SPEAKMAN LAW

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Issue 23

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- Alistair Cook's 4th double century, now 9th on all time run getter list; James Anderson 6th amongst bowlers
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- John Graham's massive tribute; well done AGS for entire school Haka in salute
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Briefly – Law/Special Interest

- Commerce Act cartel changes now law. Much broader price fixing prohibitions
- Trusts: Estimated 300,000 to 500,000 in NZ. Trusts Bill now before Parliament
- New Contracts and Commercial Law Act becomes law from 1 September
- MH370: Precise location now thought to be identified.
- Donald Trump expresses view that North Korea threatened missile strike on Guam is good for tourism. Meanwhile at home, he says Klu Klux Klan not entirely at fault for white supremacists. Hmmm…
- Peter Dunne over and out, Andrew Little, needed more, Metiria Turei…well how would you fare if you stole from the public?
- Will Winston be grinning come September 23?

Some famous quotes:

- We are what we repeatedly do; excellence is not an act but a habit.
- You can do anything, but not everything.
- Live life, like someone left the gate open.
- Everyone is a genius at least once a year. The real geniuses simply have their bright ideas closer together

… and it makes me wonder.

Hope you enjoy these. I have divided this newsletter into two parts, a tax edition and separately a commercial edition. I encourage you to read whichever edition (or both) suits you best.

Best wishes

Multilateral Conventions…

A feature of the Base Erosion Profit Sharing (BEPS) proposals is the adoption of multilateral conventions. These are an international response to multinationals escaping their fair share of tax, reportedly an annual loss of tax revenue worldwide in excess of US$100 billion.

The OECD's response to this tax abuse is wide sweeping changes predominant amongst which is tightening of transfer pricing rules. Another is changes to double tax agreements (DTAs) across the globe. Practicalities in doing so are anything but straight forward given that there are more than 3000 DTAs worldwide.

The solution to these practicalities has been the development of the multilateral instrument (MLI) which will modify those DTAs to which it applies. Content of each MLI will differ country by country (some may be the same but it can be expected that not all will be) but nevertheless minimum standards apply to all of them.

A couple of these minimum standards are troubling. One is the process by which residence of a company is to be determined in the case of a company that domestically is resident in both contracting states (to the DTA), ie it has dual residence. Currently the tiebreaker test is determined having regard to the company's place of effective

management. That approach is to change. It is to be substituted with a requirement that the tax authorities of the two applicable countries agree the company's residence. Clearly there is potential for this to delay determination of the issue implausibly long (possibly for a year and a half or more). The second troubling element of the MLI minimum standards is the forced adoption of an anti-abuse rule. This is in the form of a principal purpose test which will not be met if obtaining a benefit under a DTA was a principal purpose of an arrangement. This is yet another anti-avoidance test (along with those in domestic legislation) to be analysed in any consideration of a cross border arrangement.

Adoption of the MLI remains ahead of us. However, readers should note, for now, that once they are in place it will be necessary to go beyond an applicable DTA in providing cross border tax advice and to consider also the applicable MLI.

Timing of Associated Persons Test…

Sections CB 9(2) and CB 10(2) bring within the tax net amounts derived from the disposal of land within 10 years of acquiring it where the land is tainted. The land is tainted where an associated person carried on a business of dealing or developing land at the time the land was acquired.

Central to application of these tests is at what time the associate commenced its business of dealing or developing land. Take, for example, a person who acquires land in 2010 and disposes of it in 2017. An associate acquired land in 2008 but did not commence development of the land until 2012. What then?

The tax results for the person disposing of the land hinge on whether, in 2010, the associate carried on business of dealing or developing land. At first blush it appears, on these facts that the associate did not. This needs to be tested, however. The associate may, for example, have claimed an input tax credit on acquiring the land in 2008. Or the associate may have registered for GST sometime later but before 2012 and made a change of use adjustment.

The GST position taken by the associate will be relevant but the essential question is when did the associate commence its dealing or development business? Various cases assist in establishing when that might have been. Some clear answers emerge from those cases. First, the date of acquisition of the land by the associate is irrelevant. Similarly, the GST position taken is not determinative. Rather, the time of commencement is marked by some overt action taken that establishes an intention to make a profit. In the case of a developer undertaking a subdivision this point has been determined to be the point of time a separate title may be issued, that point distinguishing preparation or formulation of a scheme and putting into effect.

The essential point is to be aware of the need to test for association and to consider appropriately its timing. If you have any doubts don't hesitate to give me a call.

Taxation of Trusts…

Those familiar with the taxation regime for NZ trusts will understand the categorisation of complying trusts and foreign trusts on the one hand (noting that a trust may be both) and a non-complying trust on the other. A trust that is a non-complying trust can be neither a foreign trust nor a complying trust.

The tax regime makes it undesirable to be a non-complying trust (notably all distributions other than of corpus or tax paid income are taxed at 45%, including capital gains). The tax regime also triggers non-complying trust status terribly easily.

Falling into the category of a non-complying trust is almost inevitable where the settlor enters or leaves NZ. In those circumstances there is likely to be foreign sourced income. That itself will be enough to deny complying trust status unless the income is passed onto the beneficiaries. This will deny complying trust status because of the requirement that the trust have neither:

a. non-residents foreign sourced income (ie the trust has non-resident trustees who derive income from offshore); or

b. foreign sourced income derived by NZ resident trustees (which as it happens is tax exempt).

What then should the trust do?

Fortunately there is an easy solution. That is to make an election under section HC 33 by which any person who is a trustee, settlor or beneficiary may choose to satisfy the income tax liability of the trust. Such an election serves as a panacea to all evils and will restore complying trust status. There are specific requirements to such an election (notably as to timing), so be careful.

A related question concerns the scope of taxable distributions by a non-complying trust. Do they, for example, extend to foreign sourced capital gains distributed to a NZ beneficiary? Potentially might their scope extend to non-resident beneficiaries? Practitioners views on this subject differ (though I am mindful of Blackadder's comment that differing views were his on the one hand and everyone else's on the other; perhaps it is the same here!!) and I do not believe there is a definitive answer to it.

The Law Society has made a submission to Inland Revenue on this point in the course of the Taxation of Trusts Interpretation Statement update. I have also made a submission to them and will report their view if and when it comes to hand.

Limited Partnerships as Hybrids…

Limited Partnerships have been used to create double deductions for the same amount of expenditure. Reportedly, arrangements using LPs in this way have triggered NZ tax deductions over $300 million. I describe how these arrangements work below. However, you should note that Inland Revenue has seized on these arrangements and has responded by reconstructing them as tax avoidance arrangements and proposing new measures to prevent them going forward.

The arrangements take advantage of corporate entity status granted to limited partnerships that are established in Australia (ALPs). The arrangements entail an ALP borrowing funds from a local bank, incurring an interest obligation in Australia for which the ALP obtains a tax deduction. The ALP, being treated as a corporate entity in Australia, is able to form a group with a trading company in Australia. The ALP's interest deduction is then offset against the group company's trading income.

Where the ALP has a NZ limited partner, NZ tax law treats the interest cost as having been suffered by that NZ partner who, in turn, is able to claim a deduction for it in NZ. Hence, the same expenditure results in a tax benefit both in NZ and in Australia.

This is a direct result of a limited partnership being a hybrid in that it is a separate entity yielding limited liability yet it is a flow through vehicle for tax purposes.

Inland Revenue's proposal is to introduce the law changes to restrict the ability of a NZ business to use double deductions of foreign hybrid entities. An option being considered, in tandem, is to allow the NZ parent of a foreign hybrid entity to elect to treat that entity as opaque in order to match the foreign jurisdiction treatment. This would reduce compliance costs. Watch this space for more developments.

Partnerships: Asset Contributions…

It is a burning question whether assets contributed by a partner to a partnership are regarded as an outright sale of the partner's interest in the asset. Where the partner has say a 50% interest in the partnership, effectively the partner retains a 50% interest in the asset, hence is it correct that the partner has sold the property outright? Or has the partner only sold a 50% interest in it?

Inland Revenue has recently issued an exposure draft that gives IRD's view. Their view is that there is a full disposal of the asset. That is because where a person contributes an asset to a general partnership, the legal ownership of the asset fundamentally changes. Before disposal, the person is the sole owner of the asset. Following disposal, the asset ceases to be the person's property. Instead the asset belongs to the partners of the partnership as joint owners. Where the asset is sold to a limited partnership, the person has fully disposed of the asset to a separate legal person.

The question is answered by partnership law. Under partnership law a partner does not have title to specific partnership property but has a beneficial interest in the entirety of the partnership assets. Then the whole of the asset is treated as partnership property.

For more information concerning partnerships and limited partnerships please contact me.

Our Website…

Read our newsletters online at
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