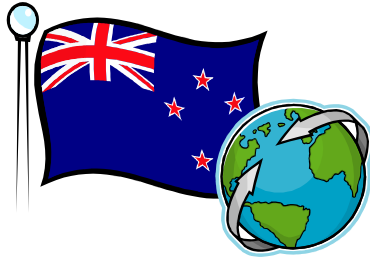


## New Zealand Resident Trustees of Foreign Trusts



### Inside this issue:

**New Zealand  
Resident Trustees of  
Foreign Trusts**

**Business Contacts**

**IRD Discretion to  
Cancel or Not Assess  
Shortfall Penalties  
for Taking an  
Unacceptable Tax  
Position**

**Proposed Changes  
To Australian  
Capital Gains Tax  
("CGT")**

**Resident  
Withholding Tax on  
Interest - Part 2**

The Taxation (Depreciation, Payment Dates Alignment, FBT, and Miscellaneous Provisions) Act 2006 finally received the Royal assent on 3 April 2006. This Amendment Act has introduced new disclosure rules and record keeping requirements for New Zealand resident trustees of foreign trusts. The application date for the new disclosure/record keeping requirements has been deferred until 30 October 2006, as the FEC recognised the IRD needed more time to publicise the requirements. Practitioners can make use of the extra time to identify which of their trusts are affected, alert the trustees to the disclosure requirements and ensure the trust's records satisfy the new requirements.

Below is a summary of the new provisions.

### **Application**

The rules apply to foreign trusts, being trusts where no settlor of that trust has been a New Zealand resident since the date any settlement was made on the trust. By way of example, a foreign trust will include the following:

- The classic foreign trust scenario when non residents use New Zealand's foreign trust regime to own foreign investments by establishing a New Zealand trust with New Zealand resident trustees.
- Ex pat New Zealander's establishing a New Zealand trust to own New Zealand property. In this case the trust is likely to be both a New Zealand qualifying trust and a foreign trust and the foreign trust disclosure/reporting requirements will apply.
- New Zealand inbound migrants who are trustees of a foreign testamentary or will trust where the deceased was a non-resident.

Note that a foreign trust does not include a unit trust.

### **Qualifying New Zealand Resident Trustees**

The final version of the Amendment Act has dispensed with the requirement for one trustee of a foreign trust to be a "qualifying New Zealand resident trustee". The earlier draft legislation provided that the qualifying trustee had to be a member of an approved organization, which was essentially a member of a New Zealand Law Society or the New Zealand Institute of Chartered



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# New Zealand Resident Trustees of Foreign Trusts

Accountants or similar approved body which has a professional code of conduct. If the trustee was a corporate then its director or manager had to be a member of such an approved organisation. The FEC did not state why it dropped this requirement, but in reality it would have been quite draconian for the legislation to have stipulated the make up of the trustees of a foreign trust.

If a foreign trust does have such a person as a trustee, there is a benefit in terms of a lesser penalty that could apply for non adherence to the disclosure requirements. Such trustees will never be liable for the New Zealand tax on the worldwide income of the trust for failing to disclose the relevant information to the Inland Revenue Department.

## The Disclosure Requirements

The Act introduces a new section 59B of the Tax Administration Act 1994 which requires New Zealand resident trustees of foreign trusts to disclose to the IRD the following information:

- The name or other identifying particulars of each trust of which the person is a trustee; and
- The name and contact particulars of the New Zealand resident trustees; and
- Whether a settlor is resident in Australia; and
- If the trustee includes a New Zealand qualifying resident foreign trustee. The name of the approved organisation and contact details of the individuals who belong to the approved organisation.
- Where there is an agency situation, the name of the agent and the appointing trustee.

If any of the above details change such alterations must be disclosed to the Inland Revenue Department within 30 days of the change.

Trustees of existing foreign trusts have 60 days from the later of 1 October 2006 or the date the trustee became resident in NZ to make disclosure. Those appointed as trustee after 1 October 2006 have 30 days from the later of the date of appointment and their arrival in NZ.

There is further relaxation for persons who are trustees of foreign trusts who become a New Zealand resident after 1 October 2006 and do not provide trustee services and have not been a resident for 5 years. Such persons have a period of 2 years from the date of which that person becomes a New Zealand resident to make the disclosure.

## Penalties for Non Disclosure

If a New Zealand resident trustee knowingly does not comply with the new requirements the IRD can prosecute under Section 143(A) of the Tax Administration Act 1994, the knowledge offence provision. The trustee has to prove that they did not know of the disclosure requirements. The Commentary to the Bill reported back from the FEC states that such knowledge offences would be considered on a case by case basis.

If convicted, the trustee would be subject to a monetary fine and a term of imprisonment or both. The worldwide income of the foreign trust will also be subject to tax in New Zealand until the information requested is provided to the IRD. This penalty would be removed once the IRD received the information. The commentary to the bill states that the penalty for non compliance and the tax penalty are considered necessary to deal with seriously recalcitrant trustees.



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# New Zealand Resident Trustees of Foreign Trusts

## Reporting Requirements

The Amendment Act also imposes new record keeping requirements by amending Section 22 of the Tax Administration Act 1994 (the provision detailing keeping of business records). Trustees of foreign trusts must retain the following records:

- Documents that evidence the creation and constitution of the foreign trust
- Particulars of settlements made on and distributions made by the foreign trust, including the date of the settlement of the distribution, the name and address if known of the settlor(s)

and the name and address if known of the recipient of the distribution

- A record of the assets and liabilities of the foreign trust, all entries from day to day of all sums of money received and expended by the trustee in relation to the foreign trust and if the trust carries on a business, the accounts, the accounting instruction manuals and the system used in each income year in the administration of the trust.

Section 22 requires trustees to retain in New Zealand all such records for a period of at least seven years after the end of the tax year to which they relate.

**Keith Turner**

## Business Contacts

This month we profile one of our successful clients, Anthony Gilbert. Anthony proves that there is life after chartered accounting, having been an audit manager in a medium sized chartered accounting practice.

He is now a shareholder/director of Affiliated Business Consultants Limited with over 10 years experience, successfully selling a range of manufacturing, import/distribution and service businesses. He is also an acknowledged expert on the sale of childcare centres.

In 2005 he sold businesses to a total value of \$15,000,000.

He is also able to provide:

- ✓ An appraisal of your business at no obligation and no cost.
- ✓ Analysis of accounting information and relating this to the sensitivities of the business.
- ✓ Advice on improving the operating efficiency of the business over a period of time to maximise the profit and value of the business.
- ✓ Advice is freely provided to business owners.
- ✓ Expert assistance in the marketing and sales process ensuring a successful conclusion.

Anthony's contact details are:

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## IRD Discretion to Cancel or Not Assess Shortfall Penalties for Taking an Unacceptable Tax Position

Inland Revenue has recently issued SPS 06/01. This policy statement appears in TIB Volume 18, Number 5 (June 2006). Section 141 KB was recently introduced and provides that there should be no shortfall penalty imposed for an unacceptable tax position where the shortfall is caused by "a clear mistake or simple oversight". The legislation in our view clarifies what really should have always occurred in that there was never an unacceptable tax position taken in situations where the tax shortfall was caused by a mistake or oversight rather than by an interpretation of a tax law.

As a consequence of this change, persons who have been charged with a penalty (as outlined in the policy statement) after 1 April 2003 may request a cancellation of the shortfall penalty and a refund provided the following criteria are met:

- "a clear mistake or simple oversight" caused the taxpayer to take the unacceptable tax position to which the UTP penalty related, or would relate if the UTP penalty were to be assessed, and

- either:
  - the tax shortfall is voluntarily disclosed to the Commissioner prior to the notification of a pending tax audit or investigation (in terms of section 141G(1)(a)), or
  - the tax shortfall is a temporary tax shortfall (in terms of section 141(3)), and
- it is appropriate that the taxpayer not be liable to pay a UTP penalty.

A request to reverse a previously imposed shortfall penalty must be made in writing before 1 October 2006.

The SPS outlines situations where the CIR considers a shortfall is due to a clear or simple oversight. If you have any cases which you consider are worth revisiting feel free to contact Norm Latimer for assistance.

**Norm Latimer**

## Proposed Changes To Australian Capital Gains Tax ("CGT")

A Bill was recently introduced in Australia which amends the income tax law to better target and strengthen Australia's CGT laws for foreign residents. This is achieved by narrowing the range of assets on which foreign residents will be subject to Australian CGT to Australian real property and the business assets of a foreign resident's Australian permanent establishment. The integrity of the narrower CGT base is strengthened by including rules covering indirect holdings of Australian real property by foreign residents.

The changes will exclude many assets held by non-residents from the

CGT net, in particular shares in Australian private companies other than companies which predominantly invest in Australian real property.

Anyone considering selling shares in an Australian private company which will give rise to a capital gain should consider deferring the sale until after the legislation has been passed.





## Tax Quotes

Tax loopholes are like parking meters. As soon as you see one they're gone.

People who complain about paying their income tax can be divided into two types: men and women.

Why did the auditor cross the road?  
Because he looked in the file and that's what they did last year.

To err is human - and to blame it on the Government is even more so.

# Resident Withholding Tax on Interest Part 2

The September 2005 edition of "NSA on Tax" contained an article on Resident Withholding Tax ("RWT"). The article reviewed a draft discussion document issued by IRD ED 0076 dealing with the timing of RWT credits. The exposure draft has not yet been finalised. Due to a number of queries raised, we firstly wanted to comment further on the IRD position and secondly clarify when RWT deductions are required to be made.

### *Further Comment on Exposure Draft*

As noted in our previous article, in the exposure draft IRD state that the RWT credit can only be claimed in the "tax year" in which the RWT is deducted. A taxpayer would not be able to match the RWT against interest income where the RWT is deducted in a later income year. For example, Company A accrues interest up to balance date of 31 March 2006 totalling \$10,000. The RWT is not deducted from the interest income until the interest is "paid". Assuming the interest is paid in June 2006, RWT of \$3,300 is deducted and paid to IRD on 20 July 2006. Based on the exposure draft issued by IRD, Company A could not claim a credit in its 2006 income tax return for the RWT of \$3,300 deducted. The credit could only be claimed in the 2007 return of income. This treatment is at odds with the common practice of matching the RWT with the accrued interest income.

The relevant section referred to by IRD in the exposure draft is section LD 3(2) which states:

*"LD 3(2) [Credit of tax payments, against tax liabilities] subject to this section, where any resident withholding tax, not being a penalty, has been paid in relation to any resident withholding income derived by any person in any tax year, the amount of resident withholding tax payment must be credited successively against:*

(a) *The income tax liability (if any) of the person for that tax year;*

- and*
- (b) *The income tax liability (if any) of the person that has not otherwise been satisfied for any tax year before that tax year; and*
- (c) *The income tax liability (if any) of the person that has not otherwise been satisfied for any tax year after that tax year ... ; and*
- (d) *The provisional tax (if any) that is due by the person and unpaid for any tax year after that tax year ..."*

Any excess must then be refunded.

In the above example it is the Commissioner's view that RWT of \$3,300 deducted and paid in the 2007 tax year cannot be applied as a credit against interest income accrued in the 2006 year of \$10,000. The Commissioner considers the RWT deducted is only available as a credit in the tax year it is paid.

Although the wording of the section is ambiguous, in our view the Commissioner's interpretation of section LD 3 is incorrect. Section LD 3 provides that where any RWT is paid in respect of any resident withholding income **derived in any tax year**, the RWT is credited firstly against the income tax liability of a person for **that tax year**. We consider that "that tax year" does not refer to the year in which the RWT is deducted and paid (as contended by IRD) but instead refers to the year in which the interest income is derived. Therefore if interest income is "derived" in accordance with the Income Tax Act in the 2006 income year, any RWT deducted from that interest should be available as a credit in the 2006 tax year provided the RWT has been paid prior to the 2006 return being filed.

Therefore in the above example Company A receives net interest income of \$6,700. Section LB 3(1) requires Company A to account for \$10,000 (being net \$6,700 plus RWT of



## Disclaimer

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This newsletter is not intended to replace specific tax advice. As always, specific advice should be obtained for the particular factual circumstances.

We accept no liability for persons relying upon information contained within this newsletter.

# Resident Withholding Tax on Interest Part 2

\$3,300). Company A has derived \$10,000 in the 2006 income year – section LD 3(2) allows a credit for RWT of \$3,300 against the income tax liability for that tax year i.e. 2006.

We consider that the above view represents the better interpretation of section LB 3(2) and recommend that advisers continue to adopt this position until ED 0076 is finalised.

### *When must RWT be deducted?*

We receive a number of queries regarding the accrual of interest to balance date and the deduction of RWT, particularly in relation to shareholder current accounts and related party borrowings.

This matter was specifically addressed by the IRD in a Tax Information Bulletin issued in 1991. Although references were to the Income Tax Act 1976, the article is still relevant in applying the 2004 Act.

As you will be aware, non natural persons such as companies or trusts are required to account for interest on an accrual basis. Where a shareholder advances or draws funds from a company, any interest payable is usually calculated after balance date when the financial accounts are prepared and the company profits determined. The IRD in its TIB article considers that the accrual of interest on shareholder current accounts to balance date must:

- Have regard to the principles of accrual accounting;
- Confirm with commercially acceptable practice;
- Result in the allocation to each income year of an amount that is fair and reasonable having regard to the tender of the spreading provisions of the Act.

The Inland Revenue Department considers apportioning interest to balance date on a straight line basis over the days in the period to which the advances relate to is acceptable. For example:

Mr X's current account is overdrawn for the first 150 days of the 2006 income year by \$120,000 and thereafter \$140,000. Company A charges interest on the overdrawn current account at 8%. The following calculation results:

$$\begin{aligned} \$120,000 \times 8\% / 365 \times 150 &= \$3,945 \\ \$170,000 \times 8\% / 365 \times 215 &= \$6,597 \end{aligned}$$

Interest of \$10,542 is accrued for the 2006 income year.

Unless a certificate of exemption is held, RWT must be deducted when the interest is "paid". The definition of "paid" includes "distribution to, credited to, applied on account of or dealt with in the interest of any person".

Thus RWT must be deducted from interest on a shareholder current account when the interest is quantified and either paid by the shareholder, credited to the current account or otherwise dealt with in their interest. The IRD's TIB article states this (the quantifying of interest and crediting to account) is generally when the accounts are actually ratified.

In summary, although interest is accrued to balance date e.g. 31 March, RWT is not deducted until the interest is quantified and "paid" which is generally when the financial accounts of the company are ratified.

**Lisa Murphy**