

13 September 2019

Susan Price / Bruce Young  
Public Consultation  
Inland Revenue  
PO Box 2198  
Wellington

Dear Susan and Bruce

### **PUB00345: Income tax – distributions from foreign trusts**

Thank you for the opportunity to review the draft item and provide feedback.

We appreciate the work that Inland Revenue has done to clarify a complex area of tax law and are pleased to see that our comments regarding the layout of the interpretation statement have been adopted. The upfront discussion and use of examples, with inclusion of the detailed legal analysis by way of an appendix, will enhance readability of the statement for those who are not trust experts.

We understand that you are also considering a follow up statement that is more practical in focus. We believe this would be useful and include further comment in this regard below. Given the importance placed on the concept of “assent” it would also be useful for the Commissioner to issue a fact sheet that explained in practical terms what this comprises. For example, what factors separately or in combination may point to “assent” having occurred? The concept of “assent” is critical to determining the taxation status of a payment received from overseas and is a concept that may not be well understood by some taxpayers.

In summary, we recommend that the draft statement consider/explain in further detail:

- How and when the provisions of the Trusts Act will apply.
- That the transition from executorship to trust may simply be a bare trust (and therefore of no tax consequence).
- When a New Zealand beneficiary may in broad terms make use of foreign tax credits for tax paid by the trust.
- Changes in Inland Revenue processes resulting from Business Transformation.

Our detailed comments follow:

### **Relevance of the Trusts Act**

The draft statement does not consider the provisions of the Trusts Act 2019. Section 5 of the Trusts Act states that it applies only to express trusts that are governed by New Zealand law. (Although under section 5(2)(b)(iii), a court may apply the provisions of the Trusts Act to any trust that is recognised at common law or equity as being a trust).

Thus, it is not clear to what extent the Trusts Act will apply to trusts that are foreign trusts for income tax purposes.

Section 5(9) of the Trusts Act states that:

“If there is an inconsistency between the provisions of this Act and those of any other enactment, the provisions of that other enactment prevail, unless this Act provides otherwise.”

For example, the term “settlor” is defined in section 15 of the Trusts Act. It is not clear whether this definition is relevant for determining the residence of the settlor (and thus the existence or otherwise of a foreign trust) given that, if there is inconsistency, the definition in the Income Tax Act should be preferred. We believe the statement should explain if a taxpayer needs to consider the provisions of the Trusts Act in addition to those in the Income Tax Act.

### **Consequences of the existence of a bare trust**

The draft statement sets out in detail when and how an estate may become a trust (paragraphs 138 – 172). We believe that it would be useful to note at the outset of this detailed discussion that the resulting trust may be a bare trust, in which case it can be ignored for tax purposes. For example, if the trustees simply continue to hold the property for a period prior to distribution, the period of executorship would have ceased, but the trust rules would not apply.

This could be achieved by directing readers to the detailed discussion on bare trusts at paragraphs 173 onwards for clarification of the treatment if they believe the relationship may represent a bare trust.

The heading that precedes paragraphs 180-184 (“Delays in Distribution”) implies that time is a factor in determining whether the resulting trust is a bare trust or a discretionary trust. The discussion however suggests that the relevant factors to consider are the obligations of the trustee(s) and the rights of the beneficiaries, rather than the time taken. The heading should be amended.

In addition, it would be useful if the item or a practically focused follow up statement provided guidance for taxpayers in the situation where the resulting trust is a bare trust. For example, what tax is likely to be payable, when and by whom.

## **Consequences of there being no trust**

As above, it would be useful if the draft statement were to include some practical guidance for taxpayers where it is determined that there is no trust in existence. For example, the beneficiary will not be taxable on the distributions; but subject to tax on any income earned from the date of death for civil law countries, or from the date of assent for common law countries. Again, this may be appropriate for an operational statement or other follow-up statement.

## **Foreign tax credits**

It would be useful for the draft statement to explain, at least in broad terms, when tax credits would be available for foreign tax paid. This is alluded to in Example 2 on page 10, which notes that tax credits may be available to reduce Ursula's tax liability. The statement should explain when tax credits would be available – either in this example or as part of the analysis. The explanation should include the extent to which foreign tax paid by the trust could be available as a tax credit to the beneficiary and consider whether credits for tax paid on income in prior years would be available for distributions (incorporating that income) made in the current year.

## **Election to become a complying trust**

Example 5 (page 13) explains how a trust may become a non-complying trust. For completeness the example should also state that the trust could elect to become a complying trust under section HC 33.

In our view the ability to elect should also extend to prior years to allow the trust to get its tax position correct. We have included this point as part of our submission on the Taxation (Kiwisaver, Student Loans, and Remedial Matters) Bill.

## **Link to Business Transformation**

We believe that this statement should also consider changes in Inland Revenue processes resulting from Business Transformation. Inland Revenue is now able to automatically determine the tax payable for taxpayers with reportable income where satisfied that they have all relevant income information for that person.

What is Inland Revenue's position going to be in the future where there has been an automatic determination of tax position, and the taxpayer is later found to be in receipt of a distribution from overseas? Group A taxpayers subject to the automated process will be under the impression that Inland Revenue has calculated their tax liability correctly and may not be sufficiently tax literate to appreciate that there is an omission of trust income.

We would be happy to discuss our comments with you. Please contact Jolayne Trim.

Yours sincerely



**John Cuthbertson CA**  
NZ Tax & Financial Services Leader



**Jolayne Trim**  
Senior Tax Advocate