

20 January 2017

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Trustee Capacity Amendment

Introduction

1. Thank you for your letter of 20 December 2016 inviting feedback on the proposal to amend Part Y of the Income Tax Act 2007 to clarify that, subject to clearly identified exceptions, an individual or company acting as a trustee of a trust is to be treated as a separate person for income tax purposes. The New Zealand Law Society (Law Society) welcomes the opportunity to comment on this proposal.

Comments

General support for proposal

2. The Law Society agrees that the Income Tax Act 2007 (and the Goods and Services Tax Act 1985) should be amended to clarify that, subject to clearly identified exceptions, an individual or company acting as a trustee of a trust is to be treated as a separate person for income tax purposes (and GST purposes), and where an individual or company acts as a trustee of more than one trust, that individual or company should be treated as acting in a different capacity in respect of each trust. The Law Society agrees that proposed section YA 5 of the Income Tax Act 2007 should achieve this objective.

Recent case law on trustee capacity

3. The High Court decisions in *Concepts 124 Limited v C of IR* [2014] NZHC 2,140 and *Staithe Drive Development Limited v C of IR* [2015] NZHC 2,593 are at odds with the previously held views of both Inland Revenue and taxpayers. Prior to these cases, it was generally accepted that a person (including a company) acting as trustee was acting in a different capacity for tax purposes than their personal (or corporate) capacity. Further, a person (including a company) acting as trustee of more than one trust would be treated as acting in a different capacity in respect of each trust.

4. The Law Society does not wish to criticise the reasoning of the above cases, but notes that:
 - a. In the *Concepts 124* case, the vendor (Ormiston) and the purchaser (Concepts 124) would have been associated under the tripartite test of association in section 2A(1)(i) of the Goods and Services Tax Act 1985 even if Clifford J had respected the capacity in which Flatbush Holdings Limited held the shares in Ormiston. That is, Mr Cummings would have been associated with both Ormiston and Concepts 124 under the company / person test of association in section 2A(1)(b) of the Goods and Services Tax Act 1985, as Mr Cummings held at least 25% of the voting shares in each company (on a look-through basis). The Law Society notes that the tripartite test of association in section 2A(1)(i) of the Goods and Services Tax Act 1985 applies where the two persons (Concepts 124 and Ormiston) are associated with the same third person (Mr Cummings) under the company / person test of association, unlike the tripartite test of association that applies for income tax purposes (section YB 14 of the Income Tax Act 2007).
 - b. In the *Staites Drive* case, Edwards J agreed with the Taxation Review Authority that the convoluted ownership structure was put in place to enable Staites Drive to claim an input tax credit to which it would not otherwise have been entitled. As such, Edwards J held that even if Staites Drive and Whitby were not associated persons, the input tax credit would have been denied on the basis that the input tax credit claim was part of a tax avoidance arrangement.

As such, the decisions in *Concepts 124* and *Staites Drive* would have been the same even if their Honours had looked beyond the legal ownership of the shares in the vendor and purchaser in each case.

Proposed amendments to subpart YA of the Income Tax Act 2007

5. The Law Society agrees that the wording of proposed section YA 5 of the Income Tax Act 2007 should achieve the stated objective. That is, proposed section YA 5 clarifies that an individual or company acting as a trustee of a trust is to be treated as a separate person for income tax purposes, and where an individual or company acts as a trustee of more than one trust, that individual or company is to be treated as acting in a different capacity in respect of each trust.
6. The Law Society notes, however, that it would be more logical if the proposed section was inserted as section YB 22, rather than section YA 5, and that the heading of subpart YB was changed to "Associated persons, nominees and trustees". The Law Society notes that section YB 21 already deals with bare trustees, so the position of trustees (other than bare trustees) should logically be dealt with immediately after section YB 21.

Proposed consequential amendments to the Income Tax Act 2007

7. The Law Society is not in a position to make specific comments on the consequential amendments required as a consequence of the proposed enactment of section YA 5 and the proposed amendments to the definitions of "natural person" and "company", as these have not yet been drafted. However, the Law Society makes the following observations:

- a. The Law Society welcomes the proposed amendment to the definition of “close company” to enable a company owned by a family trust to be treated as a “close company”.
- b. The Law Society does not agree with the proposed amendment to section HD 15 (asset stripping of companies) to expressly include corporate trustees. The Law Society does not share Inland Revenue’s view that Parliament contemplated that section HD 15 (and forerunners) would apply to a company acting in the capacity of a trustee of a trust.

Proposed amendments to section 2A of the Goods and Services Tax Act 1985

- 8. The Law Society notes Inland Revenue’s proposal to amend section 2A of the Goods and Services Tax Act 1985 to include a trustee / appointor test of association (along the lines of the equivalent test of association in section YB 11 of the Income Tax Act 2007). While the Law Society does not disagree with the inclusion of a trustee / appointor test of association for GST purposes, the Law Society notes that the outcome of the *Concepts 124* and *Staithe Drive* cases would have been the same without resorting to this test of association (as noted in paragraph 4, above).
- 9. The Law Society considers that amendments will need to be made to the definitions of “market value interest” and “voting interest” in section 2A(3) of the Goods and Services Tax Act 1985 to overcome the reasoning in the *Concepts 124* and *Staithe Drive* cases. In particular, the cross reference to the income tax definitions of “market value interest” and “voting interest” should specifically refer to and import the nominee / bare trustee provision in section YB 21 of the Income Tax Act 2007 (which was not considered in *Concepts 124* or *Staithe Drive*), along with the proposed trustee capacity provision in section YA 5 of the Income Tax Act 2007 (or section YB 22 if our submission stated in paragraph 6, above, in respect of the numbering of the proposed provision is accepted).
- 10. The Law Society is concerned with the piecemeal manner in which section 2A of the Goods and Services Tax Act 1985 is to be amended. The Law Society notes that the current provision suffers from a number of defects, including:
 - a. Overreach in the manner in which the tripartite test of association applies. This means, for example, that two companies will be associated under section 2A(1)(i) of the Goods and Services Tax Act 1985 if a person holds at least 25% of the voting interests in each of those companies, notwithstanding that those companies would not be associated under the company / company test of association in section 2A(1)(a)(i) unless that person held at least 50% of the voting shares in each of those companies.
 - b. Difficulties in applying the corporate tests of association in sections 2A(1)(a) and 2A(1)(b) of the Goods and Services Tax Act 1985 to limited partnerships, which are treated as companies for GST purposes.

The Law Society considers that section 2A of the Goods and Services Tax Act 1985 should be rewritten to be consistent with the non-land based tests of association in subpart YB of the Income Tax Act 2007. This would more appropriately deal with instances of underreach and overreach than the proposed piecemeal amendment.

Conclusion

11. These comments were prepared with assistance from the Law Society's Tax Law Committee. If you wish to discuss these comments 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).

Yours sincerely

A handwritten signature in black ink, appearing to be 'K. Beck', written in a cursive style.

Kathryn Beck
President