

26 March 2021

Public Consultation
Inland Revenue
Wellington

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

Re: IRRUIP15 – Income tax – trusts and the Australian-New Zealand Double Tax Agreement (PUB00339)

1. Introduction

1.1 The New Zealand Law Society | Te Kāhui Ture o Aotearoa (**Law Society**) welcomes the opportunity to comment on Issues Paper: *IRRUIP15 – Income tax – trusts and the Australian-New Zealand Double Tax Agreement (issues paper)*. The Law Society appreciates Inland Revenue’s willingness to consult with interested parties on these complex issues. The Law Society’s Tax Law Committee has reviewed the issues paper and comments are provided below.

2. References to complying trusts, foreign trusts and non-complying trusts

2.1 The issues paper takes the position that the trustee of a complying trust is “liable to tax as a resident”, and therefore entitled to treaty relief, but a trustee of a foreign trust or a non-complying trust is not. In this respect, the analysis in the issues paper is based on a fundamental misconception about how income derived by trustees is taxed in New Zealand.

2.2 Contrary to the position taken in the issues paper, whether a trustee is subject to comprehensive taxation in New Zealand (i.e. taxed in New Zealand on the trustee’s worldwide income) turns on whether a settlor of the trust is tax resident in New Zealand at any time during the income year, whether (if the trust is a foreign trust with a New Zealand tax resident trustee) the trustee has complied with its disclosure obligations under the Tax Administration Act 1994, and whether an election has been made to pay New Zealand income tax on the trustee’s worldwide income (including any non-resident withholding income). It does not follow (contrary to paragraph [68] of the issues paper) that a non-complying trust will necessarily be liable to tax in New Zealand on the trustee’s worldwide income – that turns on the tax residence of the settlors of the trust during the income year in question.

2.3 Whether a trust is a complying trust, foreign trust, non-complying trust, or both a foreign trust and a complying trust (termed a “dual status trust”) is relevant in determining how distributions to beneficiaries are taxed, and also what disclosure obligations the trustees are subject to in the Tax Administration Act 1994. A trust’s status as a complying trust, foreign trust, non-complying trust or a dual status trust does not necessarily determine whether the trustee is subject to comprehensive taxation in New Zealand and, therefore, “liable to tax as a resident” for the purpose of the Australia / New Zealand Double Tax Agreement (**DTA**).

2.4 Because the analysis in the issues paper is based on this fundamental misconception, the conclusions reached in the issues paper on when trustees are entitled to treaty relief are not correct. The Law Society recommends that Inland Revenue reconsiders its approach to this fundamental issue when the interpretation statement is drafted, to ensure that any conclusions on this issue (which underpin the remaining conclusions) are accurate.

3. Position of unit trusts

3.1 The issues paper makes a number of comments in relation to unit trusts (which are treated as companies for New Zealand income tax purposes, but as ordinary trusts in Australia and in other jurisdictions). The Law Society recommends that the interpretation statement includes a specific section which addresses the tax issues arising in relation to unit trusts.

4. Withholding tax on passive income derived by trusts

4.1 The Law Society recommends that Inland Revenue provides specific guidance in relation to the application of withholding tax on passive income derived by trusts. For example, guidance would be appreciated on the withholding tax obligations where a New Zealand borrower pays interest to an Australian trust (which may or may not pass the interest onto a beneficiary). It would also be helpful if Inland Revenue could address the withholding tax consequences where the Australian trust distributes that interest income to a beneficiary who is not resident in Australia (this will require consideration of which tax treaty is relevant and when treaty relief might be available). This particular issue has become more important since the entry into force of the multilateral instrument (MLI) (as a result of which, jurisdictions have made choices about whether to include a fiscal transparency article in their treaties).

5. Imposition of economic double taxation

5.1 There are a number of situations, some of which have been identified in the issues paper, where the imposition of economic double taxation appears to be considered as an acceptable outcome. The Law Society considers that policy settings should be reviewed where double taxation arises, to minimise the instances of economic double taxation.

6. Comments on initial conclusions

6.1 The Law Society agrees that the trustee is the taxable entity under the Australia / New Zealand DTA, and the residence of the trustee, not the settlor, determines the eligibility to benefit under the DTA. We also agree that the domestic approach of treating a trustee as acting in a separate capacity to the trustee's personal capacity should also apply in determining the eligibility of the trustee to benefit under the Australia / New Zealand DTA.

6.2 We also agree that where a trustee (acting in its separate capacity as a trustee) is resident in both New Zealand and Australia (which is not uncommon), the non-individual tax residence tie-breaker article in article 4(3) of the Australia / New Zealand DTA (as replaced by article 4(1) of the MLI) should apply to determine where the trustee is resident for the purpose of the DTA. We consider that this is the case even if there is only one trustee of the trust who is a natural person.

6.3 Finally, we note that the Administrative Approach to Article 4(1) of the MLI (dated May 2019) does not apply where a trust is resident in both Australia and New Zealand. The Law Society recommends that a separate agreement is reached between Inland Revenue and the Australian Tax Office in relation to dual resident trusts, so that trustees do not have to bear

the cost of applying to either competent authority for confirmation of their residence status in order to be eligible to benefit under the DTA.

Next steps

If you have any questions or would like to discuss these comments, please do not hesitate to contact the Tax Law Committee convenor Neil Russ, through the Law Society's Law Reform and Advocacy Advisor, Emily Sutton (Emily.Sutton@lawsociety.org.nz).

Yours faithfully

A handwritten signature in cursive script that reads "Arti Chand".

Arti Chand
Vice President