



## WEEKLY COMMENT: FRIDAY 2 MAY 2014

1. Interpretation Statement IS 14/01 *Tax residence* issued on 6 March 2014 (*Tax Information Bulletin* Vol. 26, No. 3, April 2014) applies from 1 April 2014. I reviewed the draft version as it applied to individuals in *Weekly Comment* 11 January 2013, and as it applied to companies in *Weekly Comment* 18 January 2013. There have been some changes between the draft and the final version.
2. At the same time as IS 14/01 was issued, Inland Revenue issued *Interpretation Statement 14/01 – Tax residence – Transitional operational position* ("the transitional position") in *Tax Information Bulletin* Vol. 26, No. 3, April 2014), including a number of Frequently Asked Questions. IS 14/01 replaces Inland Revenue's previously published statement "Income Tax Amendment Act (No 5) Rules 1989: New Residence Rules" (*Public Information Bulletin* No 180, June 1989). The transitional position sets out how Inland Revenue will apply interpretations based on the previous statement in future, and on the implications of having followed the approach in IS 14/01 in the past (contrary to the previous statement).
3. This week I look at the residence rules as they apply to natural persons. I continue this next week, when I will look at the transitional position and company tax residence in IS 14/01.
4. The discussion this week is organised under the following headings:
  - (a) Relevance of residence;
  - (b) Residence of natural persons;
  - (c) Permanent place of abode;
  - (d) Examples on permanent place of abode;
  - (e) The count tests;
  - (f) The government service rule;
  - (g) The tiebreaker tests in double tax agreements;
  - (h) Changes to the tiebreaker test examples from the draft version; and
  - (i) The transitional resident rules.

### **Relevance of residence**

5. IS 14/01 contains a new introductory section on "Relevance of residence". Apart from determining a person's liability to tax in New Zealand, reference is made to the importance of residence in applying the new foreign superannuation tax rules (discussed in the first 4 *Weekly Comment* issues this year: 3 to 24 January), and the proposed relief from the

individual tax residence backdating rule for GST purposes in the Employee Allowances Tax Bill discussed in *Weekly Comment* 14 February 2014.

### **Residence of natural persons**

6. IS 14/01 contains a new flowchart which “sets out the matters to be considered in establishing if an individual is tax resident in New Zealand, and shows the interrelationship between the various residence tests for individuals”.
7. The starting point in the flowchart is the 183-day rule: if a person has not been in New Zealand for 183 days, then whether the individual has a “dwelling in NZ that he/she could live in on an enduring rather than temporary basis” and whether that dwelling is a permanent place of abode becomes important.
8. The importance of a relevant double tax agreement is recognised at the outset: if a person is tax resident in New Zealand and also in a country with which New Zealand has a double tax agreement, the double tax agreement will determine what taxing rights each country has.

### **Permanent place of abode**

9. The comment in the draft version that “the primacy of the permanent place of abode test reflects the underlying objective of the residence rules, namely to make it easier for individuals to become resident and more difficult for them to become non-resident” has been removed. Instead, there is a statement in paragraph 54 that “the goal of making it easier for people to become tax resident in New Zealand and harder to lose that status was achieved by broadening the permanent place of abode test (to include the words “whether or not they have a permanent place of abode outside New Zealand”), and also by bolstering the personal presence test”.
10. There is a discernible change in emphasis towards the permanent place of abode test making it more difficult for New Zealanders to become non-residents (as opposed to non-residents of NZ becoming NZ tax residents). It is stated in the *Overview* in paragraph 20 that:

“The permanent place of abode test is most relevant to people leaving New Zealand. People moving to New Zealand will typically be resident under the 183-day rule and will not need to consider the permanent place of abode test. However in situations where someone moves between New Zealand and another country or countries, New Zealand residence could be triggered under either test. Also, someone moving to New Zealand could potentially establish a permanent place of abode prior to the first day of their presence under the 183-day rule.”
11. The Commissioner’s view of what constitutes a permanent place of abode is unchanged from the draft version: it is “a place where the person dwells and sleeps and that is used as a base for their daily activities” (paragraph 35). However, it is now clearly stated, in paragraph 57 that having a dwelling in New Zealand is a **pre-requisite** to having a permanent place of abode here.
12. The Commissioner’s view is that the goal of making it more difficult to lose NZ tax residence is not undermined by requiring a dwelling in New Zealand. This is because it will be possible to retain a permanent place of abode in NZ whether or not the person has another permanent place of abode outside NZ.

13. The Commissioner prefers the “narrower interpretation” – i.e. a specific dwelling which is a “current focal point of one’s living” (a phrase used by Judge Barber in *Case Q55* (1993) 15 NZTC 5,313). However, this is qualified in paragraph 67 by recognising that:

“The permanent place of abode test operates to ensure that even if someone is away from New Zealand for 325 days or more in a 12-month period, they will remain a New Zealand resident so long as they have a permanent place of abode here. Obviously when someone is away from New Zealand for 325 days or more, any place of abode they may have in New Zealand will not be a current focus of their day-to-day life (ie, what they do on a daily basis). It would therefore seem that Judge Barber meant that the place would need to remain a focal point of the person’s life in a broader sense.”

14. It is made clear that although a person must have a dwelling in New Zealand to have a permanent place of abode here, the existence of a dwelling is not determinative, and a dwelling will not, of itself, give rise to tax residence in New Zealand. It must be established that the dwelling is their permanent place of abode.

15. Since the draft was issued, case *TRA 43/11* [2013] NZTRA 10 was heard in December 2013. A taxpayer working overseas following retirement from the Army and continuing to pay child support to his ex-wife and children in NZ was held to have a permanent place of abode in NZ because he had a dwelling here in the form of an investment property rented out on a periodic tenancy. The case is on appeal to the High Court. The Commissioner states at paragraphs 74 and 78 that:

“While an investment property may be a dwelling that a person could use as a place of abode, and could potentially be a permanent place of abode, the Commissioner considers that this would not commonly be the case. ...

A person’s connections to the location in New Zealand where their place of abode is situated are relevant in objectively assessing whether the particular dwelling is the person’s permanent place of abode. The strength of such connections may indicate that the area is a focal point of a person’s life and therefore lead to an inference that the abode is the person’s permanent place of abode. In *TRA 43/11*, Judge Sinclair considered it important that the property was situated in a locality in which the taxpayer had continuing family and other ties.”

16. The “material factors for determining permanent place of abode” are essentially the same as in the draft version:

- (a) Continuity and duration of presence in New Zealand;
- (b) Durability of association;
- (c) Nature and use of the dwelling and the person’s connection with the dwelling;
- (d) Intention;
- (e) Family and social ties;
- (f) Employment, business interests and economic ties; and
- (g) Other factors.

17. In the discussion on continuity and duration of presence, specific reference is now made to:

- (a) The shareholder remuneration case of *Troon Place Investments Ltd v CIR* (1995) 17 NZTC 12,175 (HC), in which the court found that the shareholders of the taxpayers, who were

on an overseas trip for three years and one month, were resident in New Zealand under the permanent place of abode test for the duration of their absence. The shareholders had business interests in New Zealand (the businesses operated by the taxpayer companies), and were involved in the administration and management of the companies during their absence from New Zealand.

- (b) Case *TRA 43/11*, in which Judge Sinclair considered, despite the taxpayer living away from New Zealand for up to four years in the tax years in question, that he continued to have a permanent place of abode here in those years. However, Judge Sinclair noted that the taxpayer was not continuously absent during the four-year period. Rather, he made regular trips back to New Zealand, spending on average 42 days a year here.

### **Examples on permanent place of abode**

18. There is an extension to Example 1 involving Cate, who is seconded to Canada for 3 years. The answer that she retains a permanent place of abode in NZ is unchanged, despite the fact that the home she lived in in NZ is owned by a family trust in which Cate's wider family (siblings and their families) are beneficiaries and is rented out while Cate and family are in Canada. However, the conclusion in the example is qualified as follows:
- "If Cate had not intended to return to New Zealand after the period of secondment, but rather to take up other work opportunities in Canada, and the terms of her secondment were such that her employer in New Zealand would make its best endeavours to have a position available for her to return to should she wish, but could not guarantee this, and if Cate and her family had taken most of their furniture and other belongings with them, then Cate would not have a permanent place of abode in New Zealand."
19. There is also an extension to Example 2 involving Mike, who lived with his parents, then lived in a rented flat for 2 years, then left New Zealand indefinitely, but returned after 18 months:
- "If Mike had never lived independently from his parents prior to going overseas, his parents' house would be his permanent place of abode during his absence from New Zealand. ... Mike has left his personal effects at his parents' house, has family ties here, intends to return to New Zealand after his OE, and in fact returned to New Zealand to live after 18 months. ... In those circumstances Mike's parents' house would be the likely place to which he would return and live after his OE, and would remain his permanent place of abode during his absence."
20. There is a new Example 5, involving Melanie and family who sell their home and move to London so that Melanie can take up a job there. Melanie leaves in October, but her husband and children stay in NZ until the end of the school year. They retain a one-bedroom rental property in NZ. The circumstances very clearly indicate that Melanie ceased to have a permanent place of abode in NZ from the time she left in October.
21. Examples 5 to 7 in the draft version have been retained and renumbered 6 to 8. The facts and the conclusions have not changed, although the explanations have been slightly expanded (refer to paragraph 16 of *Weekly Comment* 11 January 2013).

### **The count tests**

22. There have been no changes to the discussion on the count tests from the draft version. There are several examples illustrating how the tests work, which really need to be carefully read to understand how the count tests work.

### **The government service rule**

23. There is an expanded discussion about the special government service rule in s. YD 1(7). This rule provides that any person who is absent from New Zealand in the service, in any capacity, of the government of New Zealand is treated as a New Zealand resident during the period of absence. There are 2 examples of circumstances relating to government employees:
- (a) A NZ government employee who is posted overseas for 4 years but continues to be a NZ tax resident; and
  - (b) A NZ expatriate who commences working for the NZ government overseas who will not become a NZ tax resident merely because of that.

### **The tiebreaker tests in double tax agreements**

24. There is a clear statement that a home that is let out on an arm's length basis to an unassociated person will not be a permanent home of the landlord in terms of the residence tiebreaker article in tax treaties. It is stated in paragraph 268 that:

"... the Commissioner considers a house that is let under the Residential Tenancies Act 1986 (including one let on a periodic tenancy) will generally be unavailable to the landlord as a permanent home. If the house is let to an associated person or friend it might still be available to the owner as a permanent home."

25. There is a slightly expanded (from the draft version) discussion on the personal and economic relations (centre of vital interests) test. The Commissioner acknowledges that: "In many circumstances personal relations will be more significant than economic relations because the location of a person's family is often highly significant. However, the issue needs to be determined on the specific facts relating to the person." However, the Commissioner's preferred view is unchanged from the draft version:

"... the Commissioner considers that the better view is that the "centre of vital interests" concept is a composite one, and does not give preference to either personal or economic relations. The OECD commentary states that "considerations based on the personal acts of the individual must receive special attention". The Commissioner considers that "personal acts" encompasses acts concerning both economic relations (such as seeking employment in a country) and personal relations (such as activities related to a person's family)."

### **Changes to the tiebreaker test examples from the draft version**

26. The changes to the examples merely reflect the Commissioner's view that a home rented to an unassociated person will not be a "permanent home" for the purposes of the tiebreaker test.
27. Example 19 (previously example 15 in the draft version): the conclusion is different because the NZ home of the university lecturer on sabbatical is let under "a periodic tenancy under the Residential Tenancies Act 1986, so is terminable with a 42-day notice period if Stacey

requires it as her principal place of residence". Therefore, Stacey does not have a permanent home in NZ and is tax resident only in the UK for the purposes of the double tax agreement.

28. Example 21 (previously example 17 in the draft version): the conclusion is unchanged, but it is clarified that the Canada, Megan, has let her house in Canada to a tenant who "is not associated with or a friend of Megan's". Therefore, Megan does not retain a permanent home in Canada and is tax resident only in NZ for the purpose of the double tax agreement.

### **Transitional resident rules**

29. There is a significantly expanded discussion regarding transitional residents. The point that is emphasised is regarding the starting date for transitional residence, and in particular, the back-dating of the starting date under the count test. It is stated in paragraph 226 that:

"A person meeting the requirements for transitional residence will be a transitional resident (unless they elect not to be) *from the first day that they are tax resident in New Zealand* (under either the permanent place of abode test or the 183-day rule). If the person becomes a New Zealand tax resident under the 183-day rule, their *tax residence will be back-dated under s YD 1(4) to the first of the 183 days of presence in New Zealand*, and their transitional residence will start from that date." (emphasis added)

30. It should be noted, however, that, regardless of the starting date, under the rule in s. HR 8(3)(b), transitional residence status will not end until 4 years after the month in which the person acquired a permanent place of abode here or satisfied the 183-day rule, *ignoring back-dating*.

31. It is pointed out that the items "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) are not accurate in two respects:

(a) Firstly, *Tax Information Bulletin* Vol. 18, No 5 (June 2006) states that the period of transitional residence starts on the *first day of the month in which the person migrates* to New Zealand. However, the starting point for transitional residence is aligned with the start of a person's tax residence in New Zealand, including when the period of tax residence is back-dated under s. YD 1(4).

(b) Secondly, *Tax Information Bulletin* Vol. 19, No 3 (April 2007) states that transitional residence lasts for 48 months after *migration*. However, it lasts till the end of the 48<sup>th</sup> month after the month in which the person acquired a permanent place of abode in New Zealand (which will not necessarily be at the time of migration here) or satisfied the 183-day rule.



Arun David, Director

DavidCo Limited