration Act 1969. In this case an intention to create a trust is imposed by the Court despite the fact that the person in whom the property is vested at the time had neither expressly nor impliedly undertaken any trust.

110. *Law of Trusts (NZ)* also notes (at [1.5]) that "For an express trust to be valid the following three certainties must exist": certainty of intention (to create a trust), certainty of subject matter ("there can be no trust without property") and certainty as to the object of the trust (it must be clear who is intended to benefit and to what extent).

111. The following are described (at [1.6]) as "essential structural elements":

    There are four essential structural elements of a trust: (*Garrow and Kelly*, at [1.26])

    (1) **There must be a *trustee***. If no trustee has been appointed or the trustee dies, refuses to act or is unable to act, then the Court will appoint someone to fill that office. Section 51 of the Trustee Act 1956 sets out a number of circumstances in which the Court will appoint a new trustee. There are however some circumstances in which a person nominated for the purpose in the trust instrument may appoint new trustees (see s 43).

    (2) **There must be *property* of a nature capable of being settled on a trust**. It can be real or personal but it must be alienable at law.

    (3) T**here must be a *beneficiary* or *beneficiaries***. A trustee can be a beneficiary, but must not be the only beneficiary.

    (4) **There must be an *obligation on the trustee* to deal with the property for the benefit of the beneficiaries**. The obligation is an equitable one. [Bold emphasis added].

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

113. *NZ Trusts and Asset Planning Guide* (online looseleaf ed, CCH New Zealand, accessed 4 June 2019) notes (at [120–201]) that whether a trust arises is to be determined objectively:

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

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

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

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

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

> (1) This subpart, together with the trust rules,—
>
> (a) provides for the taxation of distributions from trusts, for this purpose defining—
>
> (i) beneficiary income:
>
> (ii) a taxable distribution:
>
> (b) provides for the taxation of trustee income:
>
> (c) classifies trusts into the following 3 categories for the purposes of determining the treatment of distributions that are not beneficiary income:
>
> (i) complying trusts:
>
> (ii) foreign trusts:
>
> (iii) non-complying trusts:
>
> (d) determines who is a settlor, and sets out their income tax liability:
>
> (e) sets out the treatment of trusts settled by persons becoming resident in New Zealand.

118. In s HC 1(1)(c), trusts are said to be classified into three categories for the purposes of deciding the tax treatment of distributions (that are not of beneficiary income). Section HC 9 classifies a trust at the time of distribution:

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

119. There is no fourth category of "trust" that is not a complying, non-complying or foreign trust (other than "dual status" trusts mentioned above at [89] and discussed in [8.14] to [8.47] of IS 18/01). Each category is a classification of a trust, so this does not address whether something that would not be a trust according to New Zealand trust law, should be a trust for the purposes of the trust rules.

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

121. This intention as to meaning can be illustrated by considering what the trust rules would clearly apply to and why. It is uncontroversial, for instance, that the trust rules apply to real estate situated in New Zealand held by someone on the terms of a trust deed, whether a New Zealand resident or not, and who holds it for the benefit of someone else. This is so whether

the property is held for beneficiaries who are resident or not. The property would be regarded as held in trust for the beneficiaries under New Zealand law, and there could be no argument about the arrangement being treated as a trust that is subject to the trust rules. If there is a New Zealand settlor, then it would not be a foreign trust, but it would still be a trust.

122. The same applies to foreign property held by a foreign trustee. Provided there is a New Zealand resident beneficiary, distributions to New Zealand beneficiaries can be taxable if they satisfy the criteria in the relevant provisions of the Act. The location of the property, the settlor or the trustee need not make a difference.

123. Many of the provisions in the Act that are applicable to "foreign trusts" can be taken to assume that property in foreign jurisdictions can be subject to a "trust" or that New Zealand–situated property can have duties owed in respect of it by persons (trustees) wherever they might be resident (although the settlor must not be a New Zealand resident). For these provisions to have meaningful effect, it must have been intended that the "trust" concept not be limited simply because another jurisdiction might not have the same rules as to what is a trust or how they operate, or any rules for that matter.

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

125. Consistent with this is a proposition put forward in *Bennion on Statutory Interpretation* (7th ed, LexisNexis, London, 2017) at 544, that a "term is presumed to have its ordinary meaning in the territory to which an enactment extends, even if it applies in relation to a foreign context". This is discussed in a comment (at 545) following the proposition:

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

126. Identifying whether a distribution comes from a trust would seem to be a similar question to identifying whether an enterprise is a body corporate so as to be a "company", a defined term for New Zealand tax purposes. Professor John Prebble, in "Recognition of foreign enterprises as taxable entities", *Cahiers de Droit Fiscal International Vol LXXIIIa* (1988): 493 at 496, summarised what he considered should be the analytical steps to determine whether an entity organised under foreign laws met the requirements to be a company:

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

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

128. In the Canadian case of *Sommerer v The Queen* (2011) TCC 212, the Tax Court of Canada considered that determining whether a foreign arrangement (an Austrian "foundation") should be treated as a trust required identifying the essential elements of a trust under Canadian law and comparing the elements of the foreign arrangement with those elements. On appeal [(2012) DTC 5,126], the Federal Court of Appeal reached a conclusion in the case on different grounds but did not take substantive issue with the lower court's approach on this point, preferring to express the test in terms of the property in question being subject to conditions that are "analogous to the legal and equitable obligations of a trustee in a common law jurisdiction".

129. Conflict of laws principles may also offer some guidance. In *Dicey and Morris on the Conflict of Laws* (13th ed, London, Sweet & Maxwell, 2000), it is suggested that academic opinion favours a "domestic law of the forum" (or *lex fori*) approach as a solution to the problem of characterising the question to be decided and which law to apply. The following is said at [2.009]:

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

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

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

132. Each situation requires analysis to determine whether it would give rise to a trust for New Zealand law purposes taking into account the rights and obligations arising under foreign law. For example, it may be an appropriate conclusion that an arrangement is not a trust because of the degree of control the settlor retains over trust property, including having it returned to the settlor or where a settlor/trustee has no accountability for what would otherwise be considered a breach of trust.

133. That successful arguments can sometimes be made that arrangements, described as trusts in documents, may not be treated as effective trusts can be illustrated by *Re the AQ Revocable Trust, BQ v DQ* [2010] 13 ITELR 260 (a trust valid under United States (US) trust law but not recognised as a trust by a Bermudan court) and *Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) (a UK decision where "trust" deeds establishing New Zealand foreign trusts allowed a former Russian oligarch to retain his beneficial ownership of assets and so were either bare trusts for his benefit or were a sham).

134. For the above reasons, it is, therefore, considered that the word "trust" is used in the Act to refer to the situation where the true nature of the arrangement is that there is a legal obligation of a particular type on someone who holds property for the benefit of a person or object. Whether such an obligation exists turns on there being circumstances that give rise to something that has the essential features of a trust under New Zealand law; namely that a person (trustee) holds trust property and has a fiduciary obligation to deal with the property for the benefit of the beneficiaries or for a charitable purpose. Wherever in the world property is situated, if the legal basis on which it is owned or controlled and the surrounding circumstances are such that there are obligations that New Zealand law would recognise as trust obligations, then a trust exists for tax legislation purposes.

Beneficiary income and taxable distributions from foreign trusts

135. Having identified that money or property comes from a trust, the next question is whether anything is taxable in the hands of the recipient. This will depend on whether anything is "beneficiary income" and whether there has been a "distribution" and whether that distribution is a "taxable distribution" from a "foreign trust".

136. *Interpretation Statement IS 18/01: Taxation of Trusts – Income Tax* (Inland Revenue, 2018) contains the following description 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).

137. A "distribution" is defined broadly in the Act and in terms of a transfer of value. IS 18/01 discusses this:

> 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".

138. IS 18/01 paraphrases the definition of foreign trust (at [8.39]): "Foreign trusts are trusts that have not had a New Zealand resident settlor at any time since 17 December 1987".

139. In general terms, a "settlor" is anybody who has transferred value to a trust without getting something in return. Therefore, it will be important to know the background and where the property in the trust in question came from to determine whether it is a foreign trust. Under s HC 11, a trust will be a "foreign trust at a moment in time if no settlor is resident in New Zealand at any time in the period that starts on … the date on which a settlement was first made on the trust; and ends with the moment in time".

140. An amount of beneficiary income will be taxable to a New Zealand resident no matter what type of trust it comes from. Amounts other than beneficiary income that are distributions from a foreign trust will be taxable if they are a "taxable distribution" as defined in s HC 15. IS 18/01 states:

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

141. This legislative framework makes it important to identify how much of the distribution should be treated as corpus, capital and so forth. For this, the ordering rules in s HC 16 need to be applied to every foreign trust distribution that is not beneficiary income or from a trust that is within an exception to s HC 16. As explained from [144], the ordering rules can result in some or all of a distribution being treated as made up of income derived by a trustee. Any current year income will be beneficiary income and will be taxable as that rather than as a taxable distribution, if vested in or paid to a beneficiary in the same year as derived by the trustee or paid to a beneficiary within the extended time allowed by s HC 6(1B).

142. Note: Section HC 15 (in relation to 8.65(c) as referred to in the quotation in [140]) has been changed to modify the associated person exception. The effect of section 209 of the Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019 is that distributions will not be taxable distributions just because they are of capital gains realised by the trustee on distributions of property to beneficiaries from a foreign trust or distributions of realised capital gains made when a trustee sells assets to associated parties including beneficiaries. This is effective from 18 March 2019, but if a taxpayer has taken a tax position before 18 March 2019 that is consistent with this change that will be treated as correct.

Ordering rules (section HC 16)

143. The application of the ordering rules is a very important consideration for any taxpayer in determining whether they might have derived a taxable distribution from a foreign trust. The rules may characterise amounts distributed as something different to what the amounts are nominally. In other words, the ordering rules don't have to respect the description a trustee gives to the distribution in question or what the relevant trust deed provides.

144. IS 18/01 outlines the rules and how they work:

> 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.

145. There are exceptions to the ordering rules. The most important for present purposes is the exception in s HC 16 for "non-discretionary trusts" arising on death. Where this section applies, the source of a distribution is determined by the terms of the trust or the trustee resolution making the distribution. IS 18/01 comments on the non-discretionary trusts exception:

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.

146. If an exception to the ordering rules does not apply, a beneficiary needs information on the trust's circumstances and history to be able to apply the ordering rules. Ideally, this information will be in the form of good financial records (modified as necessary to show current year income, accumulated income, capital gains and corpus according to New Zealand income tax law – see IS 18/01 at [8.119]) and should include details of all settlements on the trust, gains in value of trust property and distributions that have been made by the trust, in the year in question and in previous years. In the absence of financial statements, other material and evidence is potentially relevant but the onus is on the beneficiary to prove the elements of a distribution to a satisfactory level of accuracy. In [8.157] of 18/01, it is noted that if there are adequate records relating to corpus but not to income or capital gains, it will still be possible for a final distribution not to be taxable to the extent the amount does not exceed the corpus.

147. Therefore, where s HC 16 and the ordering rules apply, the recipient of a distribution must point to evidence that allows application of the rules. As IS 18/01 notes, if they can't, the distribution will be deemed to be taxable:

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)).

148. The consequences of a distribution being taxable in this way will often justify a concerted effort on the part of a beneficiary to locate the required information. This may be difficult, but the onus is on the beneficiary to demonstrate that the ordering rules apply in the way the beneficiary contends.

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

Administration of estates

150. Different countries have different laws for the administration of estates. It follows that the legal basis on which property is owned or controlled may be different too and could lead to a different conclusion on whether a trust arises. However, many countries have laws like the laws in New Zealand, especially common law countries. Therefore, some discussion of the law here in New Zealand relating to the administration of estates is useful to illustrate when a trust (that is not a "bare trust" and ignored for tax purposes – see discussion at [194] below) might arise when a deceased estate is being administered overseas.

New Zealand estate administration and trusts

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

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

153. The instructions in a will may also expressly provide for trusts (testamentary trusts). This might be a direction to executors to hold property on trust for specified beneficiaries or it might be a direction to establish a trust to hold property for specified beneficiaries (for which a trust deed is usually formalised). If a distribution is made from a trust established under such instructions, the Act applies as it would for any distribution from a trust established by a person during their lifetime.

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

155. However, a trust does not arise immediately on the death of the deceased. *Tax Implications of Certain Asset Transfers* (Officials' issues paper, Policy Advice Division of Inland Revenue, 2003) describes the legal process in New Zealand for property moving from a deceased person to beneficiaries (at 11 and 12):

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

156. Other commentaries (and cases, for example, *Commissioner of Stamp Duties (Queensland) v Hugh Duncan Livingston* [1965] AC 694) confirm that, although executors and administrators are subject to fiduciary duties during the period of their executorship or administration, neither the beneficial nor the legal interest in the estate assets (that are not the subject of specific legacies) moves to those who stand to inherit. For instance, *Laws of New Zealand: Trusts Part 1* (online ed, LexisNexis NZ, accessed 18 December 2018), under the title "Introduction to Trusts: Nature of Trusts and of the Trust Relationship", says:

> **Personal representatives and trustees**. In a loose sense, a legal personal representative (while acting as such) is a trustee for the creditors and beneficiaries claiming under the deceased, as that personal representative holds the real and personal estate of the deceased for the benefit of the deceased and not for his or her own benefit. Moreover, in the Trustee Act 1956 the term "trust" extends to the duties incidental to the office of an administrator under the Administration Act 1969.
>
> However, **during the administration of the estate of the deceased, whether a testator, or an intestate, no legatee, devisee, or next of kin has any beneficial interest in the assets being administered**; he or she has merely an equitable right to have the estate administered properly. This right is enforced by means of a devastavit action. [Emphasis added].

157. In England the position is similar. *Williams on Wills* (9th ed, LexisNexis Butterworths, 2008) notes (at [1.8]):

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

158. Being an executor is not the same as being a trustee: *In re Jane Davis, In re T H Davis, Evans v Moore* [1891] 3 Ch 119. *NZ Trusts and Asset Planning Guide* (online looseleaf ed, CCH New Zealand, accessed 4 June 2019) notes (at [123–401]) the difference between the two roles of executor and trustee and refers to authority as to the time at which an executor becomes a trustee:

> An executor carries into effect a deceased's will. The duties of an executor include to collect and get in the assets of the deceased, pay expenses and debts and discharge legacies under the will (*Re Branson (Deceased)* (1911) 31 NZLR 79, at p 82). In comparison,

the essential duties of a trustee of a trust created under the will are to obtain possession or control of the trust property, get in funds due to the trust estate, preserve the trust property and to secure it from loss or risk of loss and to conform to and carry out the terms of the trust.

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

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

160. This position is not altered by the fact that, under the Act, an executor or administrator is treated as a trustee (specifically, s YA 1 defines "trustee" to include an executor or administrator). Although a personal representative is to be considered a trustee for tax purposes, it does not follow that a trust arises on death or during administration. It just means that provisions referring to "trustee" may have a broader application than they otherwise would. Where a section refers to "trust" but not "trustee", interpretation of the section requires consideration of the meaning to be given to the word trust. As noted, this would not generally include an estate during administration.

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

162. Such assent can happen for property outside of residue and at different times for different property. The commentary in *Laws of New Zealand: Trusts Part 1* set out above continues:

> **When the personal representatives realise that specific property left on trusts is not going to be resorted to to enable debts, expenses, and liabilities to be satisfied, they may assent to that property being held on trust in the strict sense. It is often important to determine when a personal representative has completed his or her functions as such in relation to any property and holds the property solely as a trustee in the strict sense**; this is because there are differences in the powers of personal representatives as such and trustees, and also the period of limitation applicable to an action may depend in certain cases upon whether the defendant holds the property which is the subject of the claim as personal representative or as trustee. Moreover, as the duty of personal representatives is owed to the estate as a whole, they, unlike trustees, do not have to hold the balance evenly between those interested in income and those interested in capital. [Emphasis added].

163. More explanation of "assent" can be found in *Laws of New Zealand: Administration of Estates II – Assents* (online ed, LexisNexis NZ, accessed 4 June 2019):

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

164. The assent need not be in any particular form and it is a question of fact whether assent has occurred:

> **459. Assent by implication. An assent to the vesting of real or personal estate may be express or implied; it need not be in writing nor need it be given in any particular form. Informal expressions, if sufficiently clear to indicate intention, may amount to an assent.** The assent may also be implied from the executor's conduct: thus, the application in the maintenance of minors, of rents of leaseholds bequeathed to the executor in trust for maintaining them during minority, and afterwards in trust for the legatee on attaining their majority; allowing a legatee of a term to receive the income; the payment by the executor of rent, coupled with the charging of the legatee with the payments in account; or the payment of a charge subject to which a legacy is given; would amount to an assent to the bequest. However, an executor may, and often does, make general payments to a legatee without binding themselves to an assent; and the Court will not infer an assent in such circumstances unless there is evidence that the executor intended to assent as, for instance, by representations to that effect or by special payments out of or on account of rents to which the legatee would be entitled after assent.

> In case of dispute, **the question whether there has been an assent or not is generally one of fact**. An expression which is ambiguous and applies equally to either view is no evidence of an assent. [Emphasis added].

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

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

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

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

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

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

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

169. The cases confirm that:

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

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

171. An equitable obligation amounting to a trust, therefore, arises only following assent by the personal representatives to the property in question being held on trust by a trustee or trustees. Such assent can be express or inferred from the circumstances.

172. If laws similar to the laws of administration of estates in New Zealand apply, where a testamentary trust or a life interest or a minority arises from a non-resident deceased's estate, then following assent, the property will be held by a person (trustee) subject to that trust from assent. This may mean an executor changes "hats" (from assent) if they are going to be that ongoing trustee. Such a trust will be a foreign trust because the settlor is the deceased who is not a New Zealand resident and whose intentions to create a will trust are being carried out by the executors (an indirect transfer of value as provided for in s HC 27(4)). To determine the tax treatment of property or amounts transferred to a New Zealand beneficiary, the possibility that what is transferred to a New Zealand resident is a taxable distribution needs to be considered. However, the trust will often not be discretionary so that the ordering rules do not apply (as discussed in [145]).

173. Where a New Zealand beneficiary of a foreign deceased estate has a vested interest after assent, a "bare" trust will arise as a matter of law. As discussed from [190], this situation can be ignored for tax purposes. Although the personal representative will be a trustee according to trust law, they will be a bare trustee. They now hold the property subject to the direction and control of the beneficiary and, for New Zealand tax purposes, the beneficiary is treated as the owner of the property.

Estate administration and trusts in other countries

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

175. This means that the position in such civil law countries is materially different from common law jurisdictions like New Zealand. A trust will not arise on death or following estate administration as the heirs have a vested legal interest immediately on death. There is no "interregnum" when the executor has the legal interest as in common law countries. It also means that transfers by personal representatives in civil law jurisdictions will not be a "distribution" for New Zealand tax purposes because they do not transfer value to heirs. The heirs already own what they inherit.

176. Further, the test discussed above for determining whether a "trust" exists was whether in all the circumstances a trust can be said to arise under New Zealand law. The facts relevant to concluding on that issue will include what legal obligations a person has in relation to property. In that case, the rules of another country as to what happens on death will affect legal obligations in relation to property. The fact that no property vests in a personal representative is critically relevant to the question of the existence or otherwise of a trust under New Zealand law.

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

178. New Zealand law would not recognise a situation as a "trust" where the situation involves property that is not owned by someone who has obligations to deal with it for the benefit of someone else. The arrangements in civil law countries will not meet the requirements under New Zealand law to be a "trust" in that situation.

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

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

181. Likewise, there will be no distribution from a trust when A transfers to C the dividends that have accumulated on the shares during the administration. They will be treated as having been derived by C as taxable income from date of death, with A being a bare trustee, as discussed from [190]. Tax paid in Switzerland may be available as a credit against liability for tax in New Zealand. If C has not returned the dividends for tax in New Zealand, an adjustment to their assessments will be required.

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

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

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

Effect on tax status of deceased's estate during administration

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

186. Before then, although it seems they are sometimes referred to as holding property "on trust", the legal position is that they hold both the legal and the beneficial interests in the estate property "in right of the deceased" (see *Nevill's Law of Trusts, Wills and Administration* (12th ed, LexisNexis, 2016) at [19.11.6]). They do not hold interests in the estate as trustee for beneficiaries. Heirs do not have any beneficial interest and can rely on only their right to force the representatives to carry out their duties. It, therefore, seems more appropriate to consider the representatives not (yet) to be trustees. This is likely to be the position for deceased estates in common law countries in general but unlikely to be the position in civil law countries.

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

- for common law countries, administration of an estate has at least reached the stage that personal representatives have assented to the property being held on trust; or
- for civil law countries, something has happened to the property before transfer to the resident that New Zealand law would consider gives rise to a trust (for instance, the property was transferred to someone in another country (a common law country) to hold on trust for the resident in New Zealand - a distribution made direct to the resident would not be a distribution from a trust).

Bare trusts

188. Commentary referred to above also suggests that a trust can still arise by assent even though the personal representative has not got to the point of identifying the residuary estate. For instance, an executor may choose to distribute a specific legacy to the person named in the will as entitled to that legacy. Assent in relation to the property or amount forming that specific legacy would be inferred once the distribution is made and, technically, there might be a brief time when what is distributed is subject to a trust under general law. This situation would not give rise to a taxable distribution, however. This is for two reasons.

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

190. The second reason is because not every distribution that would otherwise meet the legislative definition of "taxable distribution" will necessarily be a "taxable distribution from a foreign trust". If the property is held on a "bare trust", s YB 21 would have the effect of deeming no distribution to have been made by the person holding the property. Section YB 21 provides:

> **YB 21 Transparency of nominees**
>
> *Treatment of nominee*
>
> (1) In this Act, unless the context otherwise requires, **if a person holds something or does something as a nominee for another person, the other person holds or does that thing and the nominee is ignored.**
>
> *Who is a nominee?*
>
> (2) A person holds or does something as a nominee for another person if the person acts on the other person's behalf. **However, a trustee is a nominee only if the trustee is a bare trustee.**
>
> Nominal settlements
>
> (3) A person making a nominal settlement at the request of another person is treated for the purposes of this Act as a nominee in relation to the settlement. [Emphasis added].

191. In practical terms, and in the context of trusts arising in the administration of estates, the consequence of a trust being "bare" is that inheritors would not derive beneficiary income or taxable distributions but they would derive any income from the property in question.

192. The principles developed through the courts on what amounts to a "bare trust" are summarised in "Interpretation Statement IS 12/01: Income Tax – Timing of Share Transfers for the Purposes of the Continuity Provisions" *Tax Information Bulletin* Vol 24, No 7 (August 2012):20:

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

193. "QB 16/03: Goods and Services Tax – GST Treatment of Bare Trusts", *Tax Information Bulletin* Vol 28, No 5 (June 2016): 16 describes a "bare trust" as:

> 5. A bare trust is a type of trust under which the trustee holds property on trust without any duties to perform other than to convey the trust property to the beneficiary or as the beneficiary directs. The reference to "duties" in this definition is to duties that the settlor has specified. For example, the trustee may have been appointed to hold the property as nominee, or the settlor may have required that the beneficiary be maintained until becoming entitled to call for capital and income on reaching the age of majority. Once the beneficiary reaches the age of majority, the trustee no longer has a duty to maintain the beneficiary. In both situations, the trustee is "bare" of any duties specified by the settlor. However, so long as a trustee holds property on trust, they always retain their legal duty to take reasonable care of the trust property. The trustee cannot escape this duty: H*erdegen v FCT* 88 ATC 4995 (FCA); Waters' Law of Trusts in Canada (4th ed, Carswell, Toronto, 2012) at 33–34.
>
> 6. Therefore, a bare trustee has not only a duty to transfer the trust property to the beneficiary (or as directed by the beneficiary), but also a legal duty to take reasonable care of the trust property in the meantime: *Herdegen; CGU Insurance Ltd v One Tel Ltd (in liquidation)* [2010] HCA 26; *Corumo Holdings Pty Ltd v C Itoh Ltd* (1991) 24 NSWLR 370 (CA); *ISPT Nominees Pty Ltd v Chief Commissioner of State Revenue* [2003] NSWSC 697.
>
> 7. What a bare trustee must do to fulfil their duty to protect trust property depends on the nature of the trust property and any threats to the trust property. However, a bare trustee must refrain from active management that does not fall within the duty to maintain the trust property: *Bruton Holdings Pty Ltd (in liquidation) v FCT* (2011) 193 FCR 442 (FCAFC).

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

195. In the context of estates, a trust will, therefore, arise only on completion of the personal representative's role in relation to property and on the personal representative assenting in relation to that property. Then it will depend on the facts as to what is being distributed, and whether any transfer of the property to an heir is a transfer by a bare trustee. In that case, the trust rules will not apply because for tax purposes there is no trust. The beneficiary, not the trustee, is treated by s YB 21 as holding the property from the date of assent. If, on the other hand, the personal representative is more than a bare trustee, the transfer (or part of it) might be of beneficiary income or a taxable distribution to the extent it is not excluded by the application of s HC 15.

Consequences of an arrangement being a trust

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

197. The trust that arises following assent and before distribution will often be a bare trust that will not be recognised as a trust for tax purposes. A transfer of property to a New Zealand resident will, therefore, often not be a taxable distribution. This would be the case if the property continued to be held for a time because of practical difficulties in locating the beneficiary or transferring the property to them. During that time, the property would have been held for the absolute benefit of the beneficiary, who has the right to call for the property at any time and the trustee must act on that direction.

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

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

200. In the example discussed at [183], of an executor in Australia distributing the proceeds of sale of Australian shares to a New Zealand resident heir of a deceased Australian, the distribution was from a foreign trust. This is because the proceeds were part of the residuary estate that was held undistributed by the executor for a time. The deceased had died with a will that expressly provided for a trust to be established for the heir so a trust arose following assent. The ordering rules in s HC 16(2) would need to be considered, unless the trust was a non-discretionary trust covered by s HC 16(6)(b).

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

Summary

202. Common law countries are likely to have similar estate administration laws to those in New Zealand. This means that personal representatives, in that capacity, do not hold the property of a deceased person on trust for the heirs. Property will be subject to a trust only when personal representatives hold legal title subject to the terms of a trust, express or implied. This can happen only after they have given assent in relation to that property. Assent can be inferred from the circumstances and can be for individual items of property and before the residuary estate has been determined. Before such assent, the legal position is that the personal representatives hold both the legal and the beneficial interest in the estate property "in right of the deceased" rather than as trustee for beneficiaries.

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

204. Distributions from estates of residents of civil law countries are less likely to be from trusts because heirs have a legal interest from the date of death.

References

Related rulings/statements

"Interpretation Statement IS 12/01: Income Tax – Timing of Share Transfers for the Purposes of the Continuity Provisions", *Tax Information Bulletin* Vol 24, No 7 (August 2012): 20 (IS 12/01, Inland Revenue)

"Interpretation Statement IS 18/01: Taxation of Trusts – Income Tax" *Tax Information Bulletin* Vol 30, No 7 (August 2018): (IS 18/01, Inland Revenue 2018)

"Interpretation Statement IS 16/03: Tax Residence" *Tax Information Bulletin* Vol 28, No 10 (October 2016): 2 (IS 16/03, Inland Revenue)

"QB 16/03: Goods and Services Tax – GST Treatment of Bare Trusts," *Tax Information Bulletin* Vol 28, No 5 (June 2016): 16 (QB 16/03, Inland Revenue)

Subject references

assent
bare trust
beneficiary income
distribution
ordering rules
taxable distribution
trust
trustee
trustee income

Legislative references

Income Tax Act, 1918 (UK)

Income Tax Act 2007, ss BD 1, BF 1, CV 13, subpart HC, YA 1 ("trustee"), YB 21

Interpretation Act 1999, s 5(1)

Tax Administration Act 1994, s 59B

Taxation (Annual Rates for 2018–19, Modernising Tax Administration, and Remedial Matters) Act 2019, s 209

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Case references

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Law of Trusts (NZ) (online ed, LexisNexis NZ, accessed 4 June 2019)

Laws of New Zealand: Administration of Estates II – Assents (online ed, LexisNexis NZ Ltd, accessed 4 June 2019)

Laws of New Zealand: Trusts Part 1 (online ed, LexisNexis NZ, accessed 4 June 2019)

Nevill's Law of Trusts, Wills and Administration (12th ed, LexisNexis, 2016)

NZ Trusts and Asset Planning Guide (online looseleaf ed, CCH New Zealand)

Prebble, J, "Recognition of foreign enterprises as taxable entities", *Cahiers de Droit Fiscal International Vol LXXIIIa* (1988): 493

Tax Implications of Certain Asset Transfers (Officials' issues paper, Policy Advice Division of Inland Revenue, 2003)

Williams on Wills (9th ed, LexisNexis Butterworths, 2008)

Appendix B – Legislation

Income Tax Act 2007

Section BD 1 provides:

BD 1 Income, exempt income, excluded income, non-residents' foreign-sourced income, and assessable income

Amounts of income

(1) An amount is income of a person if it is their income under a provision in Part C (Income).

Exempt income

(2) An amount of income of a person is **exempt income** if it is their exempt income under a provision in subpart CW (Exempt income) or CZ (Terminating provisions).

Excluded income

(3) An amount of income of a person is **excluded income** if—

(a) it is their excluded income under a provision in subpart CX (Excluded income) or CZ; and

(b) it is not their non-residents' foreign-sourced income.

Non-residents' foreign-sourced income

(4) An amount of income of a person is non-residents' foreign-sourced income if—

(a) the amount is a foreign-sourced amount; and

(b) the person is a non-resident when it is derived; and

(c) the amount is not income of a trustee to which section HC 25(2) (Foreign-sourced amounts: non-resident trustees) applies.

Assessable income

(5) An amount of income of a person is **assessable income** in the calculation of their annual gross income if it is not income of any of the following kinds:

(a) their exempt income:

(b) their excluded income:

(c) their non-residents' foreign-sourced income.

Section BF 1 provides:

BF 1 Other obligations

A person must pay the following types of income or ancillary tax under the relevant Part:

(a) qualifying company election tax under Part H (Taxation of certain entities):

(b) income tax on taxable distributions from non-complying trusts under Part H:

(c) further income tax under Part O (Memorandum accounts):

(d) RLWT under subpart RL (Residential land withholding tax), if the person is described in section RL 2 (Vendors: who must pay, and how?).

(e) *[Repealed]*

Section CV 13 provides:

CV 13 Amounts derived from trusts

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

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

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

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

Section HC 1 provides:

HC 1 What this subpart does

What this subpart does

(1) This subpart, together with the trust rules,—

(a) provides for the taxation of distributions from trusts, for this purpose defining—

(i) beneficiary income:

(ii) a taxable distribution:

(b) provides for the taxation of trustee income:

(c) classifies trusts into the following 3 categories for the purposes of determining the treatment of distributions that are not beneficiary income:

(i) complying trusts:

(ii) foreign trusts:

(iii) non-complying trusts:

(d) determines who is a settlor, and sets out their income tax liability:

(e) sets out the treatment of trusts settled by persons becoming resident in New Zealand.

Excluded: certain funds and distributions

(2) The trust rules do not apply to—

(a) a unit trust:

(b) a group investment fund to the extent to which it is treated as a company under this Act:

(c) a Maori authority:

(d) a distribution under section HZ 1 (Distributions from trusts of pre-1989 tax reserves).

Disclosure requirements: non-resident trustees

(3) Section 59 of the Tax Administration Act 1994 requires the disclosure of a settlement on a trust with a non-resident trustee.

Avoidance arrangements

(4) Section GB 22 (Arrangements involving trust beneficiary income) may apply to treat a beneficiary as receiving property, or enjoying services or benefits, in fact received, or enjoyed, by another person.

Superannuation funds entering trust rules

(5) A superannuation scheme that is treated as a company because it is a unit trust and then becomes a superannuation fund is treated as—

(a) liquidated under section CD 12 (Superannuation schemes entering trust rules) immediately before the date on which it becomes a superannuation fund; and

(b) no longer a company.

Section HC 9 provides:

HC 9 Classifying trusts

A trust is classified at the time it makes a distribution as—

(a) a complying trust under section HC 10:

(b) a foreign trust under section HC 11:

(c) a non-complying trust under section HC 12.

Section HC 15 provides:

HC 15 Taxable distributions from non-complying and foreign trusts

When subsection (2) applies

(1) Subsection (2) applies for a trust that is a non-complying trust at the time a distribution to a beneficiary is made.

Taxable distributions: non-complying trusts

(2) The distribution is a **taxable distribution** to the extent to which it is not a distribution of—

(a) beneficiary income; or

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

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

When subsection (4) applies

(3) Subsection (4) applies for a trust that is a foreign trust at the time a distribution to a beneficiary is made.

Taxable distributions: foreign trusts

(4) The distribution is a **taxable distribution** to the extent to which it is not a distribution of—

(a) beneficiary income; or

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

(c) a profit from the realisation of a capital asset or another capital gain; or

(cb) a foreign superannuation withdrawal; or

(cc) a pension; or

(d) a payment or a transaction that represents a distribution of either the corpus of the trust referred to in paragraph (b) or a capital gain referred to in paragraph (c).

Determining amount of gain

(5) For the purposes of subsection (4)(c),—

(a) the profit or other capital gain does not include a gain that must be taken into account for the purposes of determining an income tax liability:

(ab) if the trustee is not a trustee of a trust referred to in paragraph (ac), the profit or other capital gain does not include an amount of capital gain (the gain amount) that is derived by the trustee through a transaction or a series of transactions if—

(i) the transaction or series of transactions is between the trustee and an associated person who is not a natural person or corporate trustee; and

(ii) the gain amount is greater than the capital gain that the trustee would derive from a transaction at market value:

(ac) if the trustee is a trustee of a trust, for which a CFC is a settlor and no person is treated as a settlor under section HC 28(3) or (4), the profit or other capital gain does not include an amount of capital gain that is derived by the trustee through a transaction or a series of transactions between the trustee and an associated person:

(b) the amount of the profit is determined after subtracting any capital loss that the trustee incurs in the income year in which the amount was derived.

Certain capital gains for trustee of foreign trust

(5B) For a foreign trust, profit described in subsection (5)(ab) or (ac) is income of the trustee for the purposes of section HC 16.

Amounts not subject to ordering rule

(6) To the extent to which a distribution is made from a trust that is not a complying trust by disposing of property at less than market value or providing services to a beneficiary at less than market value, the distribution is a taxable distribution and is not subject to the ordering rule in section HC 16.

Inadequate records

(7) If the records of a trust that is not a complying trust do not allow an accurate determination of the elements of a distribution under section HC 16, the distribution is a taxable distribution.

Section HC 16 provides:

HC 16 Ordering rule for distributions from non-complying and foreign trusts

When this section applies

(1) This section applies for the purposes of the trust rules when a trustee of a non-complying trust or a foreign trust makes a distribution in an income year to a beneficiary. Subsections (6) and (7) override this subsection.

Order of elements of distribution

(2) The distribution is treated as consisting of the following elements in the following order:

(a) first, an amount of income that the trustee derives in the income year:

(b) second, an amount of income, other than beneficiary income, that the trustee has derived in an earlier income year:

(c) third, an amount that the trustee derives in the income year from the realisation of a capital asset of the trust or another capital gain and that is not income under section HC 15(5B) for the purposes of this section:

(d) fourth, an amount that the trustee has derived in an earlier income year from the realisation of a capital asset of the trust or another capital gain:

(e) last, the corpus of the trust.

Order and elements

(3) In subsection (2),—

(a) an amount must not be treated as included in the distribution if the amount has been treated under this section as being included in an earlier or contemporaneous distribution from the trust:

(b) the paragraphs are applied in order, and the next paragraph applies only to the extent to which the amount of the distribution is more than the cumulative amounts described in that paragraph and the preceding paragraphs.

Deductions and capital losses subtracted

(4) For the purposes of subsection (2),—

(a) in paragraphs (a) and (b), the amount of income is determined after subtracting the amount of a deduction that is taken into account in the income year in the calculation of net or taxable income for the corresponding tax year:

(b) in paragraphs (c) and (d), the amount is determined after subtracting the amount of a capital loss that the trustee incurs in the income year.

Transactions that are not genuine

(5) In the determination of the elements of a distribution to a beneficiary (**beneficiary A**), no amount of income or capital gain derived by the trustee of the trust is treated as distributed to another beneficiary of the trust (**beneficiary B**) if the effect is that some or all of the distribution to beneficiary A would be treated as not being a taxable distribution, unless the distribution to beneficiary B meets all the following requirements:

- (a) it is a genuine transaction entered into and carried out in good faith; and
- (b) it places the amount beyond the possession and control of the trustee in their capacity as trustee; and
- (c) it does not itself constitute a settlement.

Exclusions: terms of trust

(6) This section does not apply to the following distributions which are instead treated as consisting of the amount that reflects the terms of the trust or the terms of the exercise of the trustee's discretion:

- (a) a distribution by the trustee of a complying trust which is treated as exempt income under section CW 53 (Distributions from complying trusts), unless an election to pay income tax on trustee income has been made for the purposes of section HZ 2 (Trusts that may become complying trusts); or
- (b) a distribution from a non-discretionary trust—
  - (i) created by will or codicil, or by an order of court varying or modifying the provisions of a will or codicil; or
  - (ii) created on an intestacy or partial intestacy; or
  - (iii) on which no settlement has been made after 17 December 1987; or
- (c) a distribution from a trust, other than a non-complying trust, that is settled by a natural person and for which an election is made under section HC 30(2).

Exclusions: taxable distributions

(7) This section does not apply to a distribution described in section HC 15(6).

Meaning of non-discretionary trust

(8) In this section, a **non-discretionary trust** is a trust in relation to which the trustee has no discretion as to the source, nature, and amount of distributions to beneficiaries, including but not limited to the classification of trust property as capital or income.

Section HC 18 provides:

HC 18 Taxable distributions from foreign trusts

An amount that a person derives in an income year as a taxable distribution from a foreign trust is income of the person under section CV 13(c) (Amounts derived from trusts).

Section HC 26 provides:

HC 26 Foreign-sourced amounts: resident trustees

Exempt income

(1) A foreign-sourced amount that a New Zealand resident trustee derives in an income year is exempt income under section CW 54 (Foreign-sourced amounts derived by trustees) if—

- (a) no settlor of the trust is at any time in the income year a New Zealand resident who is not a transitional resident; and
- (b) the trust is not—
  - (i) a superannuation fund; or
  - (ii) a testamentary trust or an inter vivos trust of which a settlor died resident in New Zealand (whether or not they died in the income year); and
- (c) for a foreign trust for which a resident trustee applies for registration within the period (the **application period**) given by section 59C of the Tax Administration Act 1994 and that is registered by the end of the income year (the **post-deadline year**) beginning next after the end of the application period,—
  - (i) the trust has a trust deed; and
  - (ii) the income year ends after the day on which the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 receives the Royal assent; and
  - (iii) for an income year that includes part of the application period or is the post-deadline year, the trust is registered before the end of the post-deadline year and is not deregistered before the foreign-sourced amount is derived; and
  - (iv) for an income year beginning after the end of the post-deadline year, the trust is registered when the foreign-sourced amount is derived; and
  - (v) the trustee complies with the requirements under sections 22, 59B, 59C, and 59D of the Tax Administration Act 1994 that the trustee must meet during the income year; and

(d) for a foreign trust to which paragraph (c) does not apply,—

(i) the trust has a trust deed; and

(ii) the trust is registered at the beginning of the income year; and

(iii) the trust is registered when the foreign-sourced amount is derived; and

(iv) the trustee complies with the requirements under sections 22, 59B, 59C, and 59D of the Tax Administration Act 1994 that the trustee must meet during the income year.

Time for compliance with requirements

(1B) For a trustee to satisfy subsection (1)(c)(v) or (d)(iv) for an income year, the trustee must—

(a) comply in the income year with the requirements referred to in the subparagraph:

(b) satisfy the Commissioner that the trustee made reasonable efforts in the income year to comply with the requirements referred to in the subparagraph and corrected the failure to comply within a reasonable period of time after the trustee became aware of the failure.

When subsection (3) applies [Repealed]

(2) *[Repealed]*

When knowledge offence committed [Repealed]

(3) *[Repealed]*

Exception [Repealed]

(4) *[Repealed]*

Section YB 1 provides:

YB 21 Transparency of nominees

Treatment of nominee

(1) In this Act, unless the context otherwise requires, if a person holds something or does something as a nominee for another person, the other person holds or does that thing and the nominee is ignored.

Who is a nominee?

(2) A person holds or does something as a nominee for another person if the person acts on the other person's behalf. However, a trustee is a nominee only if the trustee is a bare trustee.

Nominal settlements

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

Tax Administration Act 1994

Section 59B provides:

59B Foreign trust with resident foreign trustee: registration and disclosure

(1) The Commissioner may register a foreign trust if the foreign trust has a resident foreign trustee and a trustee pays the prescribed fee.

(2) Resident foreign trustees of a foreign trust must apply to the Commissioner for registration of the foreign trust and pay the prescribed fee.

(3) A trustee applying for registration of a foreign trust (the **contact trustee**) is responsible for communicating with the Commissioner for the trust and must provide, with the application and fee,—

(a) the name of the trust:

(b) the date, amount, settlor, and nature of each settlement on the trust that is not a provision to the trustee at less than market value of minor services incidental to the activities of the trust and is made in the period of time ending with the application and beginning with—

(i) the date on which the trust is formed, if a trustee is not a natural person or is in the business of providing trustee services; or

(ii) the later of the date on which the trust is formed and 30 June 2013, if subparagraph (i) does not apply and a trustee becomes required to register the trust on the date on which the Taxation (Business Tax, Exchange of Information, and Remedial Matters) Act 2017 receives the Royal assent; or

(iii) the later of the date on which the trust is formed and the date that is 4 years before the earliest date on which a trustee becomes required to register the trust, if subparagraphs (i) and (ii) do not apply:

(c) the name, email address, physical residential or business address, jurisdiction of tax residence, taxpayer identification number, and connection with the trust of—

(i) each settlor who makes a settlement referred to in paragraph (b):

(ii) each person with a power to appoint or dismiss a trustee, to amend the trust deed, or to add or remove a beneficiary:

(iii) each person with a power to control the exercise of a power referred to in subparagraph (ii):

(iv) each person with a power to control a trustee in the administration of the trust:

(v) each trustee:

(vi) for a fixed trust, each beneficiary that is not a minor and each nominee for a beneficiary:

(vii) for a fixed trust and a beneficiary who is a minor, the parent or guardian of the beneficiary:

(d) for a fixed trust and a beneficiary who is a minor, the name, age, and taxpayer identification number of the beneficiary:

(e) for a discretionary trust, details of each beneficiary or class of beneficiary sufficient for the Commissioner to determine, when a distribution is made under the trust, whether a person is a beneficiary:

(f) a copy of the trust deed and of each document that amends or supplements the trust deed, and a copy of each document that is the functional equivalent of a trust deed or amending or supplementing document.

(4) The contact trustee must provide a signed declaration that each person referred to in subsection (3)(c)(i) to (vii)—

(a) is deceased; or

(b) despite the efforts of the contact trustee detailed in the declaration, cannot be located by the contact trustee; or

(c) has been informed of, and has agreed to provide the information necessary for compliance with, the requirements relating to the provision of information relating to the trust and persons connected with the trust imposed by all of—

(i) the Tax Administration Act 1994:

(ii) the Anti-Money Laundering and Countering Financing of Terrorism Act 2009:

(iii) the regulations made under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009.

(5) A contact trustee must provide to the Commissioner the details of an addition or alteration to a particular to which subsection (3) refers and any signed declaration under subsection (4) required as a consequence of the addition or alteration.

(6) A contact trustee who anticipates ceasing to be the person communicating with the Commissioner for the trust must provide to the Commissioner the details of—

(a) the anticipated date on which the trustee ceases to be the contact trustee for the foreign trust:

(b) the email address and physical residential address of the trustee after the anticipated date:

(c) the name, email address, and physical residential or business address of the replacement contact trustee for the foreign trust after the anticipated date.

(7) If a foreign trust has more than 1 resident foreign trustee, each resident foreign trustee is responsible for the performance of the obligations imposed on a trustee relating to registration of the trust, disclosure of information, annual returns, financial statements, and payment of fees.

Trusts Act 2019

Section 5(8) provides:

Interrelationship between Act and common law and equity

(8) This Act—

(a) is not an exhaustive code of the law relating to express trusts; and

(b) is intended to be complemented by the rules of the common law and equity relating to trusts (except where otherwise indicated or where those rules are inconsistent with the provisions of this Act).

Section 5(9) provides:

Interrelationship between Act and other enactments

(9) If there is an inconsistency between the provisions of this Act and those of any other enactment, the provisions of that other enactment prevail, unless this Act provides otherwise.

Section 12 provides:

12 Meaning of express trust

For the purposes of this Act, an **express trust** means a trust that—

(a) has each of the characteristics set out in section 13; and

(b) complies with section 14; and

(c) is created in accordance with section 15.

Section 14 provides:

14 Sole trustee cannot be sole beneficiary

A sole trustee of a trust must not be the sole beneficiary of the trust.

Interpretation Act 1999

Section 5 provides:

5 Ascertaining meaning of legislation

(1) The meaning of an enactment must be ascertained from its text and in the light of its purpose.

(2) The matters that may be considered in ascertaining the meaning of an enactment include the indications provided in the enactment.

(3) Examples of those indications are preambles, the analysis, a table of contents, headings to Parts and sections, marginal notes, diagrams, graphics, examples and explanatory material, and the organisation and format of the enactment.

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 19/15: If property held in a trust is rented out by a beneficiary of the trust for short-stay accommodation, who should declare the income, and what deductions can be claimed?

This "Question We've Been Asked" (QWBA) explains how the income tax rules apply if property held in a trust is rented out by a beneficiary of the trust for short-stay accommodation (eg, through Airbnb, Bookabach or Holiday Houses).

The most common situation where it will be a beneficiary renting out a property held in trust is where the property is the beneficiary's family home.

Question

If property held in a discretionary trust is rented out by a beneficiary of the trust for short-stay accommodation, who should declare the income, and what deductions can be claimed?

Answer

If property is held in a discretionary trust and a beneficiary rents all or part of it out for short-stay accommodation (eg, the property is the beneficiary's home), the income belongs to the beneficiary as they're the one granting the licence to the guests to stay.

Non-capital costs[1] related to earning the income can be deducted, though some of these costs will only be partly deductible because they also relate to private use of the property.

Key terms

Guest means a person provided with short-stay accommodation in return for payment.

Renting out and similar terms are used in this QWBA to refer to granting a licence for the use of the property by short-stay accommodation guests.

Short-stay accommodation means accommodation provided for up to four consecutive weeks in a dwelling that is not the guest's ordinary residence. It doesn't include accommodation provided to residential tenants, boarders or care home residents, and it doesn't include student or emergency accommodation.

Trust is sometimes used in this QWBA as meaning the trustees of the trust, where this is helpful for simplicity.

Explanation

Who is renting out the property?

1. Under New Zealand's tax rules, rental income from land belongs to the owner of the land and they must declare it to Inland Revenue.
2. Owning land is not limited to having the legal title. Under the Income Tax Act 2007 (the Act), someone will own land if they have an estate or interest in land. This could be freehold, leasehold, or any other interest in land.
3. Beneficiaries of a discretionary trust do not have an interest in the trust property simply by virtue of being beneficiaries. So in many situations where a property is held in a trust, it will be only the trustees, who legally own the land, who have an interest in the land. This will generally be the case, for example, for a dedicated short-stay accommodation property, or for a holiday home that is also sometimes rented out to third parties. Where only the trustees have an interest in the land, it will be the trustees renting out the property, and the rental income will belong to the trustees.
4. However, in some situations there will be different people with interests relating to the same underlying piece of land, and they will all be "owners" of land for income tax purposes. If this is the case, and the property is rented out, the rental income will belong to the person whose land interest is affected.

[1] See [19].

5. For example, if a beneficiary of a trust has a right to the possession of the property, or if they in fact occupy it, they will have an interest in land as defined in the Act. A right to possession of land is specifically defined as an "interest in land" (s YA 1). Even if a beneficiary did not have the right to possession of the property, if they occupy it there will be, legally, what's called a "tenancy at will",[2] which gives rise to an interest in land.[3] The most common situation where a beneficiary will have an interest in the land is where the property is the beneficiary's family home.
6. Where a beneficiary has an interest in the land and they rent the property out to short-stay accommodation guests, it is their interest that is affected. It is their right to possession of the property, or their interest as tenant at will, that is impinged on by the property being rented out, not the trustees' legal interest in the land. As such, if a beneficiary has an interest in the land and rents out all or part of the property for short-stay accommodation, the income will be theirs.

This QWBA deals with situations where it is a **beneficiary** of the trust renting out the property for short-stay accommodation. QB 19/16 deals with situations where it is the **trustees** of the trust renting out the property for short-stay accommodation.

A beneficiary of the trust is renting out the property

7. As noted above, the most common situation where a beneficiary of a trust is deriving the short-stay accommodation income from renting out a property held in a trust, is where the property is the beneficiary's home.

Summary of the income tax implications

8. In this situation, it will be the beneficiary deriving the short-stay accommodation income because it is their interest in land that is affected by the property being rented out.
9. The beneficiary may be eligible to use a simplified method for meeting their tax obligations, known as the "standard-cost method". This is discussed from [17]. Otherwise, the deductibility of the (non-capital) property-related expenses depends on whether the expense is incurred by the person deriving the income – in this case the beneficiary. Sometimes in a family trust situation this will not be the case.
10. In addition, while some expenses will be fully-deductible, others may be only partly deductible because they also relate to private use of the property.
11. Table 1 summarises the income tax implications for short-stay accommodation properties held in trust, where the income is derived by a beneficiary of the trust.

[2] Hinde, McMorland & Sim, *Land Law in New Zealand* (online ed.), LexisNexis NZ Limited, at 11.022, and *The Laws of New Zealand* (online ed.), LexisNexis NZ Limited, "Lessor and Lessee" paras 108–112, and "Trusts" para 99.

[3] Hinde, McMorland & Sim, *Land Law in New Zealand* (online ed.), LexisNexis NZ Limited, at 10.010(c).

TABLE 1: SHORT-STAY ACCOMMODATION PROVIDED IN TRUST PROPERTY THAT IS A BENEFICIARY OF THE TRUST'S HOME – INCOME DERIVED BY BENEFICIARY

<table>
<tr><td>Income</td><td>Generally, all amounts received from paying guests are income to the beneficiary.
However, some amounts may be exempt. This will be the case:
- if DET 19/02 (discussed below) is used; or
- if DET 19/02 isn't used and the "mixed-use asset rules" (the MUA rules) apply (see from [14]).</td></tr>
<tr><td>Expenditure incurred by the trustees and paid by a beneficiary
OR
Expenditure incurred by a beneficiary</td><td>For the beneficiary
• If the beneficiary pays all of the property-related outgoings, they may be eligible to use standard-cost determination DET 19/02. This is a simplified method for meeting the tax obligations for the short-stay accommodation activity.
If DET 19/02 is used:
- the short-stay accommodation income the beneficiary gets from the property is exempt up to the amount of the standard-costs;
- only income over the amount of the standard-costs needs to be declared;
- the beneficiary can't deduct any of their actual expenditure, unless it's for something not covered by the standard-costs and they have assessable income from providing the short-stay accommodation (ie, their income from providing the short-stay accommodation exceeds their standard-costs).
If DET 19/02 isn't used, the expenditure is deductible to the beneficiary, subject to apportionment for private use (usually as per QB 19/05).
For the trustees
• The amount of any expenses incurred by the trustees and paid by the beneficiary is rental income to the trustees. This will be cancelled out by the expenditure being deductible to the trustees because it's incurred by them.
If the trust is a "non-active trust" and has filed a non-active trust declaration (IR633), the trustees don't need to file a return (s 43B of the Tax Administration Act 1994). Otherwise, the trustees do need to file a return and include the rental income and deduction.</td></tr>
<tr><td>Expenditure incurred by and paid by trustees</td><td>The expenditure is not deductible to anyone, unless the beneficiary pays rent to the trustees (including through reimbursement of the expense, on account of the right to use the property).</td></tr>
</table>

The beneficiary's income and deductions

Income

12. Generally, all of the amounts received from paying guests will be income, and, for the reasons discussed at [1] to [6], the income is derived by the beneficiary.
13. The beneficiary may be eligible to use a simplified method (in DET 19/02) for meeting their tax obligations from providing the short-stay accommodation (discussed from [17]). If they use this method, some or all of the income will be exempt, and it will only be necessary to return income over a certain level. This reflects the typical costs incurred in providing short-stay accommodation in your home.
14. If DET 19/02 isn't used and the MUA rules apply there may also be some exempt income. The MUA rules could apply, for example, if a separate dwelling (eg, a sleepout) on the same property as the beneficiary's home is rented out, or if the home is vacant for 62 days or more in the year (eg, if the beneficiary was away for an extended holiday and the home was unused during that time).
15. If the MUA rules apply, the following amounts will be exempt income:
    - amounts received for renting the property to associated natural persons (eg, close relatives of the beneficiary such as their children, grandchildren, siblings or in-laws); and
    - amounts received from renting the property at "mates' rates" (less than 80% of the market value rent).

    What will be income or exempt income under the MUA rules is discussed in detail in QB 19/07.

Deductions

16. Often where a beneficiary's home is held in a trust the beneficiary will pay all of the outgoings for the property, irrespective of who the expenses are legally incurred by (eg, rates, insurance, repairs and maintenance, and any loan repayments for the property).
17. Where the beneficiary's home is used to earn short-stay accommodation income (ie, through renting out a room or the whole property from time to time) and the beneficiary pays all of the property-related outgoings, they may be eligible to use standard-cost determination DET 19/02. This is a simplified method for a taxpayer meeting their tax obligations from providing short-stay accommodation in all or part of their home.
18. If DET 19/02 is used, income up to the amount of set standard-costs is exempt. Only income in excess of the standard-costs needs to be returned. No deductions for expenditure actually incurred are allowed, unless the expenditure is for things not covered by the standard-costs in the determination.
19. If DET 19/02 isn't used, non-capital property-related expenses the beneficiary pays will be deductible to the beneficiary, subject to appropriate apportionment for any expenses that don't solely relate to the income-earning use of the property. Deductible expenses would include things like:
    - interest payments;
    - property and contents insurance premiums;
    - rates;
    - repairs and maintenance;
    - utility bills;
    - advertising costs; and
    - any commission or fee the beneficiary pays to an advertising platform or transaction facilitator (this does not include any service fee the guests pay the platform, just fees the beneficiary pays).
20. Expenses that relate solely to the rental activity (eg, advertising fees) will be 100% deductible. But mixed expenses – those that relate to both the private use of the home and the rental activity – need to be apportioned. These mixed expenses would include things like rates, insurance, utility bills, and loan interest.
21. Generally, the appropriate basis for apportionment will be as discussed in QB 19/05. But in some situations a different basis may be required. For example, if a separate dwelling (eg, a sleepout) on the same property as the beneficiary's home is rented out, or if the home is vacant for 62 days or more in the year (eg, if the beneficiary was away for an extended holiday and the home was unused during that time). In those situations, QB 19/06 explains how to work out which tax rules apply. If the MUA rules apply, there is a formula for apportioning expenses, and periods of private use (including use that gives rise to exempt income) will restrict the availability of deductions. If the MUA rules don't apply, QB 19/06 will refer readers to the appropriate guidance on apportionment.
22. Depreciation losses on chattels in the property owned by the beneficiary and available for use by paying guests will also be deductible either in full or in part (depending on whether the chattels are used solely by paying guests). QB 19/05 explains how to calculate the percentage of depreciation losses that is tax deductible (except if the home was vacant for 62 days or more in the year – in which case see QB 19/07).

Allocation of deductions if the rental activity is loss-making

23. If the rental activity is loss-making, the residential rental ring-fencing rules in subpart EL of the Act may potentially limit the deductions that can be allocated to the income year.
24. Those rules will often not apply where the property the beneficiary is renting out is their main home. However, the rules could apply in some situations, for example, if a principal settlor of the trust has a separate main home, or if the property the beneficiary is renting out is not their main home.
25. Any deductions that can't be allocated to the year because of the ring-fencing rules will be carried forward to the next year the beneficiary derives residential income.
26. The ring-fencing rules will not apply if the short-stay accommodation is provided in a dwelling that is a mixed-use asset for the purposes of the MUA rules. For example, this could be the case for a separate dwelling (eg, a sleepout) on the same property as the beneficiary's home. There are separate rules called the "expenditure quarantine rules" that may apply in this situation if the rental activity is loss-making – see QB 19/07.

27. There is more information about the residential rental ring-fencing rules in *Tax Information Bulletin* Vol 31, No 8 (September 2019), from page 53.

The trustees' income and deductions

28. In the family home context, it's likely that most of the property-related expenditure will be incurred by the beneficiary who lives there. However, some expenditure will be incurred by the trustees, for example, the rates and possibly property insurance.
29. Often the beneficiary who lives in the property will pay the property-related outgoings incurred by the trust as part of the arrangement that allows them to live in the property. The payment of those amounts by the beneficiary would be rental income to the trustees under s CC 1.
30. However, this rental income would be offset by the trustees being able to deduct the expenditure, as it's incurred by them in deriving the rental income.
31. If the trust is non-active, the trustees **may not need to file a tax return**. A return would not be required if the trust:
    - is a complying trust (an ordinary New Zealand trust with New Zealand resident trustees and settlors);
    - is a non-active trust;
    - has submitted a non-active trust declaration (IR633) to Inland Revenue; and
    - hasn't stopped being a non-active trust since making the declaration.
32. Essentially, a trust will be a non-active trust if it hasn't derived (or been deemed to have derived) any income for the year and doesn't have any deductions for the year. There also can't have been any transactions involving assets of the trust that give rise to income to any person, or to fringe benefits to any employee or former employee.
33. In determining whether a trust is "non-active", the following payments aren't taken into account (s 43B(3) of the Tax Administration Act 1994):

    (a) reasonable fees paid to professional trustees to administer the trust; or

    (b) bank charges or other minimal administration costs totalling not more than $200 in the tax year; or

    (c) interest earned on trust assets in any bank account during the tax year, to the extent to which the total interest does not exceed $200; or

    (d) **insurance, rates, and other expenditure incidental to the occupation of a dwelling owned by the trust and incurred by the beneficiaries of the trust.**

    [Emphasis added]

34. So if a beneficiary is paying the trustee-incurred outgoings for the property because they live there, while those amounts may technically be rent, if the trust doesn't otherwise have income or make any payments other than those mentioned at [33], it may be able to submit a non-active trust declaration (see the requirements at [31]). If the trust meets the requirements and does this, the trustees won't need to file a tax return so long as the trust continues to be non-active.
35. Trusts that **aren't** non-active trusts will have to file a tax return. Example 1 explains what rental income the trustees will have and what deductions they can claim when a beneficiary lives in property held in the trust, uses it to provide short-stay accommodation, and pays the outgoings incurred by the trustees.

Could s GC 5 apply to deem adequate rent to be paid from the beneficiary to the trust?

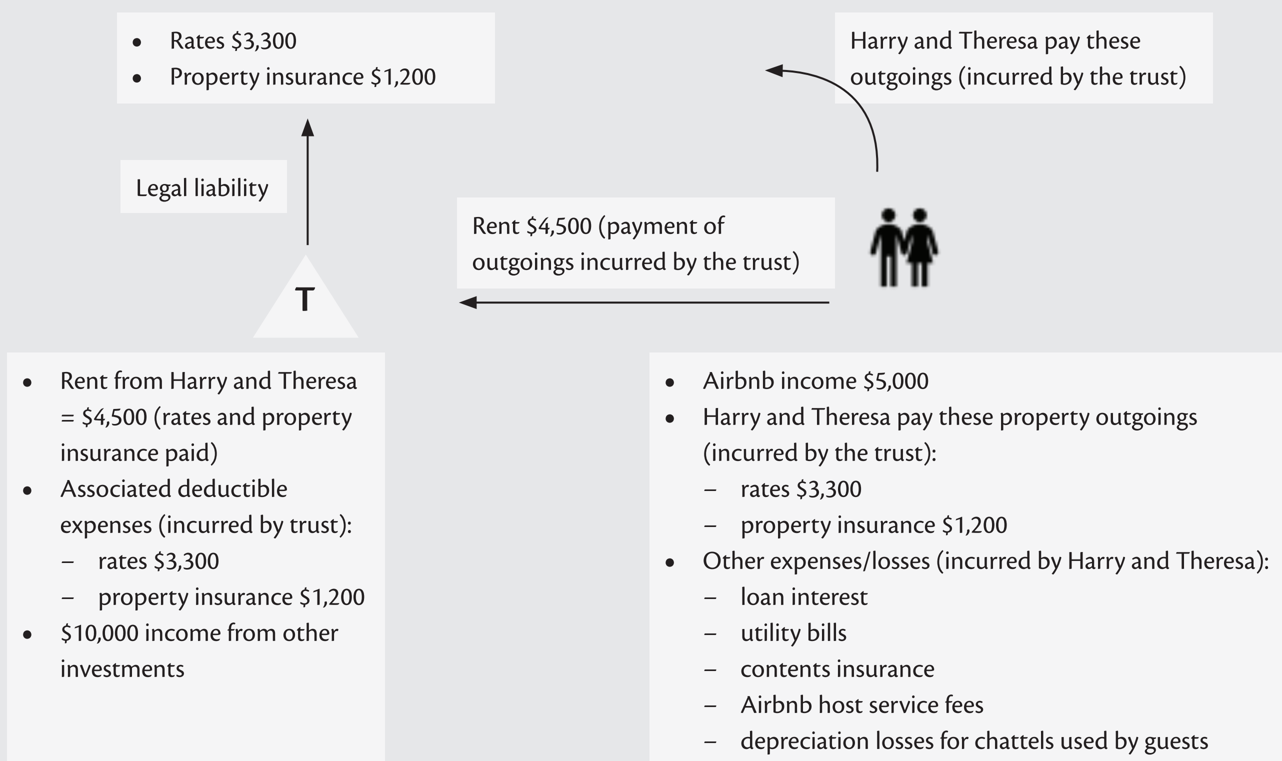
36. Section GC 5 is a provision in the Act that may apply where property is leased to someone who uses the property in deriving income. If no rent is payable by the lessee, or the rent is inadequate, s GC 5 could deem "adequate rent" to be paid by the lessee and derived by the lessor.
37. "Lease" is defined in s GC 5(5) as meaning a tenancy of any duration (it also includes a sublease or bailment). As noted at [5], where a beneficiary of a trust lives in property held in the trust, there will be a tenancy at will, which meets the definition of "lease".
38. Section GC 5 will only apply to certain leases (listed in s GC 5(2)). This includes a lease by a person to a relative. "Relative" (defined in s YA 1) includes a person connected with another person by being the trustee of a trust under which a relative has benefitted or is eligible to benefit.
39. So in a family trust situation, where a beneficiary is living in trust property and using it to derive income (eg, renting out a room for short-stay accommodation), s GC 5 could potentially apply to deem "adequate rent" to be paid by the beneficiary to the trust.

40. However, the Commissioner would not apply s GC 5 in this situation. This is because s GC 5 is aimed at ensuring income can't be assigned to someone else through leasing income-producing property to a relative or related company at a nominal rent. That mischief isn't present in the trust context, where a trust can legitimately allocate any income as beneficiary income. The Commissioner will not use s GC 5 to deem there to be "adequate rent" paid for a lease in a situation where the lease isn't creating an opportunity for a tax benefit through the shifting of income from one person to another.

Provision of below market value accommodation to the beneficiary

41. If the trust is a complying trust (an ordinary New Zealand trust with New Zealand resident trustees and settlors), the trustees allowing a beneficiary to live in the trust-owned property rent-free or for less than market rent will be an exempt distribution from the trust (ss CW 53 and HC 20). However, if the trust is a foreign trust or a non-complying trust, this will be a taxable distribution from the trust, and not subject to the ordering rules (s HC 15(6)). As to the value of the distribution, see from [8.6] of IS 18/01: *Taxation of Trusts*.

Example 1: Trust income and deductions when a beneficiary living in trust property pays property outgoings



Harry and Theresa's home is held in a family trust. They settled the trust when they bought the home, and they are beneficiaries of the trust. They have a spare room and rent it out on Airbnb, earning $5,000 from this during the year.

Because they live in the property, Harry and Theresa pay the following outgoings that are incurred by the trust: the rates ($3,300 for the year) and the property insurance ($1,200 for the year).

Harry and Theresa have other expenses related to earning the Airbnb income: loan interest (the home loan is in their names), utility bills, contents insurance, and Airbnb host service fees. They also have depreciation losses for chattels in the home that guests can use.

Because Harry and Theresa are paying the outgoings for the property that are incurred by the trust (the rates and property insurance), on the basis they can live there, those amounts would be rent to the trust. The trust can deduct the amount of the rates and property insurance because it has incurred them, having a legal liability to pay them. The result is that the rent and the deductions for the trust net off. However, the trust has $10,000 income from other investments so is not a "non-active trust". As such, the trustees need to file a tax return, which will need to include the rental income and associated deductions (even though they net off).

If Harry and Theresa meet the criteria to use Inland Revenue's "standard-cost" determination (DET 19/02), they might choose to do that, to simplify their tax obligations. But otherwise, they'll need to return all of the Airbnb income they receive, and can deduct a portion of the rates, property insurance and other expenses (and depreciation losses) they have. QB 19/05 will help them work out what proportion of their expenses they can claim as deductions.

References

Subject references

income tax
short-stay accommodation
trusts

Legislative references

Income Tax Act 2007 – ss CC 1, CW 53, DV 9, GC 5, HC 15, HC 20, subpart EL and the definitions of "**estate** in relation to land, **interest** in relation to land, **estate or interest in land**, **estate in land**, **interest in land**, and similar terms ", "land", "own" and "relative" in s YA 1
Tax Administration Act 1994 – s 43B

Other references

DET 19/02: *Standard-cost household service for short-stay accommodation providers* (Inland Revenue)
Hinde, McMorland & Sim, *Land Law in New Zealand* (online ed.), LexisNexis NZ Limited
IR633: *Non-active trust declaration* (Inland Revenue)
IS 18/01: *Taxation of Trusts* (Inland Revenue)
QB 19/05: *What are my income tax obligations if I rent out my home or a separate dwelling on my property as short-stay accommodation?* (Inland Revenue)
QB 19/06: *What income tax rules apply if I have a dwelling that I sometimes rent out as short-stay accommodation and sometimes use myself?* (Inland Revenue)
QB 19/07: *How do the mixed-use asset income tax rules apply to a dwelling that I sometimes rent out as short-stay accommodation and sometimes use privately?* (Inland Revenue)
Tax Information Bulletin Vol 31, No 8 (September 2019) (Inland Revenue)
The Laws of New Zealand (online ed.), LexisNexis NZ Limited

QB 19/16: If property held in a trust is rented out by the trustees for short-stay accommodation, who should declare the income, and what deductions can be claimed?

This "Question We've Been Asked" (QWBA) explains how the income tax rules apply if property held in a trust is rented out by the trustees for short-stay accommodation (eg, through Airbnb, Bookabach or Holiday Houses).

It will usually be the trustees renting out the property where the property is either a dedicated short-stay accommodation property, or a property that's sometimes rented out and sometimes used for other purposes (eg, it's used by beneficiaries of the trust).

Question

If property held in a discretionary trust is rented out by the trustees for short-stay accommodation, who should declare the income, and what deductions can be claimed?

Answer

If property is held in a discretionary trust and the trustees rent it out for short-stay accommodation (eg, a holiday home or dedicated short-stay accommodation rental property), the income belongs to the trustees, and will generally have to be declared in the trust's tax return. However, some or all of the income may be allocated as beneficiary income, which would mean it's taxed at the beneficiary's tax rate rather than at the trust rate.

Non-capital costs[1] related to earning the income can be deducted. However, such costs will only be partly deductible where the expenditure also relates to private use or non income-earning use of the property.

Key terms

Guest means a person provided with short-stay accommodation in return for payment.

Renting out and similar terms are used in this QWBA to refer to granting a licence for the use of the property by short-stay accommodation guests.

Short-stay accommodation means accommodation provided for up to four consecutive weeks in a dwelling that is not the guest's ordinary residence. It doesn't include accommodation provided to residential tenants, boarders or care home residents, and it doesn't include student or emergency accommodation.

Trust is sometimes used in this QWBA as meaning the trustees of the trust, where this is helpful for simplicity.

[1] See [23].

Explanation

Who is renting out the property?

1. Under New Zealand's tax rules, rental income from land belongs to the owner of the land and they must declare it to Inland Revenue.
2. Owning land is not limited to having the legal title. Under the Income Tax Act 2007 (the Act), someone will own land if they have an estate or interest in land. This could be freehold, leasehold, or any other interest in land.
3. Beneficiaries of a discretionary trust do not have an interest in the trust property simply by virtue of being beneficiaries. So in many situations where a property is held in a trust, it will be only the trustees, who legally own the land, who have an interest in the land. This will generally be the case, for example, for a dedicated short-stay accommodation property, or for a holiday home that is also sometimes rented out to third parties. Where only the trustees have an interest in the land, it will be the trustees renting out the property, and the rental income will belong to the trustees.
4. However, in some situations there will be different people with interests relating to the same underlying piece of land, and they will all be "owners" of land for income tax purposes. If this is the case, and the property is rented out, the rental income will belong to the person whose land interest is affected.
5. For example, if a beneficiary of a trust has a right to the possession of the property, or if they in fact occupy it, they will have an interest in land as defined in the Act. A right to possession of land is specifically defined as an "interest in land" (s YA 1). Even if a beneficiary did not have the right to possession of the property, if they occupy it there will be, legally, what's called a "tenancy at will",[2] which gives rise to an interest in land.[3] The most common situation where a beneficiary will have an interest in the land is where the property is the beneficiary's family home.
6. Where a beneficiary has an interest in the land and they rent the property out to short-stay accommodation guests, it is their interest that is affected. It is their right to possession of the property, or their interest as tenant at will, that is impinged on by the property being rented out, not the trustees' legal interest in the land. As such, if a beneficiary has an interest in the land and rents out all or part of the property for short-stay accommodation, the income will be theirs.

> This QWBA deals with situations where it is a **trustees** of the trust renting out the property for short-stay accommodation.
> QB 19/15 deals with situations where it is the **beneficiary** of the trust renting out the property for short-stay accommodation.

Trustees of the trust renting out the property

7. The most common situations where trustees of a trust may rent out property for short-stay accommodation are where the property is:
   - a dedicated short-stay accommodation property; or
   - a family holiday home that's also sometimes rented out.
8. In these situations, the income will usually belong to the trustees as they would usually be the only ones with an interest in the land.
9. There could be circumstances where this is not the case, for example, if a beneficiary has leased the property from the trustees, or if it can be shown that a beneficiary has been given the right to possession and use of the property. But the most common situation is that the income will belong to the trustees, so the following discussion is based on that being the case.
10. There are slight differences in the tax treatment where trustees of a trust are renting out property for short-stay accommodation, depending on which rules apply.

Summary of the income tax implications

11. In the situation covered by this QWBA – where the trustees rent out the property – any income from renting the property out for short-stay accommodation will belong to the trustees and will need to be returned by them.
12. The deductibility of the (non-capital) property-related expenses depends on whether the expense is incurred by the person deriving the income – in this case the trustees. Sometimes in a family trust situation this will not be the case.
13. Although some expenses will be fully deductible, others may be only partly deductible because they also relate to private use or non income-earning use of the property.

[2] Hinde, McMorland & Sim, *Land Law in New Zealand* (online ed.), LexisNexis NZ Limited, at 11.022, and *The Laws of New Zealand* (online ed.), LexisNexis NZ Limited, "Lessor and Lessee" paras 108–112, and "Trusts" para 99.

[3] Hinde, McMorland & Sim, *Land Law in New Zealand* (online ed.), LexisNexis NZ Limited, at 10.010(c).

14. Table 1 summarises the income tax implications for short-stay accommodation properties held in trust, where the income is derived by the trustees.

TABLE 1: SHORT-STAY ACCOMMODATION PROPERTY — INCOME DERIVED BY THE TRUSTEES

Income	Generally, all amounts received from paying guests are **income to the trustees**. However, if the property is subject to the "mixed-use asset rules" (the MUA rules) – see from [15], the following amounts are **exempt income**: • amounts received for renting the property to associated natural persons (eg, settlors and beneficiaries); and • amounts received from renting the property at "mates' rates" (less than 80% of the market value rent).
Expenditure incurred by and paid by the trustees	The expenditure is **deductible to the trustees**. However, for properties that are also used for non income-earning purposes (eg, used by the beneficiaries of the trust), this is subject to apportionment. *See from [31] for how to apportion expenditure for property subject to the MUA rules, or from [35] for property not subject to the MUA rules.*
Expenditure incurred by the trustees and paid by a beneficiary	**For the beneficiary** The expenditure isn't deductible to the beneficiary, as there is no connection between the expenditure and the beneficiary earning income. **For the trustees** • The expenditure is **deductible to the trustees**. However, for properties that are also used for non income-earning purposes (eg, used by the beneficiaries of the trust), this is subject to apportionment. • But if the beneficiary isn't reimbursed by the trustees, the amount of the expense paid by the beneficiary is **income to the trustees** as either: - rental income under s CC 1, if paid by the beneficiary for use of and/or ability to use the property, provided the property is not subject to the MUA rules; or - income under s CG 4, to the extent of the deduction the trustees have been allowed, if not paid by the beneficiary for use of and/or ability to use the property, or if the property is subject to the MUA rules. The net effect of this is that if the beneficiary isn't reimbursed, the trustees don't get the benefit of the deduction. This reflects that the trustees haven't borne the expense.
Expenditure incurred by a beneficiary	• If the trustees reimburse the beneficiary (by actual payment or through their 'beneficiary current account'), this is **deductible to the trustees**. However, for properties that are also used for non income-earning purposes (eg, used by the beneficiaries of the trust), this is subject to apportionment. • If the trustees don't reimburse the beneficiary, the expense can't be deducted by anyone. *In this case, the amount may be rental income, and there may be a settlement on the trust by the beneficiary or a distribution to the beneficiary from the trust.* *The amount could only be rental income if the property is not subject to the MUA rules, and the beneficiary incurred the expense for the use of and/or ability to use the property.* *Whether there is a settlement on the trust or a distribution from the trust depends on the value of what the beneficiary and the trust are providing each other under the arrangement. This includes the value of expenses incurred by the beneficiary that are of value to the trust and the market value of any use of and/or ability to use the property they get in return for incurring those expenses.*

Which tax rules apply?

15. If the property is sometimes rented out and sometimes used by people associated with the trust (eg, a family holiday home that's sometimes rented out), there are different rules that could apply to determine the precise tax treatment for the property – in particular what counts as income, and the proportion of the expenses that can be deducted.

16. For these properties, the first step will be to work out which rules the property falls into for the particular year:
    - the "mixed-use asset rules" (the MUA rules); or
    - the standard tax rules.
17. QB 19/06 explains how to work out which rules apply for each income year. The factor that determines which rules apply is whether the property is unused for 62 days or more during a year.
18. If property is a mixed-use asset, there are some situations in which the taxpayer can choose to opt out of the tax rules. This is explained in QB 19/06.
19. It's necessary to revisit which tax rules apply each year.

The income is derived by the trustees

20. As noted above, where the trustees are the ones renting out the short-stay accommodation, the income will belong to the trustees.
21. Generally, all amounts the trustees receive from paying guests will be income. However, this doesn't include minor contributions from family or friends who aren't charged rent (eg, if they pay $20 towards their power usage).
22. In addition, if the MUA rules apply, the following amounts will be exempt income:
    - amounts received for renting the property to associated natural persons (eg, the settlor and beneficiaries); and
    - amounts received from renting the property at "mates' rates" (less than 80% of the market value rent).

What will be income or exempt income under the MUA rules is discussed in detail in QB 19/07.

Expenditure incurred by the trustees is deductible to them

23. Because the rental income in this situation belongs to the trustees, non-capital property-related expenditure that's incurred by the trustees will be deductible to them under s DA 1, subject to any apportionment required. These expenses could include things like:
    - interest payments;
    - property and contents insurance premiums;
    - rates;
    - repairs and maintenance;
    - utility bills;
    - advertising costs; and
    - any commission or fee the trust pays to an advertising platform or transaction facilitator (this does not include any service fee the guests pay the platform, just fees the trust pays).
24. Expenses incurred by the trustees will be deductible to the trustees (subject to any apportionment), regardless of whether the expense is paid by the trustees or by a beneficiary.
25. Expenditure will be incurred by the trustees if they either paid or became definitively committed to the expenditure in the income year.
26. This would include where the trustees have incurred the obligation themselves (eg, rates and property insurance). It would also include situations where the trustees have agreed that they'll reimburse a beneficiary for expenditure incurred by the beneficiary. For example, if a beneficiary gets the power, pay-TV or internet connected in their name (which would often be the case, as this would be easier than getting those services connected in the trustees' names). In those situations, the agreement to reimburse the beneficiary is an obligation incurred by the trustees.
27. It may be that someone who is a beneficiary of the trust is also a trustee, and connects services such as power or internet in their individual name. Generally, in this case the person would be incurring the expenditure in their capacity as trustee, so the expenditure would be incurred directly by the trustees.
28. Some or all of the rental income may be allocated as beneficiary income, which would mean it's taxed at the beneficiary's tax rate rather than at the trust rate. However, for the purposes of determining the deductions the trust is allowed, the beneficiary income is treated as trustee income (s DV 9(2)). This means that all the non-capital expenses the trust incurs in relation to the rental activity will be deductible to the trustees, subject to any apportionment required.

Dedicated short-stay accommodation property

29. If the property is a dedicated short-stay accommodation property, the above expenses will be fully deductible; no apportionment is necessary. Depreciation losses on the property's chattels would also be fully deductible.

A holiday home that is sometimes rented out

30. However, if the property is sometimes rented out and sometimes used by people associated with the trust (eg, a family holiday home that's sometimes rented out), the proportion of the expenses that can be deducted will depend on whether the MUA rules or the standard tax rules apply (see from [15]).

If the MUA rules apply to the holiday home

31. If the MUA rules apply to the holiday home, expenses that relate solely to the rental activity (eg, advertising fees) will be 100% deductible. But mixed expenses – those that relate to both the rental activity and "private use" of the property – need to be apportioned. These mixed expenses would include things like rates, insurance, utility bills, and loan interest.

32. Use by natural persons who are associated with the trustees counts as "private use" for the apportionment formula in the MUA rules. Use by anyone else for less than 80% market value rent (eg, friends staying and paying "mates' rates") will also be "private use".

33. Persons associated with the trustee will (relevantly) be:
    - beneficiaries of the trust;
    - settlors of the trust;
    - persons associated with beneficiaries of the trust under the "two relatives" test in s YB 4; and
    - persons with a power of appointment or removal of trustees – unless within the exclusion for providers of professional services (s YB 11).

The IR620 guide explains how to work out if someone is associated with the trustees.

34. QB 19/07 explains how to calculate the percentage of the mixed expenses that is tax deductible under the MUA rules. The same formula is generally used to calculate the portion of depreciation losses for the property's chattels that is deductible. The exception to this is depreciation losses or depreciation recovery income on disposal, which is dealt with by the depreciation provisions in subpart EE.

If the standard tax rules apply to the holiday home

35. If the standard tax rules apply to the holiday home, expenses that relate solely to the rental activity (eg, advertising fees) will be 100% deductible. But mixed expenses – those that relate to both the rental activity and non income-earning use of the property (eg, use by beneficiaries or settlors of the trust) – need to be apportioned. These mixed expenses would include things like rates, insurance, utility bills, and loan interest.

36. These mixed expenses will usually be deductible based on the total number of nights in the year the property is rented out or available to be rented out. The discussion and examples in QB 19/08 (from [20]) explain how to calculate the percentage of the mixed expenses that is tax deductible. Although QB 19/08 refers to expenditure not being deductible for "private use" (which a trust can't have), the same approach can be used. This is because there will only be the required nexus between the expenditure and the earning of income to the extent the property is rented out or available to be rented out.

37. Depreciation losses on the property's chattels will also be partly deductible. QB 19/08 explains how to calculate the percentage of depreciation losses that is tax deductible.

Income to the trustees if beneficiary not reimbursed for paying trustees' expense

38. For properties that are either dedicated short-stay accommodation properties or holiday homes that are sometimes rented out, the trust will likely have a bank account that guests pay into. Therefore, where the trustees have incurred an obligation themselves (eg, rates and property insurance), they will likely have the funds to pay the expense.

39. But if for whatever reason they didn't, and a beneficiary pays the expense instead, the expense would still be deductible to the trustees as they have incurred the legal obligation.

40. However, if the trustees didn't reimburse the beneficiary (either in cash or through the 'beneficiary's current account'), the amount of the expense paid by the beneficiary will be income to the trustees either:
    - under s CC 1, if:
        - the amount is paid by the beneficiary for the use of and/or ability to use the property; and
        - the property is not subject to the MUA rules; or otherwise
    - under s CG 4, to the extent of the deduction the trustees have been allowed.
41. The net effect of this is that if the beneficiary isn't reimbursed, the trustees don't get the benefit of the deduction. This reflects that the trustees haven't borne the expense.

Reimbursement of expense incurred by beneficiary

42. As noted above, it may be that a beneficiary (who is not also a trustee) incurs an obligation to pay some property-related expenses (such as power bills or internet), because it's easier to have those services connected in an individual's name.
43. Those expenses aren't deductible to the beneficiary, as there's no nexus between the expenditure and the beneficiary earning income. The income from the rental activity belongs to the trustees.
44. However, the trustees may have agreed that they'll reimburse the beneficiary for this expenditure. If they have, the agreement to reimburse the beneficiary is an obligation incurred by the trustees. The trustees can therefore deduct the amount they reimburse the beneficiary (whether by actual payment or through the 'beneficiary's current account'), subject to any apportionment required (see from [30]).

Expenditure incurred by a beneficiary and not reimbursed by the trustees

45. If a beneficiary has incurred a property-related expense that the trustees don't reimburse them for, the expense can't be deducted by anyone.
46. In this case the amount of the expense the beneficiary has paid will be rental income to the trustees, if:
    - the amount is paid by the beneficiary for the use of and/or ability to use the property; and
    - the property is not subject to the MUA rules.
47. There may also be a settlement on the trust or a distribution from the trust. Whether there is a settlement on the trust or a distribution from the trust, and the amount of any such settlement or distribution, will depend on the value of what the beneficiary and the trust are providing each other under the arrangement. This includes the value of property-related expenses incurred by the beneficiary that are of value to the trust and the market value of any use of and/or ability to use the property they get in return for incurring those expenses.

Allocation of deductions if the rental activity is loss-making

48. If the property is not within the mixed-use asset rules and the rental activity is loss-making, the residential rental ring-fencing rules in subpart EL of the Act may limit the deductions that can be allocated to the income year. Any deductions that can't be allocated to the year because of the ring-fencing rules will be carried forward to the next year the trustees derive residential income.
49. There is more information about the residential rental ring-fencing rules in *Tax Information Bulletin* Vol 31, No 8 (September 2019), from page 53.

Examples

Example 1: Trust income and deductions for a dedicated rental property

The B-F Family Trust owns an investment property in Queenstown that's rented out on Airbnb. The property isn't used at all by the settlors (who are deceased) or beneficiaries of the trust – it's a dedicated Airbnb rental property.

The corporate trustee pays all of the property-related expenses from its bank account. This includes the power, internet and pay-TV bills. The connections for those services are in the names of Ani and Charlie, who are beneficiaries (but not trustees) of the trust. The connections were signed up for in Ani and Charlie's names as this was easier. But there's an agreement that the trustee will pay all those expenses.

All of the rental income is income to the trustee. All of the (non-capital) property-related expenses are deductible to the trustee. This includes the power, internet and pay-TV bills, as the trustee pays those. Because the property is only used for rental purposes, the expenses are all fully deductible.

Example 2: Trust income and deductions for a holiday house that's subject to the MUA rules

The Fab Five Family Trust owns the Brown family's holiday house. The Browns use the holiday house for 45 nights during the tax year. The trustees of the Fab Five Family Trust rent it out to friends of the Browns for 15 nights in the year for "mates' rates" of $50 a night, and the trustees rent it out to others for 80 nights in the year for $200 a night.

The trustees have used QB 19/06 to work out the holiday house is a mixed-use asset for the tax year. This is because it was: (a) used privately (by the Browns, who are beneficiaries and settlors of the trust, and by friends for less than 80% of the market value rent), (b) used to earn income, and (c) vacant for 62 days or more. Therefore, the MUA rules apply.

The trustees pay most of the property-related expenses from their bank account. This includes the power and internet bills, even though the connections for those services are in the name of Mrs Brown, who is a settlor and beneficiary of the trust. The connections were signed up for in Mrs Brown's name as this was easier. But there's an agreement that the trustees will pay those expenses. However, Mr and Mrs Brown have a loan (in their names, with a guarantee provided to the bank by the trustees) from when they bought the property and settled it on the trust, and they pay the loan repayments. The trustees reimburse Mr and Mrs Brown for the interest component of the loan repayments. This is recorded in Mr and Mrs Brown's 'beneficiary current accounts'.

The rental income from the full-rate paying guests is income to the trustees. The $50 a night "mates' rates" paid by the Browns' friends isn't income to the trustees – it's exempt because it's less than 80% of the market value rent.

Some of the trustees' expenses are fully deductible. This includes the fees they pay to Airbnb and Bookabach, and the cost of cleaners who come in after the full-rate paying guests.

Other expenses the trustees incur need to be apportioned under the formula in the MUA rules, as they relate to both the rental activity and the private use of the holiday home (by the Browns and their friends who pay less than 80% of market value rent). These expenses include the power and internet bills, as the trustees pay those, and the loan interest that the trustees reimburse Mr and Mrs Brown for. The trustees use QB 19/07 to work out the deductible portion of these mixed expenses.

There may be a settlement on the trust or a distribution from the trust. This depends on the value of what Mr and Mrs Brown and the trust are providing each other under the arrangement.

Example 3: Trust income and deductions for a holiday house that is subject to the "standard rules" not the MUA rules

The We Are Family Trust owns the Miller family's holiday house in a popular tourist destination. The Millers use the holiday house for 90 nights during the tax year, and rent it out as short-stay accommodation for 220 nights in the year.

The trustees have used QB 19/06 to work out the holiday house is not subject to the MUA rules for the tax year, so the "standard rules" apply. This is because the holiday house was not vacant for 62 days or more during the year.

The short-stay accommodation guests pay into the trustees' bank account, and the trustees pay most of the property-related expenses from their bank account. This includes the power, pay-TV and internet bills, even though the connections for those services are in the name of Mr Miller, who is a settlor and beneficiary of the trust. The connections were signed up for in Mr Miller's name as this was easier. But there is an agreement that the trustees will pay those expenses. However, Mr and Mrs Miller have a loan (in their names) from when they bought the property and settled it on the trust, and they pay the loan repayments. The trustees reimburse Mr and Mrs Miller for the interest component of the loan repayments. This is recorded in Mr and Mrs Miller's 'beneficiary current accounts'.

The rental income from the short-stay accommodation guests is income to the trustees.

Some of the trustees' expenses are fully deductible. This includes the fees they pay to the Holiday Houses and Bookabach websites, which they advertise on, and the cost of cleaners who come in after the paying guests' stays.

Other expenses the trustees incur need to be apportioned, as they relate to both the rental activity and the non income-earning use of the holiday home (when it's used by the Millers). These expenses include the power and internet bills, as the trustees pay those, and the loan interest that the trustees reimburse Mr and Mrs Miller for. The trustees use QB 19/08 to help them work out the deductible portion of these expenses.

There may be a settlement on the trust or a distribution from the trust. This depends on the value of what Mr and Mrs Miller and the trust are providing each other under the arrangement.

References

Subject references

income tax
short-stay accommodation
trusts

Legislative references

Income Tax Act 2007 – ss CC 1, CW 53, DV 9, GC 5, HC 15, HC 20, subpart EL and the definitions of "**estate** in relation to land, **interest** in relation to land, **estate or interest in land**, **estate in land**, **interest in land**, and similar terms ", "land", "own" and "relative" in s YA 1

Other references

Hinde, McMorland & Sim, *Land Law in New Zealand* (online ed.), LexisNexis NZ Limited

IR620: *Associated persons definitions for income tax purposes* (Inland Revenue)

QB 19/06: *What income tax rules apply if I have a dwelling that I sometimes rent out as short-stay accommodation and sometimes use myself?* (Inland Revenue)

QB 19/07: *How do the mixed-use asset income tax rules apply to a dwelling that I sometimes rent out as short-stay accommodation and sometimes use privately?* (Inland Revenue)

QB 19/08: *How do the standard income tax rules apply to a dwelling that I sometimes rent out as short-stay accommodation and sometimes use privately?* (Inland Revenue)

Tax Information Bulletin Vol 31, No 8 (September 2019) (Inland Revenue)

The Laws of New Zealand (online ed.), LexisNexis NZ Limited

STANDARD PRACTICE STATEMENTS

These statements describe how the Commissioner will, in practice, exercise a discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts.

SPS 19/05: Options for relief from child support debt

Introduction

Standard practice statements describe how the Commissioner of Inland Revenue will exercise a statutory discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts.

This Statement sets out the Commissioner's practice for providing relief when the immediate payment of an overdue child support or domestic maintenance obligation is not possible. The relief is provided in the form of an agreement to pay the debt in instalments; writing off penalties in certain situations; or in limited circumstances, writing off part or all the child support debt.

Inland Revenue may collect a debt owed by a receiving carer in the same manner as for financial support owed by a liable person. References to "liable person" may therefore include a receiving carer.

All references to child support debt or a child support obligation are to be read as including a domestic maintenance debt or obligation unless otherwise noted.

All references are to the Child Support Act 1991 (the "Act"), unless otherwise stated. The relevant legislative provisions of the Act are set out in Appendix 1.

Application

This Statement applies from the date of signing. It replaces *SPS 11/02 Child Support debt – Requesting an instalment arrangement* that was issued on 16 February 2011.

This Statement does not extend to other tax debt or student loan arrears. For more information on these, see SPS 18/04 *Options for relief from tax debt and SPS 11/03 Student Loans – Relief from repayment obligations* or any statements issued in replacement.

Standard practice

Summary

1. This Statement applies to the Commissioner's discretion to provide relief when considering requests for payment agreements to settle child support debt.
2. The Act provides limited discretion when a liable person is unable to pay their child support debt in full and on time. A liable person is encouraged to contact Inland Revenue as soon as possible if they think that they may have trouble paying their child support obligations. We can then discuss options for payment, which may include a payment agreement and/or writing off penalties (in full or in part).
3. Although it is best to contact Inland Revenue before getting behind with child support payments, it is never too late to discuss the options for resolving child support debt and minimising related penalties.
4. Requests for a payment agreement may be made in writing, by telephone, or any other manner acceptable to the Commissioner – for example, through myIR secure online services at **www.ird.govt.nz**
5. Requests for financial relief will be considered on a case-by-case basis. A liable person will need to be able to show why they cannot make immediate payments towards their child support obligation. They may be asked to supply further information about their financial circumstances in support of their request for a payment agreement.
6. If the Commissioner is satisfied that a liable person is not able to make immediate payment, a payment agreement may be agreed to.

7. A payment agreement will be for more than the annual assessed amount of child support payable. This is because payment agreements must include the annual assessed rate of child support payable for a current year, plus a reasonable amount toward reducing the child support debt.
8. A payment agreement will be structured so that the child support debt will be paid in the shortest possible time.
9. When the Commissioner agrees to a payment agreement, the terms will be confirmed and both the liable person's and the Commissioner's obligations under the payment agreement will be set out. For liable persons with a myIR Secure Online Services account, confirmation may be made electronically.
10. A liable person who enters into a payment agreement should inform the Commissioner as soon as possible if there is a change to their circumstances that may affect:
    - an earlier decision to provide financial relief; or
    - their ability to repay their child support debt.
11. In certain circumstances, the initial late payment penalty and/or incremental penalties that were incurred prior to a payment agreement being made may be written off.
12. When a payment agreement has been made, the Commissioner will provide relief to the liable person from ongoing incremental penalties for a particular month if all the payments that are due in that month are made.
13. Missing payments of an instalment may not undo the overall payment agreement. When the Commissioner is satisfied that a liable person is unable to pay their child support debt under a payment agreement, the terms of the payment agreement may be changed at the request of the liable person.
14. However, when a payment agreement is cancelled because a liable person does not comply with their repayment obligations, the Commissioner will consider whether other options may be available to collect the child support debt. Penalties will accrue on any unpaid amount.
15. Where a liable person has defaulted on child support obligations, the Commissioner will look to make automatic deductions from their salary/wages or benefit income, as generally required under ss 130 and 131.

Detailed Discussion

16. A liable person should contact Inland Revenue as soon as possible if they think they are unable to pay their child support obligations on time and in full. Options for payment, which may include a payment agreement, can be discussed. The Commissioner will consider requests for relief on a case-by-case basis. Early contact may also minimise penalties where a payment agreement can be entered into.
17. Applications may be made by telephone, in person, in writing or by electronic means. Details on contact methods for Child Support are available at: **www.ird.govt.nz/contact-us**

Available options for relief

18. The Commissioner may, when satisfied that immediate payment of child support debt is not possible, grant relief to a liable person by:
    - agreeing to a payment agreement;
    - in some instances, being able to grant relief from initial late payment penalties and/or incremental late payment penalties; or
    - writing off part or all of the debt to the extent it is child support that was payable in respect of a period in which the receiving carer was a social security beneficiary (Crown entitlement) and payment will place the liable person in serious hardship.
19. Mandatory relief is also available for initial late payment penalties charged on the first payment due, if a payment arrangement is entered into, or a deduction notice is issued, (which includes that first payment), within 3 months of the issue date of the first assessment.
20. Where a payment agreement is adhered to, a mandatory write-off of related incremental penalties will occur.

When will relief be provided?

21. For the Commissioner to consider a payment agreement, she must be satisfied that the liable person is not able to make immediate payment of their child support debt.
22. The Commissioner will consider all options available for payment but will look for arrangements that will see this debt repaid in the shortest possible time while also ensuring the liable person maintains their current child support obligations.

Payment agreements

23. A payment agreement may consist of one or more payments to settle a child support debt. To ensure that the liable person meets their current child support obligations a payment agreement will include any current-year child support payable.
24. The liable person will be expected to meet their current-year child support obligations, as well as providing a reasonable amount toward reducing the outstanding debt.

Information to support application

25. The Commissioner's decision on whether to agree to a payment agreement will be based on the circumstances of each case, with the aim of recovering the child support debt in the shortest possible time. The Commissioner will also consider whether the liable person can reasonably afford to pay their child support debt at the rate proposed in their payment agreement application.
26. The liable person may be asked to provide information to support their application for a payment agreement, including their proposed payment plan. Alternatively, they may be asked to complete a *Child support – repayment of arrears (IR130)* form. The information provided will be used to assist the Commissioner in considering the application and to determine whether the liable person has other options for settling their child support debt. The IR130 form is available on our website at **www.ird.govt.nz/forms-guides**
27. A liable person may ask for the payment agreement to be renegotiated at any time. Although the legislation does not prevent the Commissioner from reviewing a payment agreement at any time, generally the Commissioner will renegotiate a payment agreement only after two years from the date the agreement was entered into. This is to provide the liable person with some certainty as to the level of payments towards their child support debt. However, where the Commissioner becomes aware of a material change in the circumstances of the liable person, the Commissioner reserves the right to renegotiate the agreement at any time.

Defaulting on instalments

28. Inland Revenue acknowledges that a liable person's circumstances can change for reasons outside their control. For example, they may face an unforeseen household expense or default by debtors can erode their cash flow and affect their ability to maintain a payment agreement.
29. If this happens, the liable person should contact Inland Revenue promptly to discuss an adjustment to their payment agreement. If the Commissioner is satisfied that the liable person is unable to continue to meet their payment agreement, it may be re-negotiated or other options to recover the debt will be considered.
30. If a liable person does not comply with the terms of a payment agreement, the Commissioner may cancel that arrangement and look to collect the debt in another way. In considering whether to cancel the arrangement, where possible, the reasons for the default will be considered and the Commissioner will take into account the liable person's overall child support compliance behaviour, including:
    - regularity of payments;
    - current financial circumstances;
    - the circumstances under which the payments were missed; and
    - the liable person's cooperativeness and willingness to maintain current child support obligations and resolve their debt.
31. The Commissioner may also decline to enter into a payment agreement if the liable person has not complied with earlier agreements and there was no reasonable cause for the non-compliance.
32. The Commissioner may cancel a payment agreement if it was entered into on the basis of false or misleading information provided by the liable person.

Charging of penalties

33. If child support obligations are not paid in full and on time, an initial late payment penalty is charged on the unpaid amount as follows:
    - The greater of 2% of the unpaid amount or $5.00 is charged on the day after the due date;
    - 8% of the unpaid amount (excluding the 2%) is charged 8 days after the due date.
34. Amounts remaining unpaid during the following 11 months will be charged an incremental late payment penalty of 2% each month. Amounts still unpaid after this will be charged a penalty of 1% each month.

Discretionary relief from penalties

35. When a liable person enters into a payment agreement, the Commissioner can grant the liable person relief from the payment of late payment penalties, either the initial or the incremental penalties (or both). The Commissioner can grant relief by writing off the whole or part of the penalty. Each of the write offs that may be available are discussed below.

Incremental penalties unpaid before agreement entered into (s 135FA)

36. The Commissioner may grant relief in respect of incremental penalties that were unpaid at the time a payment agreement was entered into if she is satisfied that the recovery of those penalties would place the liable person in serious hardship, or that it would be fair and reasonable to grant relief.
37. The payment agreement must be entered into on or after 1 April 2016 and require the liable person to pay, in 1 sum or 2 or more instalments under a payment agreement, the amount of child support outstanding and the initial late payment penalties as well as any child support that the person will become liable to pay during the term of the payment agreement.
38. Before the Commissioner decides to grant relief due to serious hardship, she must have regard to the matters referred to in ss 6 and 6A of the Tax Administration Act 1994 which pertain to protecting the integrity of the tax system and encouraging voluntary compliance.

Incremental penalties where some or all of the debt paid (s 135G)

39. Where the liable person has paid some or all of the financial support debt and initial late payment penalties, the Commissioner may grant relief from the payment of the related incremental penalties if she is satisfied that the recovery of the penalties would place the liable person in serious hardship, or it would be fair and reasonable to grant relief.

Residual initial/incremental penalties (s 135GA)

40. The Commissioner may grant relief to a liable person from the payment of initial late payment penalties and/or incremental penalties if the liable person has paid or had written off all their financial support debt and the Commissioner is satisfied that recovery of those penalties would place the person in serious hardship or that it would be fair and reasonable to grant relief.
41. Similarly, the Commissioner may grant relief to a liable person from the payment of initial late payment penalties and/or incremental penalties if the Commissioner has written off some or all of the benefit component of an amount of child support that is payable by the person and the Commissioner is satisfied that the recovery of those penalties would place the person in serious hardship or that it would be fair and reasonable to grant relief.
42. In this instance the Commissioner must be satisfied that the penalties relate to, or arise from, some or all of the written-off benefit component.

Determining serious hardship

43. In determining whether serious hardship exists, the Commissioner will consider whether the liable person will suffer significant financial difficulties that arise because:
    (a) the liable person would likely be unable to meet minimum living expenses estimated according to normal community standards; or
    (b) the liable person must meet the cost of medical treatment for an illness or injury of the liable person, or their dependant; or
    (c) the liable person or their dependant has a serious illness; or
    (d) the liable person must meet the cost of education for their dependant.
44. Serious hardship does not include significant financial difficulties due to having to pay tax or child support, because the liable person may become bankrupt or that the person's social activities and entertainment may be limited, or the liable person may not be able to afford expensive or high-quality goods or services.
45. The definition of serious hardship refers to "normal community standards". While these standards must be considered in the context of the wider community of New Zealand, the actual expenditure of liable persons in different parts of the country may vary. When calculating a liable person's minimum living expenses, the Commissioner will consider the reasonable costs of food, heating and accommodation in the liable person's area, based on information provided by Statistics New Zealand. However, this is just a starting point and the Commissioner will have regard to expenditure incurred that is outside the norm due to the liable person's specific circumstances.

46. The definition of serious hardship also refers to a "dependant". Whether a person is a liable person's dependant will be determined on a case-by-case basis. The Commissioner will consider whether the person depends on the liable person for financial support, what degree of financial support is provided, and to what extent providing financial support affects the liable person's ability to meet minimum living expenses according to normal community standards.

Fair and reasonable test

47. Whether it is fair and reasonable to write off incremental penalties depends on the circumstances of each case. Some of the factors that the Commissioner will consider include:
    - whether the payment was late due to a circumstance beyond the liable person's control, including medical or mental incapability, incarceration, hospitalisation, travel disruption, natural disasters, civil emergencies;
    - whether the person generally has a good payment history;
    - whether the person took reasonable steps to mitigate the debt;
    - whether the person genuinely misunderstood the payment requirements;
    - whether the person paid other debts or acquired assets in preference to paying financial support.

Mandatory relief

48. Other provisions of the Act direct the Commissioner to grant relief from the payment of initial late payment penalties or incremental penalties if certain criteria are met.

Full or substantial compliance with payment arrangement (s 135GB)

49. Where a liable parent has a child support debt that includes their first payment of child support and they entered into a payment arrangement after 1 April 2016 within 3 months of the date of the assessment, the initial late payment penalty will be written off if the arrangement is fully or substantially adhered to.
50. A payment arrangement includes a payment agreement, or a deduction notice issued under s 154.
51. A first payment is the first time a person is liable to make a payment of child support under a new liability. This includes when a liable person's liability ceases then restarts at a later date (except when this is due to the person's status changing between a person who is entitled to receive child support to being the person who is liable to pay). It does not include the situation where a liable person has an existing liability and they incur an additional liability, for example, the addition of a qualifying child.
52. An assessment may be a formula assessment, voluntary agreement or an order of the court. The payment arrangement needs to have been made within 3 months of the date the assessment is issued.
53. A payment arrangement has been fully or substantially complied with when:
    - it has operated for a period that the Commissioner considers reasonable; and;
    - there has been no default in the payments under the arrangement; or
    - the only default is to an extent, or arising from a cause, that the Commissioner considers reasonable.
54. The extent of the default means the level or range of the default. Is the level or range of the default reasonable in the Commissioner's opinion? This will depend upon the facts of each case.
55. A default that arises from a reasonable cause will include a default due to a cause beyond the control of the liable person such as a serious illness, accident or disaster.
56. The Commissioner considers that the payment arrangement has operated for a reasonable period when the first payment of child support that was due, is cleared by the arrangement. If the arrangement has been fully or substantially complied with over this time, then the initial late payment penalty can be written off.

Relief from incremental penalties unpaid before agreement entered into on or after 26 September 2006 (s 135J)

57. The Commissioner must write off incremental penalties unpaid at the time a payment agreement is entered into if the liable person has complied with the payment agreement up to a particular review date.
58. Any payment agreement must require the liable person to pay the amount of the initial debt (child support plus initial late payment penalties) along with the amount of child support that the person will become liable to pay during the term of the agreement.
59. A review date will be set for a payment agreement. That review date will be at 26-week intervals from the date the liable person enters into the payment agreement.

60. A person has complied with the payment agreement up to a particular review date if the person has paid every instalment in full when required to by the agreement.
61. If a person has satisfied the criteria above, the incremental penalties will be written off proportionally to the amount of the initial debt that has been repaid over the last 26-week period.
62. In addition, if the liable person makes all the payments as agreed during the last month, the Commissioner must write off all the ongoing incremental penalties charged during that last month (s 135M).
63. When a liable person has not complied with a payment agreement, but the Commissioner is satisfied that the non-compliance was caused by:
    - circumstances beyond that person's control and a reasonable cause for the delay of payment; or
    - the delay in payment of the debt was caused by an honest oversight, and there is no history of default with previous payments of financial support, and the oversight was corrected promptly; or
    - the liable person had acted on in good faith, on an error made by Inland Revenue leading to the debt, and it would be fair and reasonable to grant relief;

    the incremental penalties may still be written off.
64. If a liable person has not complied with a payment agreement and has not contacted Inland Revenue to discuss options, it is likely that the payment agreement will be cancelled. Should a payment agreement be cancelled, incremental penalties will remain and continue to accrue on any unpaid child support debt.
65. After the payment agreement has been completed, and the child support debt and any initial late payment penalties have been paid, some incremental penalties may still remain. Those remaining incremental penalties may be written off (refer paragraph 38).

Write-off of Crown entitlement (s180A)

66. Child support (not including domestic maintenance) will be payable to the Crown in respect of the period that the receiving carer is in receipt of a social security benefit.
67. A write-off of the amount of child support that is owed to the Crown may be available if the Commissioner is satisfied that recovery of part or all of the amount will place the liable person in serious hardship and/or would involve an inefficient use of the Commissioner's resources.
68. A liable person cannot request that their child support debt be written off because they consider that collection would be an inefficient use of the Commissioner's resources. That is a decision solely for the Commissioner to make under the duties charged to her under ss 6 and 6A of the Tax Administration Act 1994.

Other relief that may be available

Reasonable cause (s 135B)

69. Where the Commissioner is satisfied that the delay in payment was due to a reasonable cause and the liable person made payment of the debt as soon as practicable, relief may be granted.
70. Reasonable cause means an event or circumstance that is beyond the control of the liable person and includes a serious illness, an accident or a disaster. The Commissioner must be satisfied that it was the event or circumstance that caused a reasonable delay in the payment of the debt.

Failure by another person to make deduction (s 135C)

71. Where the Commissioner is satisfied that the circumstances that contributed to the delay in the payment of the debt were due to or caused directly or indirectly by the failure of any person to make a deduction as instructed by a notice issued by the Commissioner under Part 10 of the Act and the liable person has taken reasonable steps to mitigate the effects of those circumstances, the Commissioner may grant relief if after having regard to the nature of those circumstances it would be fair and reasonable to do so.

Honest oversight (s 135D)

72. The Commissioner may grant relief to a liable person if she is satisfied that the penalty arose due to an honest oversight and the person has no history of missing payments and the person paid the debt as soon as they became aware of the oversight.
73. Whether a liable person has a history of missing payments will be a matter of fact in each case.

Error made by Inland Revenue (s 135E)

74. The Commissioner may grant relief to a liable person if she is satisfied that the delay in payment which resulted in the penalty being applied was due to an error made by an officer of Inland Revenue and the person has acted in good faith and has altered his or her position in reliance on the error and it would be fair and reasonable to do so.

Debt waived or uplifted (s 135F)

75. Where the Commissioner is satisfied that the payee has waived the right to the payment to which the penalty relates or has uplifted the debt, relief may be granted if it would be fair and reasonable to do so.

Reviewing a decision

76. If a liable person is concerned that their circumstances have not been given proper consideration, they should raise their concern and ask for the decision to be reviewed.

77. If a liable person is still not satisfied with the level of service they receive, they can obtain more information about the Inland Revenue Complaints Management Service at **www.classic.ird.govt.nz/contact-us/disputes-process/complaints-process/complaints-process.html** or phone 0800 274 138 (Monday to Friday between 8am and 5pm).

This Standard Practice Statement is signed on 21 November 2019.

Rob Falk
National Advisor, Technical Standards (Legal Services)

APPENDIX 1 – LEGISLATION

Child Support Act 1991

135A Application of sections 135B to 135GA

(1) Sections 135B to 135GA apply in relation to a penalty that is payable by a liable person in relation to a financial support debt.

(2) The Commissioner may grant relief to a liable person on any of the grounds specified in sections 135B to 135GA by—

(a) writing off the whole or part of a penalty; or

(b) if a penalty has been paid, in whole or in part, refunding to the liable person the whole or any part of that penalty that has been paid, with or without the writing off of any part of that penalty that has not been paid.

135B Discretionary relief if reasonable cause

(1) The Commissioner may grant relief to a liable person in the manner prescribed by section 135A if the Commissioner is satisfied that—

(a) there was a reasonable cause for the delay in payment of the debt to which a penalty relates; and

(b) the liable person remedied the default as soon as practicable.

(2) For the purposes of this section, **reasonable cause** means an event or circumstance in relation to a liable person that—

(a) is beyond the control of the liable person, including a serious illness, an accident, or a disaster; and

(b) caused, in the opinion of the Commissioner, a reasonable delay in the payment of a financial support debt by the liable person.

135C Discretionary relief if failure of another person to make deduction

The Commissioner may grant relief to a liable person in the manner prescribed by section 135A if the Commissioner is satisfied that—

(a) the circumstances that contributed to the delay in the payment of the debt to which a penalty relates were due to, or caused directly or indirectly by, the failure of any person to make a deduction under Part 10; and

(b) the liable person has taken reasonable action to mitigate, or mitigate the effects of, those circumstances; and

(c) having regard to the nature of those circumstances, it would be fair and reasonable to grant relief.

135D Discretionary relief if honest oversight by liable person with no history of default

The Commissioner may grant relief to a liable person in the manner prescribed by section 135A if the Commissioner is satisfied that—

(a) the delay in payment of the debt to which a penalty relates is due to an honest oversight by the liable person; and

(b) the liable person has no history of default in previous payments of financial support; and

(c) the liable person paid the debt as soon as he or she became aware of the oversight.

135E Discretionary relief if error made by Department

The Commissioner may grant relief to a liable person in the manner prescribed by section 135A if the Commissioner is satisfied that—

(a) the delay in payment of the debt to which a penalty relates was due to an error made by an officer of the Department; and

(b) the liable person has acted in good faith and has altered his or her position in reliance on the error; and

(c) having regard to the circumstances of the case, it would be fair and reasonable to grant relief

135F Discretionary relief if debt waived or uplifted

The Commissioner may grant relief to a liable person in the manner prescribed by section 135A if the Commissioner is satisfied that—

(a) the payee has—

(i) waived under section 179A the right to the payment to which the penalty relates; or

(ii) uplifted under section 180 the debt to which the penalty relates; and

(b) it would be fair and reasonable to grant relief.

135FA Discretionary relief from incremental penalties unpaid before agreement entered into on or after 1 April 2016

(1) For the purposes of this section,—

initial debt, in relation to a payment agreement, means the amount the liable person owes at the time that the agreement is entered into in respect of financial support and initial late payment penalties

payment agreement means an agreement entered into on or after 1 April 2016 between a liable person and the Commissioner that requires the liable person to pay, in 1 sum or 2 or more instalments of specified amounts,—

(a) the amount of the initial debt; and

(b) the amount of financial support (if any) that the person will become liable to pay during the term of the payment agreement.

(2) The Commissioner may grant relief to the liable person in the manner prescribed by section 135A in respect of the incremental penalties of the liable person that were unpaid at the time a payment agreement was entered into if the Commissioner is satisfied—

(a) that recovery of those incremental penalties would place the liable person in serious hardship (as defined in section 135G(3)); or

(b) that it would be fair and reasonable to grant relief.

(3) Before making a decision under subsection (2)(a), the Commissioner must have regard to the matters referred to in sections 6 and 6A of the Tax Administration Act 1994.

135G Discretionary relief from payment of incremental penalties

(1) The Commissioner may grant relief to a liable person from the payment of incremental penalties in the manner prescribed by section 135A if—

(a) the liable person has paid some or all of the financial support debt and initial late payment penalties to which the incremental penalties relate; and

(b) the Commissioner is satisfied—

(i) that recovery of the incremental penalties would place the liable person in serious hardship; or

(ii) that it would be fair and reasonable to grant relief.

(2) Before making a decision under subsection (1)(b)(i), the Commissioner must have regard to the matters referred to in sections 6 and 6A of the Tax Administration Act 1994.

(3) In this section and sections 135GA and 180A(1)(b)(i),—

serious hardship, in relation to a liable person,—

(a) includes significant financial difficulties that arise because of—

(i) the liable person's inability to meet minimum living expenses according to normal community standards; or

(ii) the cost of medical treatment for an illness or injury of the liable person or the liable person's dependant; or

(iii) a serious illness suffered by the liable person or the liable person's dependant; or

(iv) the cost of education for the liable person's dependant:

(b) does not include significant financial difficulties that arise because—

(i) the liable person is obligated to pay tax or financial support; or

(ii) the liable person may become bankrupt; or

(iii) the liable person's, or the liable person's dependant's, social activities and entertainment may be limited; or

(iv) the liable person is unable to afford goods or services that are expensive or of a high quality or standard according to normal community standards.

135GA Discretionary relief for residual penalty-only debt

(1) The Commissioner may grant relief to a liable person from the payment of initial late payment penalties or incremental penalties or both in the manner prescribed by section 135A if—

(a) the liable person has paid, or had written off in accordance with this Act, all of the liable person's financial support debt; and

(b) the Commissioner is satisfied—

(i) that recovery of those penalties would place the liable person in serious hardship (as defined in section 135G(3)); or

(ii) that it would be fair and reasonable to grant relief.

(2) The Commissioner may grant relief to a liable person from the payment of initial late payment penalties or incremental penalties or both in the manner prescribed by section 135A if—

(a) the Commissioner has under section 180A written off some or all of the benefit component of an amount of child support (as defined in section 180A(2)) that is payable by the liable person to the Crown under this Act; and

(b) the Commissioner is satisfied that those penalties relate to, or arise from, some or all of that written-off benefit component; and

(c) the Commissioner is satisfied—

(i) that recovery of those penalties would place the liable person in serious hardship (as defined in section 135G(3)); or

(ii) that it would be fair and reasonable to grant relief.

(3) Before making a decision under subsection (1)(b)(i) or (2)(c)(i), the Commissioner must have regard to the matters referred to in sections 6 and 6A of the Tax Administration Act 1994.

135GB Relief from initial late payment penalty if full or substantial compliance with payment arrangement entered into or made on or after 1 April 2016 and within 3-month period

(1) The Commissioner must write off an initial late payment penalty if satisfied that—

(a) that penalty was imposed in respect of a debt that is or includes the first payment of financial support payable by the liable person under a formula assessment, voluntary agreement, or order of the court issued or made before, on, or after 1 April 2016; and

(b) a payment arrangement was entered into or made on or after 1 April 2016 and within the 3 months that began on the date of issue or making of the assessment, agreement, or order under which that first payment is payable, and has been fully or substantially complied with in accordance with subsection (5).

(2) The payment arrangement referred to in subsection (1)(b) must be a payment agreement specified in subsection (3) or a deduction notice specified in subsection (4).

(3) The payment agreement is one that the liable person entered into with the Commissioner to pay, in 1 sum or 2 or more instalments of specified amounts,—

(a) the first payment mentioned in subsection (1)(a); and

(b) other payments of financial support that were or would become payable (under the assessment, agreement, or order mentioned in subsection (1)(a), or any other assessment, voluntary agreement, or order of the court) by the liable person.

(4) The deduction notice is one that the Commissioner gave a person under section 154 in relation to the liable person in order to collect, in 1 sum or 2 or more deductions and payments,—

(a) the first payment mentioned in subsection (1)(a); and

(b) other payments of financial support that were or would become payable (under the assessment, agreement, or order mentioned in subsection (1)(a) or any other assessment, voluntary agreement, or order of the court) by the liable person.

(5) The payment arrangement referred to in subsection (1)(b) has been fully or substantially complied with in accordance with this subsection if the arrangement has operated for a period that the Commissioner considers reasonable and—

(a) it is a payment agreement, and to date there has been either no default in the payment in accordance with that agreement of the 1 sum, or every one of the 2 or more instalments, specified in subsection (3), or only default of that kind to an extent, or arising from a cause, that the Commissioner considers reasonable; or

(b) it is a deduction notice, and to date there has been either no default in the making in accordance with that notice of every one of the 2 or more deductions and payments specified in subsection (4), or only default of that kind to an extent, or arising from a cause, that the Commissioner considers reasonable.

(6) If an initial late payment penalty written off under subsection (1) has been paid in whole or in part, the Commissioner must refund to the liable person the whole or part of the penalty paid.

135J Relief from incremental penalties unpaid before agreement entered into on or after 26 September 2006

(1) For the purposes of this section,—

initial debt, in relation to a payment agreement, means the amount the liable person owes at the time that the agreement is entered into in respect of financial support and related initial late payment penalties

payment agreement means an agreement entered into on or after 26 September 2006 between a liable person and the Commissioner that requires the liable person to pay, in 1 sum or 2 or more instalments of specified amounts,—

(a) the amount of the initial debt; and

(b) the amount of financial support (if any) that the person will become liable to pay during the term of the payment agreement

review date means—

(a) the day that is 26 weeks after the date that the liable person enters into the payment agreement; and

(b) each of the days on which there expire periods of 26 weeks that consecutively succeed the first period of 26 weeks described in paragraph (a); and

(c) the day on which the payment agreement expires.

(2) If a liable person has entered into a payment agreement, and the person has complied with the payment agreement up until a particular review date in accordance with subsection (3), the Commissioner must, on that review date,—

(a) review the incremental penalties in relation to the initial debt of the liable person that were unpaid at the time the payment agreement was entered into; and

(b) write off those penalties proportionally in accordance with subsection (4).

(3) For the purposes of subsection (2), a person has complied with the payment agreement up until a particular review date if—

(a) the person has paid every instalment in full that has fallen due in accordance with the agreement; or

(b) in the case of an agreement to pay 1 sum only, the person has paid that sum in accordance with the agreement.

(4) For the purposes of subsection (2), the proportion of incremental penalties that must be written off must be calculated in accordance with the following formula:

$$r = (a \times c \div b) - d$$

where—

r is the amount of incremental penalty that is to be written off

a is the total amount of the initial debt that has been paid since the payment agreement was entered into

b is the initial debt

c is the total amount of incremental penalties related to the initial debt of the liable person that were unpaid at the time that the payment agreement was entered into

d is the total amount of incremental penalties related to the initial debt of the liable person that have already been written off in accordance with this section since the payment agreement was entered into.

(5) If an incremental penalty that is written off under this section has been paid in whole or in part, the Commissioner must refund to the liable person the whole or part of the incremental penalty that has been paid.

135L Writing-off of incremental penalties if non-compliance with arrangement

(1) Subsection (2) applies if,—

(a) at the time of a review date in relation to a payment agreement under section 135J or 135K, the liable person has failed to pay any amount in accordance with the agreement; and

(b) the Commissioner is satisfied, in respect of each failure to make a payment in accordance with the payment agreement, that the circumstances in relation to the failure would, if they were related to the payment of a debt to which a penalty relates, entitle the Commissioner to grant relief under any of the provisions of sections 135B to 135E.

(2) The Commissioner may disregard a failure to make a payment for the purpose of applying section 135J or 135K as the case may be.

…

135M Relief from ongoing incremental penalties if payment agreement in force

(1) This section applies if—

(a) an incremental penalty is by operation of law imposed on a person at the expiry of a 1-month period; and

(b) during that 1-month period, the person is liable to pay financial support, initial late payment penalties, or incremental penalties that are payable in 1 sum, or in 2 or more instalments, under a payment agreement entered into between the person and the Commissioner; and

(c) every sum or instalment payable under the payment agreement during that 1-month period has during that 1-month period been paid in full in accordance with the payment agreement.

(2) The Commissioner must grant relief to the liable person—

(a) by writing off the incremental penalty referred to in subsection (1)(a); or

(b) if that incremental penalty has been paid, in whole or in part, by refunding to that person the whole or the part of that incremental penalty that has been paid, with or without writing off any part of that incremental penalty that has not been paid.

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

OS 19/05: Employer-provided travel from home to a distant workplace – income tax (PAYE) and fringe benefit tax

Operational statements set out the Commissioner of Inland Revenue'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.

All legislative references in this Statement are to the Income Tax Act 2007, unless specified otherwise.

Introduction

The Commissioner is aware that there has been significant uncertainty regarding whether employer-provided travel[1] from home to a distant workplace is subject to income tax, so PAYE must be deducted, or to fringe benefit tax (FBT). This Statement addresses whether this type of travel is subject to tax and outlines the approach to the tax treatment in this area which the Commissioner will, on a prospective basis, accept as correct. To reduce uncertainty and foster taxpayer compliance, the Commissioner has deliberately sought to take a pragmatic approach as far as this is possible within the law.

In this Statement:

- **employer-provided travel** means:
  - travel an employer organises;
  - travel that an employee organises but an employer pays for;
  - travel that an employer reimburses an employee for; or
  - an allowance paid to an employee by their employer that is paid to cover the cost of travel to a distant workplace;
- **home** means a dwelling you use as a residence;
- **hometown** means the city or town where your home is located; and
- a **distant workplace** is a workplace that is not within reasonable daily travelling distance of the employee's home.[2]

When an employer physically provides the travel or pays for it directly, then that travel may be subject to FBT, which the employer must pay.

If the employee is provided with an allowance or is reimbursed in relation to the cost of the travel, then the employer may have to deduct and pay PAYE in relation to that payment.

We are aware that many employers and employees are uncertain about when employer-provided travel to a distant workplace is subject to tax. Indeed, some employers have been treating all employer-provided travel to a distant workplace as not taxable.

This Statement addresses that uncertainty by setting out the Commissioner's approach to determining whether employer-provided travel from home to a distant workplace is subject to either income tax or FBT or not taxed.

Summary of approach

1. Payments made by an employer in relation to a private expense of an employee are usually subject to tax. The cost of home-to-work travel is generally private expenditure as it is incurred so an employee can get to work. As this expenditure is usually private, if the employer provides[3] the employee's travel from home to work the starting point is that it is taxable.

[1] Travel can be, for example, by car, taxi, plane, bus or train.

[2] See also "Guidance on 'Reasonable Daily Travelling Distance'", *Tax Information Bulletin* Vol 21, No 9 (December 2009): 6; **www.classic.ird.govt.nz/technical-tax/general-articles/leg-2009guidance-reasonable-distance.html**

[3] In the context of this Statement, "provides" includes pays for directly or indirectly, including by way of a reimbursement or allowance.

Inland Revenue's approach

Employer-provided travel from home to a distant workplace will be taxable (and subject to FBT or income tax) unless one of the following applies:

- the travel is one-off or very occasional (*de minimis* applies);
- the travel relates to a temporary posting or secondment (up to two years);
- the employee also genuinely works at a hometown workplace;
- the employee works from home on specified days (home being their place of work on those days, and the travel relates to one of those days).

2. However, the courts have recognised that some travel from home to work is not taxable because the expenditure relates to travel that is "on work".
3. This means not all employer-provided travel from an employee's home to work is taxable, and an employer who provides travel from home to a distant workplace must consider whether that travel is subject to tax.
4. Where an employer physically makes available or directly pays for an employee's travel from home to a distant workplace, the travel may be subject to FBT, which the employer must pay.
5. If the employee is provided with an allowance or is reimbursed in relation to the travel, that amount may be subject to income tax. If an allowance or reimbursement is taxable for income tax purposes, then the employer must deduct and pay PAYE in relation to that payment. This is because the allowance or reimbursing payment would be "salary or wages" under the PAYE rules.
6. It does not matter whether you are considering whether employer-provided travel from home to a distant workplace is subject to FBT or income tax, the test is still effectively the same.
7. We recognise that it can be difficult to determine whether travel provided to employees to enable them to travel to a distant workplace is subject to tax. The following paragraphs set out the Commissioner's approach to determining whether employer-provided travel from an employee's home to a distant workplace is subject to tax.

Application of the Statement

8. The Commissioner is aware that there has been significant uncertainty regarding employer-provided travel from home to a distant workplace, in relation to both the correct interpretation of the law and the appropriate practice. Consequently, the Commissioner has developed an approach to the tax treatment in this area which she will, on a prospective basis, accept as correct. In an effort to reduce uncertainty and foster taxpayer compliance, the Commissioner has deliberately sought to take a pragmatic approach as far as this is possible within the law.
9. Therefore, recognising that some taxpayers may need time to implement this approach the Commissioner does not expect taxpayers to apply this Statement to travel taken before **1 April 2020**. However, taxpayers can choose to begin applying the approach outlined in this Statement from the date it is issued if they wish to.
10. Given the uncertainty that has existed, taxpayers do not need to revisit tax positions taken before publication of this Statement, and (in the absence of identified avoidance) the Commissioner will not be doing so.
11. The approach outlined in this Statement does not apply where the travel arrangements have been entered into with a purpose of avoiding tax.
12. When considering the tax treatment of employer-provided travel from home to a distant workplace, to the extent that there is inconsistency between this Statement and the Interpretation Statement IS3448 *Travel by Motor Vehicle between Home and Work: Deductibility of expenditure and FBT implications*, the approach in this Statement is to be followed.

Discussion

13. As noted above, if the employer provides the employee's travel from home to work, the starting point is that it is taxable as either:
    - income to the employee, so subject to PAYE (see from [14]);
    - a fringe benefit subject to FBT (see from [25]).

PAYE

14. Payments made by an employer to reimburse an employee for that employee's private expenditure are generally taxable as income of the employee. This is because these payments reduce the need for the employee to incur those costs themselves.

15. When a reimbursement or allowance is taxable it is included as salary or wages for the purposes of the PAYE rules (s RD 5(8)). This means PAYE must be deducted and paid by the employer to Inland Revenue for that reimbursement or allowance.
16. When a reimbursement or allowance is paid to cover costs for which the employee would be allowed a deduction if the employment limitation on deductions did not exist, then it is not subject to income tax (s CW 17). This means the employer would not have to pay PAYE to Inland Revenue in respect of that reimbursement or allowance.[4]
17. Therefore, the issue is whether the cost of the particular travel from the employee's home to a distant workplace would be deductible to the employee (if employees could claim deductions).
18. A deduction is allowable for expenditure incurred in deriving income or necessarily incurred in the course of carrying on a business for that purpose (s DA 1). But expenditure that is of a private or domestic nature is not an allowable deduction (s DA 2(2)).
19. The general rule is that home-to-work travel is private expenditure as it is expenditure to get to work and reflects the employee's personal choice as to their home location.[5] The two main reasons for this rule are that the:
    - cost of home-to-work travel is predominantly determined by the private choices of the employee (where to live, how to get to work);
    - expense of commencing work is distinguished from expenses while "on work", and employees are expected to bear the cost of commencing work.
20. This means the starting point is that employer-provided travel from home to work is private expenditure and would not be deductible to the employee (if employees could claim deductions). This is the case even if the employee's travel is funded by the employer or the employee's attendance at the workplace is required by the employer.
21. The courts have recognised exceptions to this general rule.[6] The cases relating to deductibility of travel expenditure between home and work have identified four broad factual situations where travel between home and work is regarded as business or work-related travel. These situations are where:
    - a vehicle is essential for transporting goods or equipment necessary for the performance of employment duties at the home and elsewhere;
    - the taxpayer carries on an "itinerant occupation" (that is, the taxpayer does not work from a fixed work place, and the home is the taxpayer's base of operations);
    - the taxpayer is required to be accessible at their home for employment duties and is required to undertake travel in response to emergency calls;
    - the travel is "on work" travel between two workplaces, one of which is also the taxpayer's home.
22. It can be seen from the cases that for home-to-work travel to be deductible, the employee must actually undertake work at home.
23. It is not sufficient to establish that the home **is or can be** a workplace. For expenditure to be deductible, the need for the work to be performed at the home, and, therefore, the need for the travel, must arise from the nature of the work and not from the personal choice or personal circumstances of the taxpayer.
24. In addition, the actual travel must be travel undertaken in the course of performing work (that is, the travel is "on work"). If that is the case, then the cost of that travel is not private expenditure of the employee; rather, it is expenditure that would be deductible if employees were not otherwise prevented from claiming deductions. This means the employer does not have to deduct PAYE in respect of the reimbursement or allowance, and the employee is not liable for income tax on the payments.[7],[8]

OPERATIONAL STATEMENTS

[4] Operational Statement OS 19/04b: *Commissioner's statement on using a kilometre rate for employee reimbursement of a motor vehicle* explains the acceptable method to establish the tax-exempt portion of an amount paid to an employee as a reimbursement where the employee uses their private motor vehicle in the employer's business.

[5] See, for example, *Ricketts v Colquhoun* [1926] AC 1.

[6] See *Taylor v Provan* [1975] AC 194; *Garrett v FCT* 82 ATC 4,060; *FCT v Genys* 87 ATC 4,875; *Case F72* (1984) 6 NZTC 59,924; *Miners v Atkinson* [1995] STC 58; *Kirkwood v Evans* [2002] STC 231.

[7] To the extent that the payments are a reimbursement of actual costs or an allowance paid to cover the costs of the travel when the employee incurs the costs themselves. If amounts in excess are received by the employee, the excess amount is taxable.

[8] See *Travel by Motor Vehicle between Home and Work: Deductibility of expenditure and FBT implications* (Interpretation Statement IS3448, Inland Revenue, 2004), which discusses the question of determining deductibility of home-to-work travel generally.

Fringe benefit tax

25. Where an employer provides travel from a person's home to their workplace (other than by way of a motor vehicle), the position is that this "benefit" amounts to a "fringe benefit" as it is an "unclassified benefit".[9]
26. This travel will be subject to FBT unless one of the exclusions applies.
27. The Commissioner considers that the only exclusions that **might** apply in respect of employer-provided travel from home to a distant workplace are:
    - benefits provided instead of exempt allowances (s CX 19); and
    - benefits provided to enable the performance of duties (s CX 20).
28. Benefits are not fringe benefits to the extent that they replace the need to pay certain exempt allowances (s CX 19(1)).
29. Travel provided by the employer will not be a fringe benefit where that travel is necessary for an employee to undertake their employment duties (s CX 20).
30. It could be argued that travel from home to work is travel that is necessary for an employee to undertake their employment duties. However, s CX 20 implicitly adopts the distinction between travel "on work" and travel "to work", with s CX 20 relating to circumstances where an employee is travelling "on work". The purpose behind the original predecessor to s CX 20 was to exclude from FBT incidental benefits arising to an employee as a result of travelling in the course of their employment and was not intended to exclude home-to-work travel from the coverage of FBT.
31. The Commissioner considers that whether these exemptions apply to employer-provided travel is determined by applying the same test as the one used for determining whether employer-provided travel is subject to income tax, and, therefore, salary and wages for PAYE purposes.
32. This means employer-provided travel from home to a distant workplace will be subject to FBT unless the:
    - need for the work to be performed partly at the home (and, therefore, the need for the travel itself) arises from the nature of the work; and
    - travel itself is actually "on work".

Motor vehicles

33. A fringe benefit arises in relation to a motor vehicle made available to an employee for private use (s CX 6). This Statement does not replace the FBT on motor vehicle rules.[10]
34. However, determining whether travel in an employer-provided motor vehicle from home to a distant work location is private use can be relevant in determining whether a motor vehicle was available for private use and therefore a benefit to the employee under those rules.
35. Using an employer-provided motor vehicle for travel between home and work will not be private use of that motor vehicle for FBT purposes if the:
    - need for the work to be performed partly at the home (and, therefore, the need for the travel itself) arises from the nature of the work; and
    - travel itself is actually "on work".[11]
36. Therefore, the Commissioner considers that the approach in this Statement can be used in determining whether using an employer-provided motor vehicle (for example, a rental car) to travel from home to a distant workplace is work-related travel and not private use.
37. Note that even if travel between home and work is work-related travel (so that the use of a motor vehicle for **that** purpose is not private use), the employer must establish that the vehicle is not **available** for any private use.[12]

[9] Travel by employer-provided motor vehicle is discussed from [33].

[10] As set out in further detail in *Fringe Benefit Tax – Motor Vehicles* (Interpretation Statement IS 17/07, Inland Revenue, 2017).

[11] Using an employer-provided motor vehicle to travel between home and work is discussed in more detail in *Travel by Motor Vehicle between Home and Work: Deductibility of expenditure and FBT Implications* (Interpretation Statement IS3448, Inland Revenue, 2004).

[12] How FBT applies to motor vehicles is discussed in further detail in *Fringe Benefit Tax – Motor Vehicles* (Interpretation Statement IS 17/07, Inland Revenue, 2017). In the context of determining whether travel from home to a distant workplace is private use, to the extent that there is inconsistency between this Statement and IS 17/07, the approach in this Statement is to be followed.

When employer-provided travel from home to a distant workplace is not subject to tax

38. We acknowledge that in the modern working environment employees have more flexibility around where they can live and work than in earlier times. As a result, it can be difficult and costly to determine whether employer provided travel from an employee's home to a distant workplace is subject to tax.

39. Bearing that in mind and taking into account the legislation, the case law and the Commissioner's care and management duties under ss 6 and 6A of the Tax Administration Act 1994, the Commissioner has developed an approach to make it easier to determine whether employer-provided travel from an employee's home to a distant workplace is taxable.

40. In arriving at this approach, the Commissioner considered it appropriate to treat temporary travel to a distant workplace as different from more longterm travel arrangements. This is because we recognise that where the requirement for the travel is a temporary one, the cost of the travel is less likely to have been predominantly determined by the private choices of the employee (where to live, how to get to work). Where the travel is temporary, an employee is less likely to have the ability to mitigate the costs arising from the requirement to work at a distant location (by relocating).

41. In relation to determining whether accommodation is subject to tax, Parliament introduced clear rules that treat an arrangement where accommodation is provided for two years or less as temporary. While similar rules have not been enacted in relation to travel, how these rules apply to accommodation at a distant workplace does provide a useful indication of what Parliament considered was an appropriate line to draw between temporary and more permanent arrangements in relation to working at a distant workplace.

Summary of approach

42. In summary, the Commissioner's approach is that travel from home to a distant workplace that is provided by the employer will be taxable (and subject to FBT or income tax) unless one of the following applies:
    - the travel is one-off or very occasional (*de minimis*);
    - the travel relates to a temporary posting or secondment (up to two years);
    - the employee also genuinely works at a local workplace (meaning they have two workplaces);
    - the employee works from home on specified days and the travel relates to one of those days.

One-off or very occasional travel

43. Inland Revenue considers that one-off or very occasional travel from home to a distant location for work (when required by the employer) can be treated as not taxable on an incidental or *de minimis* basis. For example, attendance at a two-day conference at a distant location.

44. This approach will apply to employees who work at an office of their employer located in their hometown **as well** as employees who work all the time from their home.

Temporary travel

45. More frequent or ongoing employer-provided travel from home to a distant workplace (when the employer requires the travel) can be treated as non taxable where the requirement for travel is a temporary requirement (which means for a period of two years or less). An example might be a posting or secondment to another office or a client's premises for a 12-month term (see Example 1).

46. To treat the travel as temporary the employer must be able to show that the parties reasonably expected that the requirement for the travel was for two years or less. Reasonable expectation is initially measured at the time the requirement for the travel arose. The parties' expectation may be evidenced by the employee's terms of employment, but in many cases there may not be a written agreement. Other documentation such as board minutes, planning documents, and correspondence may demonstrate the expectation as to length of the secondment.

47. It is possible that travel which is treated as non-taxable can become taxable. If it becomes clear that there is now a reasonable expectation that the requirement for travel is no longer a temporary requirement (for a period of two years or less) that travel will be taxable going forward from the date the expectation changed.[13]

48. Equally, if it becomes clear that a requirement for travel which was expected to be more than a temporary requirement is **now** expected to be a temporary requirement (a period of two years or less) then that travel can be treated as non-taxable from the date the expectation changed.

[13] Not from the end of the original date of the arrangement.

Example 1: Temporary travel

Robyn lives in Auckland but is seconded to a job in Wellington for 12 months. Robyn's employer agrees to meet the costs of Robyn flying between Auckland and Wellington (and back) every week as well as taxis to and from the airport.

As the secondment is for two years or less (in this case, 12 months) any employer-provided travel from home to the distant location can be treated as non-taxable.

Example 2: Temporary travel

After 11 months Robyn and her employer agree that she will continue to work in Wellington for another sixteen months.

As it is now expected that Robyn will be working in Wellington for more than two years (27 months in total) the travel can no longer be treated as temporary and will be taxable from the date the expectation changed.

Ongoing travel from home to a distant workplace

49. Ongoing employer-provided travel from an employee's home to a distant workplace will be taxable when the travel is for more than two years. This is because Inland Revenue considers that at that stage the arrangement for the travel is more than temporary. (See Example 3.)

Example 3: Ongoing travel from home to a distant workplace

Rudolf is a senior manager in a multinational company with its head office in Auckland. Rather than move his family to Auckland, Rudolf negotiated an arrangement whereby his employer provided him with an apartment in Auckland and flies him to Auckland on Monday morning and flies him to Wellington on Friday afternoon.

As well as the cost of flights, his employer also covers the cost of his taxi travel to and from Auckland and Wellington airports.

The arrangement is for more than two years, so this employer-provided travel is taxable.

The outcome would be the same if Rudolf were seconded to the job in Auckland for a period greater than two years (rather than permanently appointed).

50. This approach applies **except** where the employee has at least two workplaces.

Travel between multiple workplaces

51. As noted above, the courts have recognised that travel between two workplaces is not private expenditure when the employer requires that travel. Therefore, where an employee has two (or more) workplaces that they work from, one in their hometown and one distant, the Commissioner considers that the travel from the employee's home to the distant workplace can be treated as work-related travel (being travel between multiple workplaces) and not taxable (the "multiple workplace approach").

52. The Commissioner does not require an employee to be travelling from their workplace in their hometown to the distant workplace before treating the travel as being between multiple workplaces. This means the multiple workplace approach can apply when an employee instead travels directly from their home to a distant workplace. The Commissioner has taken this approach to recognise the travel between the multiple workplaces and, at the same time, minimise taxpayer compliance costs.

An employer's workplace in their hometown can still be a workplace of that employee for the purposes of this approach, even if most of the employee's working week is spent at a distant workplace. (See Examples 4 and 5.)

Example 4: Travel between multiple workplaces

Jim is employed as a specialist to provide ongoing advice to senior managers. The job was advertised as being based in Wellington, but Jim was not interested in working full time in Wellington because his family lives in Auckland.

Jim and the employer agree that Jim can work two days a week in Auckland at the Auckland office and three days a week in Wellington. The employer provides Jim with the travel between his home and the Wellington office.

Jim's travel from home to the Wellington office and back will be travel between two workplaces and not subject to tax.

Example 5: Travel between multiple workplaces

Charlotte is a manager based in Nelson. She has staff based throughout the country that she visits regularly. She is often required to be in Wellington for meetings.

The travel in question is the travel from her home in Nelson to the distant location(s) and back again.

Charlotte's travel to the distant workplaces will be travel between two (multiple) workplaces and not subject to tax.

If Charlotte were to use an employer-provided car (such as a rental) to undertake that travel between home and a distant workplace, as the Commissioner is treating the travel as travel between two workplaces it would not be private use for the purposes of determining whether the car was available for private use.

Whether home is a workplace for the purposes of the multiple workplaces approach

53. If an employee does not have a workplace that is local to their home, then the travel to a distant workplace can still be travel between two workplaces, but only if their home can be considered to be a workplace.

54. Under the approach outlined in this Statement, the Commissioner will accept that in relation to travel, home can be a workplace for the purposes of the multiple workplace approach. But whether home is actually a workplace depends on the arrangement entered into between the parties, and an employee does not have multiple workplaces just because they can **choose** to work at home from time to time.

55. The Commissioner notes that by accepting that home could be a workplace in the context of travel to a distant workplace, she is taking a more concessionary approach than Parliament has taken in relation to the question of multiple workplaces and accommodation. Accommodation that an employer provides or pays for can be exempt where the employee has multiple workplaces (section CW 16F). However, where the employee has only two workplaces and one of them is a home office, this approach cannot apply.

56. While home may be a workplace, it is also the employee's home, so it is easy for the line between home-to-work travel and "on-work" travel to become blurred. This raises the question as to what extent does working from home convert that home to being a workplace for the purposes of the multiple workplace approach.

57. In considering whether a person is travelling between two workplaces when they travel from home to a work location, the courts have said it is not enough that a person **can** work at home. The courts tend to treat the place where you live as private and require an explicit and demonstrable distinction to exist before treating where you live as anything other than your home.

58. The Commissioner also requires such an explicit and demonstrated connection with home as a workplace on any particular day. If this were otherwise, then a "tainting" issue would arise as to what portion of time working at home in a week would be sufficient for home to be treated as a workplace for the whole week. There is no legal basis for the selection of any particular proportion, and the Commissioner does not believe that the courts would support such an outcome.

59. Accordingly, the Commissioner's position is that, for the purposes of the multiple workplace approach, home should be regarded as a workplace in this context only in relation to the days where home is contractually and actually the employee's usual place of work.

60. For an employee whose arrangement requires that they work at home on every working day, home is clearly a workplace.

61. Where an employee's employment arrangement requires that their home is their formal workplace where **they are expected to work** on specified days (such as every Monday and Tuesday), their home will be their workplace on those days for the purposes of the multiple workplace approach. However, their home is still home on the other days, and travel from home to a distant workplace in relation to the other days is travel from home to work and is taxable.

62. For a home to be a workplace on any day, the arrangement with the employer must provide that it is a specified day where the employee is required to work at home, rather than the employee simply having the potential to work at home on that day.

63. Where travel from the home to the distant workplace relates to a "working from home day" (being a day when home is a workplace), this travel will be treated as travel between multiple workplaces.

64. On other days, home is still regarded as home, so the travel from home to a distant workplace will generally still be taxed on the basis that it is home to work travel.

65. The Commissioner recognises that this approach could be seen as a constraint on the parties' contracting arrangements or as a compliance cost. However, she considers it a necessary part of the approach being taken, which is itself an attempt to minimise compliance costs. (See Examples 6–9.)

66. It is important to note that when applying the Commissioner's approach outlined in this Statement, whether home is a workplace only becomes relevant in determining whether the multiple workplace approach applies.

Example 6: Multiple workplace approach - Whether home is a workplace when person is contracted to work from home full time

Under Adele's employment arrangement, she is contracted to work at home on a full-time basis. This means home is usually her sole place of work. Therefore, it can be considered to be her workplace on every work day.

As any employer-provided travel from Adele's home to a distant workplace (for example, for a specific meeting or purpose) is very occasional or could be considered to be one-off, it is not subject to tax.

Example 7: Multiple workplace approach - Whether a person has multiple workplaces

Ruby lives in Auckland and works for a government agency. She has a permanent working arrangement where she works Monday and Tuesday at home. On Wednesday, Thursday and Friday, Ruby works at the agency's Auckland office. Ruby is seconded to work on a 26-month project that requires her to work in Wellington on Thursday and Friday.

As the project is for more than two years, the key question is whether Ruby has at least two workplaces so that the multiple workplace approach applies. As Ruby normally works in the Auckland office on Wednesday, Thursday and Friday, any employer-provided travel from Ruby's home to Wellington in relation to her work in Wellington would be treated as travel between multiple workplaces (the Auckland office and the Wellington workplace).

Therefore, the multiple workplaces approach would apply in relation to this particular employer-provided travel and it would not be subject to tax.

Example 8: Multiple workplace approach - Whether home is a workplace when a person is permitted to work at home

Leo lives in Tauranga but the company he works for is based in Auckland. Under his employment contract Leo can work up to two days a week at home in Tauranga. The days that Leo works at home can vary depending on personal and business convenience. Leo's employer provides him with travel between his home in Tauranga and the Auckland office in the form of plane flights and connecting taxis.

This is an ongoing arrangement, so the main question is whether Leo has at least two workplaces so that the multiple workplace approach applies.

It is important to determine whether Leo's home is a workplace. Leo does not have specified days where he works at home, which means the Commissioner will not accept that his home is a workplace for any particular day, for the purposes of the multiple workplaces approach.

Therefore, as Leo only has one workplace (the Auckland office) the multiple workplace approach does not apply in relation to this employer-provided travel, which is subject to tax.

(If Leo and his employer had a different arrangement where Leo had specified days where he was required to work from home (for example, Monday and Tuesday), then home would be accepted to be Leo's workplace on those days.)

Example 9: Multiple workplace approach - Whether home is a workplace when a person is required to work at specified places on different days

Phil is contracted on an ongoing basis to work Monday, Tuesday and Wednesday at his home and Thursday and Friday at a distant workplace. This ongoing arrangement is expected to last for more than two years. Therefore, the key question to answer when determining whether this travel to a distant workplace is taxable is whether Phil has at least two workplaces (the possibilities are home and the distant workplace) so that the multiple workplace approach applies.

It is important to determine whether home is a workplace. In this circumstance, home is clearly a workplace on Monday, Tuesday and Wednesday, and employer-provided travel to the distant workplace relating to those days will not be taxable. An example of this would be attendance at a conference or meeting on one or more of those days.

But on Thursday and Friday Phil does not work from his home, so home is still his home for these purposes on those days. Consequently, employer-provided travel from home to the distant workplace will be travel from home to work (and taxable) when it is undertaken for the purpose of getting Phil to that distant location, so he can work there on Thursday and/or Friday.

This means employer-provided travel from his home to a distant workplace on Monday, Tuesday or Wednesday will be taxable, if the travel is undertaken so Phil can undertake his work on Thursday and Friday.

67. This Statement applies from **1 April 2020**. However, taxpayers may choose to apply it from the date of issue if they wish to do so.

68. If you are unsure how this Statement applies to you, seek guidance from a tax professional.

This Statement was signed on 18 December 2019.

Vanessa Montgomery
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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.

High Court upholds TRA decision regarding Income Tax, GST and PAYE assessments and TAA ss 108 and 108A time bar

Case	*Dowden v Commissioner of Inland Revenue* [2019] NZHC 2729
Decision date	24 October 2019
Act(s)	Income Tax Acts 1994, 2004 & 2007; Student Loan Scheme 1992; Tax Administration Act 1994, ss 108 and 108A.
Keywords	fraudulent, wilfully misleading, knowingly

Summary

This is an appeal from a decision of the Taxation Review Authority ("TRA") regarding Mr Dowden's challenge to the Commissioner of Inland Revenue's ("Commissioner") PAYE, GST and INC assessments for tax periods between January 2004 and May 2012.

These assessments concerned several businesses run by Mr Dowden, including Safeguard Security ("Safeguard"). Mr Dowden claimed to have transferred his interest in Safeguard to his former partner, Ms Jackson, in December 2003. Mr Dowden's case was that Ms Jackson was liable for tax relating to Safeguard between January 2004 and December 2011.

The TRA upheld the Commissioner's assessments. The TRA held that Mr Dowden had not ceased to trade as Safeguard from January 2004 to December 2011 and also that the Commissioner was not bound by the limitation periods in ss 108 and 108A of the TAA.

Impact

The decision reaffirms the TRA's entitlement to determine the weight to place on evidence where the witness was not available for cross-examination and that it is not required to disregard entirely, the conflicting statements of a witness. The decision also reaffirms the TRA's entitlement to take into account all information relevant to the assessment made by the Commissioner.

The decision reaffirms case law surrounding TAA ss 108 and 108A and provides a useful summary of judicial definitions of the terms used in these sections.

Issues

The issues for determination were: whether the TRA erred in finding that Mr Dowden had carried on business as Safeguard during the relevant period; and whether the TRA's determinations regarding ss 108 and 108A were in error.

Decision

Mr Dowden argued that the TRA did not accord enough weight to statements made by Ms Jackson during an interview with Inland Revenue staff, which, according to Mr Dowden, were admissions that she and/or a company she controlled had taken over Safeguard. He also argued that various documents, which the TRA considered showed that Mr Dowden was owner/operator of Safeguard, evidenced no more than an inattention to detail on Mr Dowden's part and did not show that Mr Dowden was trading as Safeguard.

The High Court did not accept Mr Dowden's submissions, stating that the conclusion that Mr Dowden was operating Safeguard was plainly open on the evidence and that the contemporaneous documents, including Mr Dowden's representations, led to this conclusion.

The High Court also stated that, in deciding what weight to give Ms Jackson's statements, the TRA was entitled to take into account that she had not given evidence and was not available for cross-examination.

Mr Dowden's argument regarding ss 108 and 108A was that the Commissioner was statute-barred from amending assessments relating to Mr Dowden's 2004 Income Tax return and various GST returns throughout 2003, 2004, 2005, 2008 and 2009.

Section 108(2) permits the Commissioner to amend assessments for income tax outside a 4-year statute bar where the Commissioner is of the opinion that the relevant return was fraudulent or wilfully misleading or does not mention income (i.e. "omitted all mention of a gain subsequently found to be assessable income").

Section 108A(3) permits the Commissioner to amend GST assessments outside a 4-year statute bar where the Commissioner considers that the person assessed has knowingly or fraudulently failed to disclose to the Commissioner all of the material facts necessary for determining the amount of GST payable.

The Court held that the TRA made no error regarding the application of ss 108 and 108A, in light of its factual findings that the relevant income tax return "did not reflect [Mr Dowden's] true tax position, […] was misleading" and omitted income, and also that Mr Dowden, knowingly or fraudulently, failed to disclose all material facts in the relevant GST returns.

The consequence of these findings was that the Commissioner was not bound by ss 108 and 108A and was entitled to increase the amounts assessed as she had done.

Commissioner successful in donations GST case

Case	[2019] NZTRA 6
Decision date	20 November 2019
Act(s)	Goods and Services Tax Act 1985 (GST), ss 2(1), 6(1) and (3), 8, 10(2)(a) and 14(1)(b). Tax Administration Act 1994 (TAA), ss 3(1), 108, 108A, 138E, 138P, 141A, 141B, 141FB and 149A.
Keywords	GST, taxable activity, donated goods and services, unconditional gift, consideration, non-profit body, exempt supplies, time bar.

Summary

This proceeding was a tax challenge in relation to reassessments made for six GST periods (from the tax year ended 31 March 2012 to the tax year ended 31 March 2015) to include payments that the disputant, CD Trust, has treated as not being subject to GST. The Taxation Review Authority ("**the Authority**") found for the Commissioner of Inland Revenue ("the Commissioner") and upheld the reassessments (during the preparation for the hearing the Commissioner's investigator identified that there were errors in the calculations underlying the assessments and recalculated what the correct amount of the assessments should be. The Taxation Review Authority varied the assessments accordingly pursuant to s 138P of the TAA.)

Impact

This decision was an orthodox application of the law on GST.

The decision highlights that nomenclature used by a party is not decisive. It did not matter how the disputant's chose to characterise the payments they were receiving for X sport court hire and coaching fees if the true nature of the payments were such that they were taxable supplies which should have been included in their GST returns.

Facts

The disputant was an incorporated society for the disputed period but later became a registered charity. Mr Smith was the main trustee and essentially controlled the disputant. Mr Smith leased a property ("**the ABX Centre**") he owned to the disputant. The disputant subleased office space and returned the output tax on this in its returns. Mr Smith returned output on the rents he received from the disputant. In all periods the disputant's GST inputs were greater than its outputs and therefore received a refund.

In 2014 it appeared to the Commissioner that the disputant was utilising parts of the building it leased office space in to hire out X sport courts and charge fees for X sport coaching without returning GST output.

The Commissioner amended the disputant's GST returns to account for this income which resulted in the denial of all the GST refunds and tax owing to the Commissioner.

Issues

Judge Sinclair applied the law of GST to the facts of this case by analysing the following issues:

1. Whether the disputant can challenge the Commissioner's decision under s 108A(3) of the TAA to reopen the time-bar in s 108(1)(a) of the TAA?
2. Whether the payments received by the disputant were donations and therefore not subject to GST?
3. In the alternative, whether the payments were for exempt supplies under s 14(1)(b) of the GST Act 1985?
4. If the disputant is found to have made taxable supplies, whether it is liable for shortfall penalties under s 141A of the TAA?

Decision

The Authority dismissed the time bar issue on the basis that pursuant to s 138E(1)(i)(v) of the TAA the decision to lift the time bar for a GST return reassessment under s 108A of the TAA is not a disputable decision that can be challenged to the Authority.

The Authority held that payments received by the disputant for X sport court hire and coaching fees were not donated because these payments were not "unconditional gifts". The disputant was not a non-profit body because the disputant's trust deed did not prohibit it from making any distribution to its members. The use of the courts and receipt of coaching services were conditional on fees to be paid.

The Authority held that payments received by the disputant for X sport court hire and coaching fees were not exempt supplies which required a supply of donated goods and services to be made by a non-profit body. The disputant was not a non-profit body. The supply of X sport court hire and provision of X sport coaching services were not donated. A lease agreement showed that the disputant was renting the X sport courts from Mr Smith. The Authority concluded that the disputant was only in the position to pay their rent to Mr Smith by hiring out the X sport courts. The disputant's bank statements reflected reasonably regular payments being made directly to Mr Smith who conducted some X sport coaching at the ABX Centre. The disputant was not able to discharge their onus of establishing that Mr Smith (and any other X sport coaches) had donated their services to the disputant.

The Authority held that the disputant did not take reasonable care in taking a tax position when it filed its GST returns. The disputant did not establish it relied on professional advice when filing their returns. The Authority accepted that Mr Smith (who prepared and managed the affairs of the disputant) was an experienced businessman who was personally GST registered meaning he had an understanding of the GST legislation. The Authority held that a reasonable person in his position would have known that the supply of X sport court hire and coaching services were taxable supplies and required GST output tax to be included in the disputant's GST returns.

Court of Appeal dismisses appeal of application for judicial review of child support assessment

Case	*P(CA85/2019) v CIR & Ors* [2019] NZCA 531
Decision date	4 November 2019 (re-issued 3 Dec 2019)
Act(s)	Child Support Act 1991
Keywords	Ongoing daily care; change in circumstances

Summary

The Court of Appeal dismissed P's appeal and accepted the Commissioner of Inland Revenue ("CIR") had acted correctly in changing P's child support entitlement to nil.

Impact

The judgment confirms the result reached in the High Court. The judgment also offers some guidance regarding the relationship between amending an ongoing assessment at s 82(2) and cessing assessments under s 25.

Facts

P was the Receiving Carer in respect of A. The liable parent ("W") resides in Australia. The original assessment was made on the basis P was providing 100% of the "ongoing daily care" of A.

P and W agreed that A would go to Australia to stay with W. A was residing with W from December 2017 to July 2018. The Court found the evidence allowed the CIR to conclude the visit was intended to be for at least six months (par [13] of judgment).

The CIR decided there had been a change in circumstances and that the ongoing daily care during this period had changed: that W provided 100% of the ongoing daily care and P had provided none.

P argued there had been no change to the ongoing daily care of A and that she was entitled to receive child support payments during the relevant period. P argued that because the period of time A was staying with W fell over two child support years, there was no change of circumstances in each of the two child support years affected.

The High Court had dismissed P's judicial review ([2019] NZHC 98).

Issues

Was the CIR correct to form the opinion there had been a change in circumstances in the ongoing daily care of A in the period December 2017 to July 2018?

Decision

The Court accepted the general scheme of the Child Support Act 1991 ("CSA") was that the money should follow the child so that the person providing the ongoing daily care received the financial support to do so: par [4]

At par [6] the Court observed:

> Where there has been a request for a formula assessment, the Commissioner is required to establish the proportion of ongoing daily care that each parent and/or non-parent carer provides. The phrase "ongoing daily care" is not defined but it is evident that this is an assessment to be made by the Commissioner on the basis of all the relevant information and with the assistance of other provisions of the Act. For example, in establishing the proportions of ongoing daily care being provided by each carer, the Commissioner is required to rely on any care order or agreement in place. However a parent or carer may challenge the establishing of proportions of care on that basis if there are reasons that a care order or agreement should not be relied on. In addition, if the Commissioner is satisfied that a care order or agreement does not accurately reflect the proportion of ongoing daily care provided, she must establish the proportion of care primarily on the basis of the number of nights that the child spends with the carer. And if the number of nights spent with a carer is not regarded as a true reflection of the proportion of care actually provided then the Commissioner must establish that proportion on the basis of the amount of time the carer is responsible for the daily care of the child.

On the facts of this case the Court of Appeal noted:

> [27] However, during Ms P's submissions she conceded that, faced with the fact that A would be in Mr W's care for a continuous six-month period, the Commissioner was entitled to conclude that a change in circumstances had occurred and to have assessed the 2018 child support year on that basis. This was a responsible concession. **Although "ongoing daily care" is not defined, the ordinary meaning of that phrase conveys continuity of present circumstances into the future. Who has the ongoing daily care of a child is not a retrospective enquiry; rather, it is directed towards the current and prospective situations.** Only once that assessment is made does the past becomes relevant in order to determine (by reference to the past arrangements) whether there has been a change in circumstances. [Emphasis added]

The Court continued at[28]:

> … The parties [here P and W] were required by s 82(1)(a) to notify the Commissioner of the change in circumstances because it was a change that might have affected the determination of the cost care percentage. Such notification is required specifically "[f]or the purpose of enabling the Commissioner to make or amend a calculation of child support payable in respect of a child". **The scheme of the Act is clear that the Commissioner must respond to changes in circumstances when they occur and on a prospective basis i.e. assessing entitlements on the basis of ongoing care arrangements.** If the response was determined by past arrangements the integrity and purpose of the scheme would be undermined. [Emphasis added]

On these facts the CIR was right to conclude the living circumstances had changed. The combined effect of ss 25(3)(b), 86, and 87 meant the CIR was entitled to alter the existing assessment and did so.

In an obiter dicta footnote the Court specifically excluded the circumstances of this case from the ambit of 82(2) stating:

> [Footnote 36] …Section 82(2) goes on to specify the dates on which a change of circumstances is to be treated as having occurred where the change either increases the liability of the liable parent or decreases the liability of the receiving carer or where notice of the change was received within 28 days of the change being notified to the Commissioner. **The present case does not fall within those provisions because the result in this case was that the respective liability and entitlement ceased rather than increased or decreased. Cessation of liability is specifically governed by ss 25 and 62. So although s 82 applies generally insofar as it imposes the requirement to notify of changes in circumstances, the effect of the change where liability or entitlement ceases is not affected by s 82(2).** [Emphasis added]

Given the lack of a definition of the phrase "ongoing daily care" and the fact there were no earlier decisions on the phrases, the Court did not award costs to the CIR.

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