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Tax Counsel Office (Public Advice and Guidance)
Inland Revenue Department
New Zealand

By email: **Public.Consultation@ird.govt.nz**

Dear Sir or Madam,

Issues Paper IRRUIP15: Income tax – trusts and the Australian–New Zealand Double Tax Agreement

CPA Australia represents the diverse interests of more than 168,000 members, including over 2,600 members in New Zealand, working in over a 100 countries and regions supported by 19 offices around the world. We make this submission on behalf of our members and in the broader public interest.

The Inland Revenue's Issues Paper **IRRUIP15: Income tax – trusts and the Australian-New Zealand Double Tax Agreement** (**the Issues Paper**) seeks to clarify the tax treatment of trusts under the network of double tax treaties that New Zealand has entered into with other countries. The Issues Paper approaches this area by examining how New Zealand's treaty with Australia, the Australian-New Zealand Double Tax Agreement (**the Aus-NZ DTA**), addresses this subject.

Generally, we agree with the interpretation of the relevant tax laws and suggested conclusions by the Commissioner.

We suggest that the Issues Paper should provide guidance on the requirements under the **Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting** (**MLI**), the Administrative Approach and how this needs to be applied in a trust situation as the MLI is now fully in force for taxable periods beginning on or after 1 July 2019.

The Issues Paper should also address what it means for a trustee not to obtain a determination or a Competent Authority endorsement as some articles of the DTA would subsequently not be applicable.

Our responses to the Summary of initial conclusions presented in the Issues Paper are in the Attachment.

If you have any queries about this submission, contact Rick Jones, Country Head, New Zealand on +64 21 190 1039 or **rick.jones@cpaaustralia.com.au** or Elinor Kasapidis, Senior Manager Tax Policy on +61 3 9606 9666 or **elinor.kasapidis@cpaaustralia.com.au**.

Yours sincerely,

Dr Gary Pflugrath
Executive General Manager,
Policy and Advocacy

Mr Rick Jones
Country Head,
New Zealand

Consultation questions

1. What is the taxable entity in a trust context?

4. The taxable entity for a trust is the trustee if income is accumulated or a beneficiary where income is distributed to them.

And at:

192. The trustee is the taxable entity both domestically and under the Aus–NZ DTA. A trustee is treated as beneficially entitled as a resident person to interest, dividends and royalties that it retains under the Aus–NZ DTA. A beneficiary is the relevant taxable entity when income is distributed.

We agree with this interpretation. Trust income is taxed either as income of the trustee (not the trust) or income of a beneficiary under New Zealand law. If there is no beneficiary income, the taxpayer must be considered to be the trustee, and not the trust, for the purposes of the Aus-NZ DTA analysis under New Zealand law. The beneficiary is only taxed if he or she has an immediate right to or has received income. This is provided for by subpart HC of the *Income Tax Act 2007* (ITA 2007).

2. Is it the residence of the trustee or the settlor, or both, that determines eligibility to the benefits of the Aus–NZ DTA?

4. The domestic tax residence of a New Zealand trustee primarily determines eligibility to the benefits of the Aus–NZ DTA. However, that trustee must also be liable to tax on worldwide income to qualify.

And at:

193. The residence of the trustee and not the settlor determines eligibility to the benefits of the Aus–NZ DTA as a resident. The role that a settlor plays in the effective management of a trust may have an impact on tie-breaker determinations where a trustee is dual resident.

We agree with this interpretation. Article 4(1) of the OECD model requires the trustee to be resident for tax purposes according to New Zealand law. A New Zealand corporate trustee, or a New Zealand resident person who acts as a trustee, clearly is a resident for tax purposes. This is in accord with the provisions of S HC26, where for the section to apply, the trustee must be resident in New Zealand. A trustee resident in New Zealand for these purposes is defined in S33(1) of the *Tax Administration Act 1994* as a person (which includes a company) who acts as a trustee of a foreign trust that is not registered as a charitable entity and is resident in New Zealand.

3. Does the Aus–NZ DTA require that a trustee be treated in a separate capacity from their personal or private capacity?

4. The Aus–NZ DTA (in the same manner as domestic legislation) requires a trustee to be treated in a separate capacity from their personal capacity and their capacity as trustee of any other trust.

And at:

194. Yes, the Aus–NZ DTA reflects the domestic approach of treating a trustee as acting in their capacity as trustee of a particular trust and not in their private capacity.

We agree with this interpretation. The Issues Paper highlights in paragraphs 98 and 99 the "approach of treating a trustee as a non-individual" resident "and as a beneficial owner", "operat[ing] in a separate notional capacity from their status as a private individual when performing the functions as trustee and this is reflected in the Aus-NZ DTA". Section HC24(1) of ITA 2007 states that a trustee is to be treated as individually beneficially entitled to the trustee (not beneficiary) income.

As an example, it is hard to argue that in a fully discretionary accumulating trust, which has broad powers of appointment in respect of income and capital, that there can be any other answer other than that the income flowing from the trust assets is beneficially owned by the trustee as a separate person in respect of their trustee capacity, as it is otherwise impossible to determine the beneficial owner.

4. How does the residency tie-breaker provision deal with two or more trustees of mixed residency and is the test only that for non-natural persons?

4. The tie-breaker test for non-natural persons is the test applicable to a dual resident trustee. A single natural person who is a dual resident trustee could apply the test for natural persons, if the competent authorities endorsed that application.

And at:

195. The tie-breaker test in art 4(3) of the Aus–NZ DTA for persons other than an individual applies. Where a sole dual resident individual is the trustee, the competent authorities need to first agree that art 4(2) of the DTA can be used to determine the matter.

We agree with this interpretation.

5. What is the scope of the requirement to recognise income derived by or through a trust that is treated as resident in one country as the income of a beneficiary who is taxable on it in the other country?

4. Where a trust is treated as fiscally transparent in either country and income is taxed to a beneficiary as a resident of the other country, a resident of the other country is considered the recipient of the income.

And at:

196. The Aus–NZ DTA directs both countries to recognise a resident of the other country as the recipient of income from a trust if it is taxable to a beneficiary in the other jurisdiction. This means a non-resident beneficiary is treated as the beneficial owner of the income in the jurisdiction in which the trust/trustee is treated as resident. However, it is overridden by the preservation of the right of a country to tax its resident entities (discussed next).

We agree with this interpretation. The non-resident beneficiary is only taxed and will only be regarded as the beneficial owner if he or she has an immediate right to or has received income. That is, income which vests absolutely in interest in a non-resident beneficiary or is paid to a non-resident beneficiary of the trust in the income year, after the trustees exercise their discretion in his or her favour.

6. How does the obligation in the question above sit with the rights of each country to tax its own residents?

4. The right of each country to tax a trust as a resident entity on an opaque basis overrides the country's obligation to treat a trust as fiscally transparent.

And at:

197. The right to tax a resident trust/trustee domestically overrides the obligation to recognise a beneficiary as the recipient of income from such an entity under art 11 of the MLI. In other words, the Aus–NZ DTA treats trusts as partially fiscally transparent entities, so each country can choose domestically not to recognise a beneficiary from the other country as the recipient of income and treat it as income of the resident trust/trustee.

We agree with this interpretation. In this case, Article 1(2) of the Aus-NZ DTA requires that an item by item analysis be undertaken to determine whether a particular item of income meets the residence qualification for DTA relief to apply instead.

7. What is the extent of the obligation to grant a tax credit for tax paid in the other country by either the trustee or a beneficiary?

4. Both countries must provide relief from double tax under their existing domestic provisions where tax is imposed in the other country on a beneficiary or trustee resident in their country; and where tax is imposed on income of a trust that is treated as opaque in the other country and as income of a beneficiary resident in their country. When a trust is referred to as an entity in this paper, the person treated as the taxpayer is the trustee. Consequently, these terms (trust and trustee) are treated as interchangeable in the paper and that has no significance. The legislation in Australia identifies both the trustee and the trust estate in different provisions, (see footnote 23) but no separate treatment results for these two concepts.

And at:

198. Each country has an obligation to grant relief under its prevailing domestic provisions for juridical tax. That is, where the same income is taxed to a beneficiary in both countries, the beneficiary's country of residence must provide the relief, and where a trust/trustee is taxed in one country and the same income is taxed to a beneficiary in the other country.

We agree with this interpretation.

8. Other Comments

We suggest that the proposed commentary is an excellent opportunity to illustrate the impact of the Multilateral Agreement when interpreting a double tax treaty especially as the MLI is enforced in New Zealand and Australia. The IRRPUIP15 would also enable the Commissioner to illustrate the implication of the Administrative Approach, especially in a trust context, as the interpretation is not always clear and as straight forward as it appears.

Examples elaborating on the dual tax residence issue in the light of the MLI should be included. This would enable the Commissioner to elaborate on the importance of the MLI especially when a residence determination is not obtained, or an endorsement is not received. The consequence of this needs to be illustrated as it is a major shift in our self-assessment approach. This might also have an impact on the status of a trust as a compliant trust in the future.

To apply the self-assessment approach, the trustee must:

1. Be an ordinary company
2. Reasonably self-determine its place of effective management (PoEM) to be solely in Australia or New Zealand for the purposes of the Aus-NZ DTA

3. Have less than AUD $250 / NZD $260 million in group annual accounting income
4. Have less than 20 per cent gross passive income compared to total assessable income in the last income year
5. Have less than 20 per cent of the value of its total assets be intangible assets (other than goodwill)
6. Not currently (or in the last five years) be engaged in any "compliance activity" relating to determination of residency, including members of the taxpayer's group
7. Not currently be engaged in any objection, challenge, settlement procedure or litigation in relation to any dispute with the Australian Taxation Office (**ATO**) or Inland Revenue (**IR**), including members of the taxpayer's group
8. Notify the IR / ATO of its self-determined PoEM if a new compliance activity is begun
9. Not have entered into a tax avoidance scheme or arrangements that, broadly, intends to defeat the MLI or rules of residency, including actions by the taxpayer's group.

It appears clear that the administrative approach does not apply or, if it applies (i.e., to the trustee is a company) it will not apply to asset-protecting New Zealand trusts as they generally derive more than 20 per cent gross passive income.

The Issues Paper should attempt to comment on the requirements under the MLI, the Administrative Approach and how this needs to be applied in a trust situation due to the fact that the MLI is now fully in force for taxable periods beginning on or after 1 July 2019.

The Issues Paper should also address what it means for a trustee not to obtain a determination or a Competent Authority endorsement as some articles of the Aus-NZ DTA would subsequently not be applicable.