



WEEKLY COMMENT: FRIDAY 11 JANUARY 2013

1. The currently available draft interpretation statement *INS0117: Income tax-residence* (“the draft IS”) was released for consultation by Inland Revenue on 7 December 2012. Submissions close on 31 January 2013. The IS is to be an update of *PIB No 180* (June 1989) on the residence rules. It also replaces the TIB items on Permanent place of abode (*TIB Vol 7 No 1*, July 1995), Residence of a person on leave of absence for 2 years (*TIB Vol 11 No 10*, November 1999) and Residence of a person seeking a returning resident’s visa (*TIB Vol 11 No 11*, December 1999).
2. The draft IS deals with:
 - (a) The residence of natural persons;
 - (b) The residence rules for companies (including the relationship of the company residence rules to the CFC regime); and
 - (c) The residence and tax regime for trusts.
3. This week I look at the differences between the draft IS and *PIB No 180*, and the tax residence of natural persons. Next week I will consider the implications for companies and trusts.

Preliminary comments

4. The draft IS is essential reading for anyone advising on, or involved with, departing NZ residents or visiting foreign residents. It is quite detailed (it is 75 pages long) and contains a number of examples. Two key contentions are that:
 - (a) The underlying objective of the residence rules is to make it easier for individuals to become resident and more difficult for them to become a non-resident (paragraph 16 on page 6); and
 - (b) There are no “bright line” tests and different results in different examples are not to be construed as indicating that there are.
5. The old “rule of thumb” – if there actually was one – that an individual’s absence from New Zealand for at least 3 years signaled non-residence, is out of the window (refer to Example 1 on page 12 of the draft IS illustrating the permanent place of abode test and to paragraph 16 below).
6. There are 4 examples illustrating the DTA tiebreaker tests. Particularly problematic are Examples 17 & 18 on pages 33 – 34. Example 18 is new. Example 17 arrives at a different conclusion from the corresponding example in *PIB No 180*. Refer to paragraph 22 below. However, it must be remembered that the transitional resident rules did not exist at the time *PIB No 180* was written (refer to paragraphs 23 onwards below).

Key differences between the draft IS and PIB No 180

7. There are some important differences between the draft IS and *PIB No 180* which are summarised at the beginning of the IAS:
 - (a) To have a permanent place of abode in New Zealand a person must have a particular place of abode that is an “available dwelling”. (An available dwelling was not considered to be essential in *PIB No 180*.)
 - (b) The permanent home does not have to be immediately available for occupation. (*PIB No 180*, in effect, required the home to be immediately available, by stating that a home rented to non-related persons will not be a permanent home).
 - (c) Following *FFF v Commissioner of Inland Revenue* [2011] NZTRA 8 (30 September 2011), *Case 12/2011* (2011) 25 NZTC 1-012 it is contended in the draft IS that the application of the double tax agreement ‘habitual abode’ tiebreaker test may require consideration of periods outside the period of dual residence. (It was stated in *PIB No 180* that the test is not focused on only the income year concerned, but there is no reference to whether the extended period includes periods of no dual residence.)
 - (d) There is no preference given to either personal or economic relations as being more important when undertaking the centre of vital interests test. (It was stated in *PIB No 180* that personal relations are to be given greater weight than economic relations.)
 - (e) Some implications for student loans and working for families is also discussed. Tax residence may be relevant in determining if a student loan borrower is New Zealand-based, which determines if their loan is interest-free, and also determines their repayment obligations. (These are not discussed in *PIB No 180*.)
 - (f) When interpreting double tax agreements, where a double tax agreement uses the same or very similar wording to the *OECD Model Tax Convention On Income and Capital* (1977) and the terms are undefined in the agreement itself, it can be inferred that the *OECD Commentary* in that regard reflects the meaning the parties intend the relevant terms to be given. It is not necessary to resort to a domestic tax law interpretation, which may or may not exist. (*PIB No 180* suggested that the meaning in the *OECD Commentary* only applied to undefined terms if there was no domestic tax law interpretation.)
 - (g) There have been a number of changes to the examples included in *PIB No 180*.

Individuals: the permanent place of abode test

8. According to the draft IS the permanent place of abode test requires the availability for use of a dwelling in New Zealand. It does not need to be one that is owned or rented by the person – it could be the home of a parent, a friend or relative. The place of abode does not have to be “available” in the sense of being vacant or able to be occupied immediately. This follows *Case Q55* (1993) 15 NZTC 5,313.
9. The enduring availability of a dwelling is the important factor and the facts of any given situation need to be considered to see if a person could occupy a dwelling with sufficient immediacy or ease for it to be considered “available” to them as a place of abode, given their particular circumstances.
10. The nature and quality of the use made by the person of the particular place of abode is important in assessing whether a place of abode is a person's permanent place of abode. Material considerations are the continuity of the taxpayer's presence, the duration of their

presence, and their durability of their association with New Zealand. A permanent place of abode is not necessarily the place in which a person intends to live for the remainder of their life. The test is different from the tests for establishing domicile of choice.

11. The test is an objective test, but a person's intention can be a relevant factor. For example where a person is absent from New Zealand for an extended period but intends ultimately to return, that intention alone will not be sufficient to establish that the person has a permanent place of abode here.
12. Consideration is not limited to factors occurring within the relevant income year.
13. Importantly the draft IS states that there is no specific length of presence in or absence from New Zealand that will result in a person acquiring or losing a permanent place of abode here. If a person has strong connections with New Zealand it could be expected that a longer period of absence would be required.
14. Overall, material factors to be considered are:
 - (a) The nature and use of the person's available dwelling – whether it is owned or, for example, whether it is a parent's home;
 - (b) The intention of the person with respect to their presence in New Zealand;
 - (c) Family and social ties – whether the person has a spouse/partner and children in New Zealand, and other social ties such as membership of sporting and cultural associations;
 - (d) Whether all or part of a person's employment, business, trade, or profession is carried on in New Zealand and overall economic connections such as a bank account or credit card facilities, insurance coverage and superannuation, and investments managed from New Zealand. Membership of trade and professional associations should also be taken into account.
 - (e) Whether the person has personal property situated in New Zealand.
 - (f) Other miscellaneous factors such as the receipt of social welfare benefits or holidays regularly spent in New Zealand.
15. There is a brief discussion about how person would acquire or lose a permanent place of abode and the factors listed to consider the time of occurrence of such events are:
 - (a) Commencement or termination of employment;
 - (b) Changes in the location of the person's family;
 - (c) Purchase or sale of real or personal property;
 - (d) Commencement or termination of the lease;
 - (e) Transferral of financial affairs;
 - (f) Appointment to or resignation from trade, professional, sporting or cultural associations;
and
 - (g) Departure from, or arrival in, New Zealand for an extended period.

16. There are a series of examples illustrating the concept of personal place permanent place of abode:

- *Example 1:* A secondment to Canada for a fixed period of 3 years with the rest of the family while retaining New Zealand investments, connections and a home rented out here will not result in a person losing a permanent place of abode in New Zealand. (This example corresponds to *Example 3* in *PIB No 180* and **arrives at a different conclusion.**)
- *Example 2:* Leaving New Zealand on a working holiday of indefinite duration with no dwelling readily available here will result in a loss of a permanent place of abode. (This example corresponds to *Example 2* in *PIB No 180* and arrives at the same conclusion.)
- *Example 3:* Regular trips to New Zealand, significant investments in New Zealand and cultural and sporting associations here could mean that a person has a permanent place of abode in New Zealand. (This example corresponds to *Example 4* in *PIB No 180* and arrives at the same conclusion.)
- *Example 4:* A two-year contract overseas while intending to ultimately return to New Zealand, with other social and economic ties to New Zealand will not result in a person losing a permanent place of abode in New Zealand. (This example does not correspond to an example in *PIB No 180*.)
- *Example 5:* A secondment overseas for 18 months while the wife and children stay in New Zealand will not result in a loss of a permanent place of abode in New Zealand. (This example does not correspond to an example in *PIB No 180*.)
- *Example 6:* A job overseas for fixed periods during the year with holidays in New Zealand will not result in the loss of a permanent place of abode. (This example does not correspond to an example in *PIB No 180*.)
- *Example 7:* Leaving New Zealand with no plans to return permanently and the intention to work and live overseas indefinitely will result in a loss of a permanent place of abode in New Zealand. (This example does not correspond to an example in *PIB No 180*.)

Individuals: the count tests

17. The count tests: the 183-day rule and the 325-day rule are then discussed together with a series of examples (*Examples 8 to 13* on pages 16 to 22 of the draft IS) illustrating the rules. The examples are essential reading for anyone who wants to understand how the count tests work.

18. It is noted at paragraph 94 that where there is an overlap between a period taken into account for the purposes of the 183-day rule and a period taken into account for the purposes of the 325-day rule, the later period operates to confer residence or non-residence, respectively, from the first day of that period. *Example 13* on pages 21 to 22 of the draft IS illustrates the overlap rule.

Implications of changes in residence

19. There is a discussion of the implications of changes in residence in relation to:

- (a) The taxation of foreign source income;
- (b) Foreign dividend payments (applicable up until 31 March 2013);

- (c) The financial arrangements rules;
- (d) Provisional tax; and
- (e) The trust regime (the residence of settlors).

20. The discussion on the implications for the trust regime is focused on the election that settlors who become tax resident in New Zealand may make, under s. HC 30 and s. HC 33, in order to satisfy the income tax liability of the trustee. The trust is then treated as a complying trust in relation to distributions made on or after the date of the election.

The tiebreaker tests in double tax agreements

21. There is quite a lengthy discussion of the tiebreaker test in double tax agreements, including 4 examples. The key points that emerge are:

- (a) The provisions of the double tax agreement have overriding effect: s. BH 1(4) stipulates that DTAs override the Inland Revenue Acts in relation to income tax, any other tax imposed by the Act, or exchanges of information relating to a tax. As noted by the Court of Appeal in *CIR v ER Squibb & Sons (NZ) Ltd* (1992) 14 NZTC 9,146 at 9.154, this means that “wherever and to the extent that there is any difference between the domestic legislation and the double tax agreement provision, the agreement has overriding effect”.
- (b) Someone who is resident in 2 countries under the domestic tax laws of those countries remains resident in both countries for other tax purposes – for example GST.
- (c) The Commissioner considers that the context of New Zealand's DTA's (provided that they follow, or closely follow the wording in the OECD *Model Convention*) does not require recourse to be had to the domestic law meaning (if any) of terms are not defined in the agreements. The Commissioner considers that it can be inferred that the meaning in the OECD *Commentary* on that article reflects the meaning the parties intended to be given to any undefined terms in the agreements.
- (d) The permanent home test requires a home available for use, and the “availability” is determined in the same way as for the permanent place of abode test. A number of cases are cited in support of this including the Canadian cases of *Salt v The Queen* 2007 TCC 118 and *Minin v The Queen* 2008 TCC 429.
- (e) The center of vital interests test requires equal weight to be given to personal and economic relations with the country.
- (f) In applying the habitual abode test the focus is on where the person normally lives during the period of dual residence, however a wider view may assist in cases where it is unclear where the person has a habitual abode.

22. There are 4 examples illustrating the DTA residence tie-breaker tests:

- *Example 15*: A university lecturer who travels to the UK for 15 months sabbatical leave at a UK university is deemed to be a resident of New Zealand under the double tax agreement with the UK. (This example corresponds to *Example 23* in *PIB No 180* and arrives at the same conclusion.)
- *Example 16*: A businessman who owns a house in New Zealand and in Malaysia has extensive business interests in both countries. He regularly spends time in New Zealand

that totals up to 5 months of the year, but works and lives in Malaysia the rest of the time. His family is with him in Malaysia. He is deemed to be a resident of Malaysia under the double tax agreement with Malaysia. (This example corresponds to *Example 24* in *PIB No 180* and arrives at a similar conclusion.)

- *Example 17*: A Canadian resident is seconded to New Zealand for a period of 18 months. She lets her Canadian house for a fixed term of 18 months and lives in rented accommodation in New Zealand. Her property and investments are in Canada. She is deemed to be resident in New Zealand under the double tax agreement with Canada on the grounds that she has a permanent home available in New Zealand but not in Canada. (This example corresponds to *Example 25* in *PIB No 180* and **arrives at a different conclusion.**)
- *Example 18*: A Canadian resident is initially seconded to New Zealand for 2 years and his stay is extended for another 18 months. He is deemed to be resident in New Zealand under the double tax agreement with Canada. (This example does not correspond to an example in *PIB No 180*.)

Transitional residents

23. A person who becomes resident in New Zealand and who meets the requirements for transitional residence will be a transitional resident for 4 years after they become tax resident in New Zealand (or until they stop being a tax resident of New Zealand, if earlier).
24. The transitional resident rules provide a temporary tax exemption, under s. CW 27, for all foreign sourced income, except for:
 - (a) Employment income in connection with employment or service performed while the person is a transitional resident; and
 - (b) Income from the supply of services.
25. The requirements to be a transitional resident, under s. HR 8(2), are:
 - (a) The person becomes a New Zealand resident under the permanent place of abode or count tests; and
 - (b) For a continuous period of at least 10 years immediately before acquiring a permanent place of abode or meeting the count test for New Zealand residence, the person did not meet those requirements and was not resident in New Zealand; and
 - (c) The person has not previously been a transitional resident; and
 - (d) The person has not ceased to be a transitional resident.
26. Information and examples on the transitional resident rules are contained in "Temporary exemption from tax on foreign income for new migrants and certain returning New Zealanders" *Tax Information Bulletin* Vol 18 No 5 (June 2006) at 103 and "Temporary exemption for transitional residents" *Tax Information Bulletin* Vol 19, No 3 (April 2007) at 83.



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