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Your ref: Taxation of Trusts PUB00345

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Office of the Chief Tax Counsel
Inland Revenue
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17 September 2019

Dear Sir/Madam

PUB00345 – Income Tax – distributions from foreign trusts

We respond to the request for comment on PUB00345. We appreciate the opportunity to respond after the deadline. We note that our response raises a number of questions which we have not had time to consider in detail. However, we assume that in line with usual practice, we will be able to discuss these questions with you.

PUB00345 deals with receipts from overseas which might be a distribution from a trust.

The draft deals with determining whether a trust exists or not and details the consequences if the receipt is a distribution from a trust. It does not deal with the consequences if the receipt is not from a trust.

Whether a trust exists?

We make several comments on the analysis:

- The draft notes there is no definition of trust in the Income Tax Act 2007 ("the Act") which applies generally. It applies a definition of trust which is the New Zealand common law definition:
 - The case law on the definition of company is less relevant to support this approach. The Act has a definition of company. This means the approach to determining whether a foreign entity is a company does not necessarily apply to the determination of whether a trust exists.
 - The Trusts Act 2019 amends section YA 1's existing definitions of "trust" and "trustee". It is not clear that these definitions actually achieve what was intended. (We have submitted on this for the trust rule amendments in the KiwiSaver Bill. That submission is attached.) This amendment may provide an Act definition of "trust" which would apply.
- The draft contrasts the position for countries which recognise trusts and those which do not. It seems reasonably clear that for countries which do not recognise trusts, that it is only relationships which would be a trust under New Zealand law which are trusts for the Act. However, we consider it less clear for a country which recognises trusts.

- The question is for a relationship which that other country recognises as a trust but New Zealand does not.
- There is a possibility that such a relationship, if it can actually exist, would be recognised as a trust for the purposes of the Act. However, we note that the draft appears to rule this out as it refers to the arrangement needing to have the essential features of a trust under New Zealand rules.
- The position with respect to inheritances is complicated. We note that executors and administrators are treated as trustees. This raises a question of whether the intention is to treat an estate as a trust for the Act despite not strictly being a trust relationship. The draft seems to only briefly consider this. As executors and administrators are trustees per the "trust" definition in s YA 1, we would be interested in the more detailed analysis which supports the conclusion that they are not covered by subpart HC.

Estate distributions - Not a distribution from a trust

The draft allows that an amount may not be a distribution from a trust. If the draft's conclusion above is correct, it should address the consequences of this.

These are potentially positive. There is less interaction with the trust rules and the taxable distribution penal tax rules do not apply.

However, there are consequential compliance problems for taxpayers. This is particularly the case because estates may not be settled very quickly. As in some of the examples, it may be many years before an amount is received or that taxpayers are aware that there is an entitlement.

The draft provides no practical guidance on complying with historical obligations, which may be a consequence of the draft's conclusion. Further, it does not advise that there may be penalties and interest for incorrectly filed tax returns.

Inland Revenue should consider, at a minimum, an operational statement.

Flowchart

Subject to the comments on what is a trust, we consider that the draft would benefit from a flow chart. This would make clear Inland Revenue's view on the questions we have raised as well as providing clearer guidance.

Policy impact

In our view, the draft raises questions on the appropriate policy outcome for receipts from overseas. It is unlikely that taxing inheritances at a potentially penal tax rate would be an expected outcome for taxpayers. The tracing and ordering rules are difficult and also penal. We further note that the definition of capital gains has not maintained parity with the treatment of capital gains made by companies.

The impact of the trust rules and the death rules on foreign receipts should be considered for whether the outcomes stated in the draft remain the appropriate policy outcomes.

We trust that these comments make sense. We would be pleased to discuss them with you. Please do not hesitate to contact me on 04 816 4518.



Inland Revenue

17 September 2019

Yours sincerely

A handwritten signature in blue ink that reads "John Cantin".

John Cantin

Partner