

TAX DEVELOPMENTS OF RELEVANCE TO TRUST PRACTICE

Trusts Special Interest Group

27 February 2018



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TAX DEVELOPMENTS OF RELEVANCE TO TRUST PRACTICE

(Introduction)

- Core tax trust rules in Income Tax Act 2007 and GST Act 1985 very stable
- Important tax developments in 2018 to be aware of:
 - IRD's finalisation of its *Interpretation Statement on Taxation of Trusts – Income Tax*
 - Extension bright-line test from 2 years to 5 years
 - BEPs proposals in relation to improper profit – shifting under cross-border arrangements (including foreign trusts as reverse hybrid arrangements)
 - Section BG 1 and trust distributions
 - Relevant cases

TAX DEVELOPMENTS OF RELEVANCE TO TRUST PRACTICE (IRD Interpretation Statement)

- When tax trust rules in Income Tax Act reformed in 1988, IRD prepared detailed tax commentary (**commentary**) on that reform (1989, *Tax Information Bulletin*)
- Last year, IRD published updated draft of that commentary (*PUB 00261 – Draft Interpretation Statement On The Taxation of Trusts – Income Tax*)
- IRD received submissions on commentary and has indicated that new commentary will be finalised *circa* April 2018
- While tax trust rules largely same, original commentary did not address things like core provisions and rewrite Income Tax Act, minor beneficiary rule, transitional residence, CRS, new disclosure requirements foreign trusts, which the new commentary now does.

TAX DEVELOPMENTS OF RELEVANCE TO TRUST PRACTICE (IRD Interpretation Statement)

- New commentary very useful guide to workings of tax trust rules (far easier to follow than original commentary)
- Commentary does not cover all trust-related areas (e.g. s BG 1, bare trusts and double tax agreements) as these either already subject to IRD commentaries or will be covered in future ones)
- Consultation process on draft commentary flushed-out technical points have been unclear in tax trust rules for years

TAX DEVELOPMENTS OF RELEVANCE TO TRUST PRACTICE (IRD Interpretation Statement)

- IRD now working through some of these technical points and where these cannot be addressed in commentary and require legislative amendment these will be covered off in future remedial Bills
- Some of the more important additional questions identified for consideration include:
 - Status of bare trusts
 - In specie distributions from foreign trusts, unintended tax liability arising?
 - Dual status trusts
 - Incidental trust-related services as “settlements”

TAX DEVELOPMENTS OF RELEVANCE TO TRUST PRACTICE (Section BG 1 and Trust Distributions)

- Distributions of beneficiary income to solvent tax-loss discretionary beneficiary vehicles (company/trust) is commonplace
- IRD has given statement that supports proposition that such a transaction will not constitute tax avoidance despite significant tax motivations
- Despite IRD's general support for distribution not being tax avoidance increasing examination of whether the distribution was actually made to the beneficiary and whether the beneficiary received a benefit from that distribution



TAX DEVELOPMENTS OF RELEVANCE TO TRUST PRACTICE

5-year Bright-line Test

- Government extending bright-line period to 5 years (15/2/18 announcement)
- Amendment contained in Supplementary Order Paper to Taxation (Annual Rates for 2017-18, Employment and Investment Income, and Remedial Matters Bill)
- Rule applies to acquisition of land from date of Royal Assent of legislation
- Reform will catch extended class of residential land owned by trusts outside “main home”

TAX DEVELOPMENTS OF RELEVANCE TO TRUST PRACTICE

(Recent Cases)

- *Chatfield v CIR* [2017] NZHC 3289
- Significant judicial review decision on obligations of IRD when requesting information from NZ taxpayer on behalf of foreign revenue authority (**KNTS**) using s 17 information request notice (particular relevance foreign trusts with non-compliant foreign settlors)
- Wylie J held that 2014 information notice was invalid because his Honour not satisfied NZ competent authority had properly satisfied itself that the KNTS request was both necessary and complied with terms of DTA and law required IRD to be in a position to explain itself and disclose all necessary information
- Court rejected proposition that review of the IRD's decision-making was not "justiciable" or required IRD to show deference to KNTS' request in some manner
- Case subject to appeal

TAX DEVELOPMENTS OF RELEVANCE TO TRUST PRACTICE (BEPS Reforms and Foreign Trusts)

- To ensure all tax jurisdictions get fair share of tax OECD been driving major reforms to existing international tax rules which contain tax holes or deficiencies (e.g. double non-taxation)
- Some of these reforms implemented already in New Zealand, e.g. like new tax transparency and disclosure rules for financial account information (AEOI and CRS)
- Other reforms being implemented generally known as *base erosion and profit shifting rules* (**BEPS**)

TAX DEVELOPMENTS OF RELEVANCE TO TRUST PRACTICE (BEPS and Foreign Trusts)

- BEPS being rolled-out in New Zealand and other countries in a largely uniform legal and tax manner (like AEOI/CRS)
- The Taxation (Neutralising Base Erosion and Profit Shifting) Bill (**Bill**) introduced in December 2016 contains key changes to some of NZ's tax rules which are designed to prevent tax advantages arising due to the exploitation of differences in tax treatments applying between countries on same tax question

TAX DEVELOPMENTS OF RELEVANCE TO TRUST PRACTICE (BEPS and Foreign Trusts)

- The Bill (and related reforms) designed to counter the improper exploitation of New Zealand's existing tax rules in the cross-border context and does this by making changes *inter alia* to NZ's source rules, permanent establishment rules (in DTAs), thin capitalisation rules and introduces new interest limitation and hybrid and branch mismatch rules (**hybrid mismatch rules**)
- Reforms in Bill may impact NZ trusts with commercial/investment elements and foreign participants (e.g. loans, management agreements, supply arrangements, etc.)

TAX DEVELOPMENTS OF RELEVANCE TO TRUST PRACTICE (BEPS and Foreign Trusts)

- Hybrid mismatch rules describe a situation where instruments or entities are utilised by taxpayers to exploit the differences in the tax laws of two or more countries to produce a mismatch in tax outcomes which lowers the aggregate tax burden of the parties to the arrangement (Action 2 on BEPS Action Plan)
- Foreign trusts identified as “reverse hybrids” for NZ tax purposes because, in relation to foreign-source income, this income is not taxed in NZ and also may not be taxed in the country of the trust’s settlor/investor
- Strong submissions made that foreign trusts not “reverse hybrids”, these rejected by Government (concession to OECD, *Panama Papers*)

TAX DEVELOPMENTS OF RELEVANCE TO TRUST PRACTICE (BEPS and Foreign Trusts)

Details of this reform likely to be included in next (May?) 2018 Bill:

- Certain income of foreign trust not taxed anywhere in world because income not recognised as being within relevant taxing rules in relevant jurisdictions
- Foreign-sourced income of many foreign trusts not taxed in NZ and offshore (double non-taxation)
- New rules likely require foreign trusts to be subject to some form of “control” test (“association” rules)
- Application of new rules, 1 April 2019
- *De minimus* rules apply if low level of foreign-sourced income