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**Draft Issues Paper No. 8 – Unit trusts – whether more than one unit holder is required (IRRUIP8)**

**Introduction**

1. The New Zealand Law Society (Law Society) appreciates the opportunity to comment on the draft issues paper no. 8, *Unit Trusts – Whether more than one unit holder is required* (Issues Paper).

**Comments**

*Policy review of the tax treatment of unit trusts may be warranted*

2. The starting point for this submission on the Issues Paper is that there will continue to be provision for a "unit trust", however defined, to be compulsorily taxed as a company under the Income Tax Act 2007 (ITA 2007).
3. The Law Society notes, however, that in light of the fact that (as highlighted in the Issues Paper) current company and trust tax rules differ substantially from the rules that applied when the treatment of unit trusts as companies was first introduced, there may be grounds for a wider review of the policy rationale(s) for that treatment and whether or not that treatment is still appropriate. (It might be the case, for example, that although the default position should continue to be that unit trusts are treated as companies for tax purposes, there could be provision for the trust tax rules to apply, or for there to be an election to apply those rules, instead of the company rules in appropriate circumstances.)

*Interpretation of the current "unit trust" definition - two or more subscribers etc. required*

4. Subject to the above comment, in relation to the particular issue of whether or not a unit trust that provides for, or has, only one subscriber, purchaser or contributor falls within the "unit trust" definition as currently drafted, the Law Society considers that the weight of factors

favours the position that a unit trust must have, or at least provide facilities for, two or more subscribers etc. and that a Court more likely than not would adopt that position.

5. While Inland Revenue has identified various factors that might reasonably be relied upon in taking a contrary position, other factors identified by Inland Revenue in the Issues Paper carry greater weight, including in particular:
  - the plain text of the definition, with its exclusive, and apparently deliberate, use of the plural rather than the singular;
  - the legislative history of the definition, which only points to an intention that the definition cover unit trusts that have, or provide for, two or more subscribers etc. (even though its application to single unit holder trusts was not explicitly discounted);
  - the subsequent effective affirmation of that interpretation of the definition by Inland Revenue, in BR Pub 95/5A and the comments on that ruling in Tax Information Bulletin Vol. 12, No 5 May 2000, and also by Parliament, in particular in sections HM 3(1)(b)(iii) and HM 9(c) of the ITA 2007; and
  - the extent to which that interpretation has become well-settled over time, and has accordingly been relied upon by taxpayers.

In the latter regard, although the Law Society has not comprehensively surveyed the position, it is understood that a number of single unit holder trusts have been treated as trusts, not companies, for tax purposes, on the basis that the "unit trust" definition does not apply. In contrast, the Law Society is not aware of any widespread practice of treating such trusts as companies for tax purposes.

6. The Law Society also considers that the better view of the current definition (and the preferred approach to any amended definition) is that the legal relationships entered into should determine whether or not a scheme or arrangement falls within the definition. (This would, of course, be subject to the application of the general anti-avoidance rule in the ITA 2007.)

*Amendment of the current "unit trust" definition recommended*

7. The Law Society also submits that regardless of the position ultimately reached by Inland Revenue on this issue, the unit trust definition in section YA 1 of the ITA 2007 should be amended as soon as possible in order to provide certainty for taxpayers. In light of the interpretation issues raised by the Issues Paper, it would not be sufficient for Inland Revenue merely to issue a public ruling or other type of public item, as suggested at paragraph 5 of the Issues Paper.
8. Amendments to address this issue should also be relatively straightforward. For example, the definition could be amended as follows (added wording underlined):

*"unit trust means a scheme or arrangement that is made for the purpose or has the effect of providing facilities for two or more subscribers, purchasers, or contributors to participate, as beneficiaries under a trust, in income and capital gains arising from the property that is subject to the trust"*

*or alternatively:*

*"unit trust means a scheme or arrangement that is made for the purpose or has the effect of providing a facility or facilities for one or more subscribers, purchasers, or contributors to participate, as the beneficiary or beneficiaries under a trust, in income and capital gains arising from the property that is subject to the trust"*

9. In the first case, it may also be appropriate to add, for the avoidance of doubt, wording to the effect that the definition applies *"regardless of whether there are two or more subscribers, purchasers, or contributors at any particular time"*.
10. If an amendment were to be made to the effect that it is sufficient for a unit trust to provide a facility or facilities for one or more subscribers etc., then consequential amendments would also need to be made in relation to sections HM 3(1)(b)(iii) and HM 9(c) of the ITA 2007. It would seem sufficient simply to repeal the two provisions in these circumstances (so long as the amendment to the definition is retrospective, as discussed below).

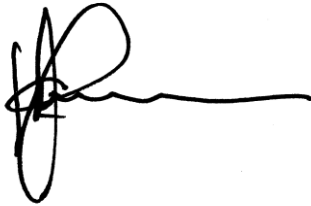
*Protection of taxpayers in relation to whichever position they have taken to date*

11. The uncertainties raised by the Issues Paper in relation to this aspect of the interpretation of the current "unit trust" definition also suggest that taxpayers should be protected in relation to whichever position they have taken to date. As noted above, this is because even though the weight of factors favours the position that a unit trust must have, or at least provide facilities for, two or more subscribers etc., other factors identified by Inland Revenue might still have reasonably been relied upon in taking a contrary position. This could be done, for example, by making the relevant amendment to the definition retrospective while preserving the treatment of unit trusts in respect of which a contrary position has been taken.
12. For example, if Inland Revenue were to affirm the view that a unit trust must provide facilities for two or more subscribers etc.:
  - As noted above, the definition could be amended to refer to *"a scheme or arrangement that is made for the purpose or has the effect of providing facilities for two or more subscribers..." etc.*, with retrospective effect (to the date of commencement of the ITA 2007). This would cover the position of any existing single unit holder trust in respect of which the trust tax rules, rather than the company rules, have been applied.
  - A savings provision would then apply to any existing single unit holder trust in respect of which the company tax rules, rather than the trust tax rules, have been applied, and such a trust might also be permitted to continue to apply the company tax rules either for a limited period or indefinitely (unless a return position is taken that the trust tax rules apply).

**Conclusion**

13. This submission was prepared with assistance from the Law Society's Tax Law Committee. If you wish to discuss this further please do not hesitate to contact the committee convenor Neil Russ, through the committee secretary Jo Holland (04 463 2967), [jo.holland@lawsociety.org.nz](mailto:jo.holland@lawsociety.org.nz)).

Yours faithfully

A handwritten signature in black ink, consisting of a large, stylized initial 'C' followed by a horizontal line extending to the right.

Chris Moore  
**President**