



## WEEKLY COMMENT: FRIDAY 9 MAY 2014

1. Last week I looked at the residence rules applying to natural persons in Interpretation Statement IS 14/01 *Tax residence* issued on 6 March 2014 (*Tax Information Bulletin* Vol. 26, No. 3, April 2014). IS 14/01 applies from 1 April 2014, and differs from and 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).
2. Consequently, 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. This week I look at the transitional position, which sets out how Inland Revenue will apply interpretations based on the previous statement in future, and on the implications of having followed the new approach in IS 14/01 in the past.
3. This week I also look at the tax residence of companies to complete my review of IS 14/01. As I noted last week, I reviewed the draft version of the Interpretation Statement in *Weekly Comment* 11 January 2013 (individuals), and *Weekly Comment* 18 January 2013 (companies). The review points this week focus on the differences between the draft and the final version.
4. The discussion this week is organised under the following headings:
  - (a) Transitional operational position;
  - (b) Residence of companies: comparison of the tests;
  - (c) Examples illustrating company residence;
  - (d) Changes in company residence;
  - (e) Residence and trusts.

### **Transitional operational position**

5. As noted, IS 14/01 applies from 1 April 2014. Taxpayers who have applied the analysis in earlier *Public Information Bulletin* in years before the 2014-15 income year will not be required to change their tax position adopted in past years. IS 14/01 must be applied from the 2014-15 income year onwards.
6. However, Inland Revenue will accept the analysis contained in IS 14/01 as applying to earlier years. Taxpayers may request an amendment to an earlier assessment to apply the new interpretation. The Commissioner will apply SPS 07/03 *Requests to Amend Assessments* published in *Tax Information Bulletin* Vol. 19, No. 5 (June 2007) on a case-by-case basis. (Note that exposure draft ED0162 of a replacement Standard Practice Statement (SPS)

*Requests to amend assessments* was issued earlier this year and discussed in *Weekly Comment* 25 April 2014.)

7. The converse will not apply: i.e. taxpayers who have previously applied the analysis in IS 14/01 cannot request an amendment to an earlier assessment to comply with the earlier *Public Information Bulletin*.
8. There are two important transitional issues:
  - (a) The previous “3-years away from NZ” rule of thumb no longer applies. Persons who considered themselves to have become non-residents under the previous “3-years away from NZ” rule of thumb will need to reconsider their position. Tax treatment as a non-resident in past years will not need to be amended, but tax residence from 1 April 2014 onwards will need to be determined applying the analysis in IS 14/01. This is particularly so if there is a dwelling in NZ that the person could live in and the person has strong connections with New Zealand.
  - (b) The previous ability to perhaps retain a permanent place of abode in NZ without a dwelling in NZ no longer applies. Persons who considered themselves to be tax residents of NZ despite having become non-residents under the count tests will need to consider whether they in fact have a permanent place of abode in the form of a dwelling in NZ they could live in on a enduring rather than a temporary basis. Such persons may be non-residents under the analysis in IS 14/01. In that case, it is open to them to request amended assessments for past years.
9. Taxpayers and tax advisors who have questions about the transitional operational position can email Inland Revenue at [TaxResidence@ird.govt.nz](mailto:TaxResidence@ird.govt.nz).

### **Residence of companies: comparison of the tests**

10. In relation to the **head office test**, there is now a reference to the definition of “office” in the Oxford English Dictionary as “a room, set of rooms, or building used as a place of business for nonmanual work; a room or department for clerical or administrative work”.
11. Therefore, the Commissioner considers that “office” in the context of the head office test means a physical place from where the business is conducted. The remainder of the discussion on the head office test is largely unchanged from the draft version. It is stated in paragraph 321 that:

“Usually there will not be uncertainty as to the location of a company’s head office. If a company is engaged in carrying on business activities, identifying the company’s highest office should not be difficult. An example where it could be more difficult is where a company is merely a passive investment vehicle. The passive nature of the company’s activities may make identifying its highest office difficult, or the company may simply have no office.”
12. The **centre of management test** has been updated for the decision in *Vinelight Nominees Limited and Weyand Investments Limited v CIR* [2013] NZCA 655. The Commissioner has stated, in paragraph 322, that in determining where the centre of management of a company as a whole is, acts of management at various levels may be relevant. In *Vinelight Nominees*, the Court held that where the centre of management was is a question of fact depending on the nature of the company’s business and activities. In the High Court, Peters J had found that

the company had its centre of management in New Zealand even if the test focussed on the acts of superior management:

“(A NZ director) alone decided to consult Ernst & Young about the structure and its implementation, in which he was closely involved; he demanded interest on the debt from Weyand, addressing the demand to his own residential address in Auckland; he decided that the interest rate ought to be reduced; and he and (his wife and co-director) attended to the preparation of financial statements in New Zealand.”

13. The comment in IS 14/01 that the centre of management will be in NZ even if the persons giving instructions from New Zealand are not officers of the company under the company's constitution is qualified as follows:

“That said, there may well be persons who influence the decisions made by the executives managing a company, or who provide guidance to them. This will not amount to *de facto* management of the company if those charged with the management are in fact exercising that management function independently, not merely doing the bidding of others who are in reality managing the company.”

14. Notably, all references to “day-to-day management” have been removed from the discussion on the centre of management test. Instead, the focus is on “acts of management at various levels” (as opposed to simply the top level) in the management of the company as a whole. In *Vinelight Nominees* Counsel for the taxpayer argued that the centre of management test concerns “only true acts of central or superior management”. In the High Court, (*Vinelight Nominees Limited v Commissioner of Inland Revenue* [2012] NZHC 3306) Peters J stated at [53] to [55]:

“[53] I am satisfied that Weyand had its centre of management in New Zealand during the relevant period. That is so whether the centre of management is where a company's administrative, day-to-day management is undertaken or whether it is where its superior management is undertaken ...

[54] For that reason, it is unnecessary for me to determine what acts should and should not be taken into account in determining the location of a company's centre of management.

[55] The enquiry as to where a company's centre of management is located is factual and is to be considered by reference to the nature of the company's business and activities. In *De Beers Consolidated Mines Ltd v Howe (Surveyor of Taxes)* [1906] AC 455 (HL) the House of Lords said that a company's place of residence is “a pure question of fact to be determined upon a scrutiny of the course of business and trading.”

15. While there is no change to the analysis of the **director control test**, the comparison between the centre of management and director control tests is less clear cut. It is recognised that acts of management at various levels may be relevant to the centre of management test whereas the director control test concentrates on the directorial control of the company. However, it is noted at paragraph 358 that:

“In some cases there may not be a clear distinction between aspects of the management of the company and the directorial decision making and control because, for example, the directors are involved in managing the company.”

### **Examples illustrating company residence**

16. The reference to “day-to-day management” in Example 23 in the draft has been replaced by “management” in Example 27 of the final version of IS 14/01.

17. In Example 28 in IS 14/01, which concerns the directors of a Cook Islands company acting on the instructions of a NZ resident group company, the phrase “acting on instructions received” is extended by adding “without discussing or considering those instructions”.

### **Changes in company residence**

18. As in the draft version, there is a useful analysis of the implications of a company gaining or losing NZ tax residence. It is noted that if a company is a settlor or beneficiary of a trust and its residence status changes there may be tax implications – see paragraph 20 onwards below.

19. It is explicitly recognised that a company may transfer its place of incorporation from NZ to overseas, and there is a short paragraph on the company migration rules. A company that ceases to be a New Zealand resident is an “emigrating company”, and under the company migration rules it is treated for tax purposes as if, immediately before emigrating, it had disposed of its property at market value, liquidated, and distributed the full amount available for distribution as dividends (s FL 1).

### **Residence and trusts**

20. There is now a Table setting out how trust income is taxed and a short introductory section on when amounts will be beneficiary income and when amounts will be trustee income.

21. There is a new reference to circumstances in which foreign-sourced income will not be exempt if derived a NZ “resident foreign trustee” of a foreign trust, as defined in s 3(1) of the *Tax Administration Act 1994*, who is not a “qualifying resident foreign trustee” and fails to disclose to the Commissioner certain information relating to the trust and maintain certain financial and other records in relation to the trust.

22. There is a new reference to the treatment of the trustee as a notional single person in s. HC 2. When a trust has co-trustees, the trustees are treated as a notional single person. Where one of the co-trustees is resident, then all of the co-trustees as the notional single person are resident in that capacity. If all of the co-trustees are non-resident, then the notional single person will be non-resident.

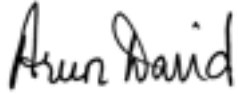
23. There is an additional section on changes in residence in relation to residence and trusts. If the tax residence of any settlor of a trust changes, there could be tax implications:

(a) If there are no New Zealand resident settlors of a trust and then a settlor becomes resident in New Zealand (and is not a transitional resident) foreign-sourced amounts derived by a trustee in the year that the settlor became resident will generally be assessable.

(b) If a settlor ceases to be New Zealand resident and there are no other New Zealand resident settlors of the trust, foreign-sourced amounts derived by a trustee in the following year will be exempt (provided that no settlor is resident in New Zealand at any point in that income year).

(c) If a settlor becomes resident in New Zealand, a settlor, trustee or beneficiary of the trust may be able to make an election (under s HC 33) to satisfy the trustee’s income tax liability in respect of the trustee income they have derived.

24. The implications of making an election under s. HC 33, and of failing to make an election, are also discussed.

A handwritten signature in black ink that reads "Arun David". The signature is written in a cursive, slightly slanted style.

Arun David, Director  
DavidCo Limited