



# ***TR 2005/14 - Income tax: application of the Australia/New Zealand Double Tax Agreement to New Zealand Resident Trustees of New Zealand Foreign Trusts***

 This cover sheet is provided for information only. It does not form part of *TR 2005/14 - Income tax: application of the Australia/New Zealand Double Tax Agreement to New Zealand Resident Trustees of New Zealand Foreign Trusts*

 This ruling contains references to repealed provisions, some of which may have been re-enacted or remade. The ruling has effect in relation to the re-enacted or remade provisions. Paragraph 32 in [TR 2006/10](#) provides further guidance on the status and binding effect of public rulings where the law has been repealed or repealed and rewritten. Australia's tax treaties and other agreements except for the Taipei Agreement are set out in the [Australian Treaty Series](#). The citation for each is in a note to the applicable defined term in [sections 3AAA or 3AAB](#) of the International Tax Agreements Act 1953.



## Taxation Ruling

# Income tax: application of the Australia/New Zealand Double Tax Agreement to New Zealand Resident Trustees of New Zealand Foreign Trusts

Contents	Para
<b>What this Ruling is about</b>	<b>1</b>
<b>Date of effect</b>	<b>4</b>
<b>Previous Rulings</b>	<b>5</b>
<b>Ruling</b>	<b>6</b>
<b>Explanation</b>	<b>10</b>
<b>Alternative views</b>	<b>66</b>
<b>Examples</b>	<b>68</b>
<b>Detailed contents list</b>	<b>73</b>

### **Preamble**

*The number, subject heading, **What this Ruling is about** (including **Class of person/arrangement** section), **Date of effect**, and **Ruling** parts of this document are a 'public ruling' for the purposes of **Part IVA** of the **Taxation Administration Act 1953** and are legally binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a 'public ruling' and how it is binding on the Commissioner.*

## What this Ruling is about

### **Class of person/arrangement**

1. This Ruling deals with the question of the residency status under the Australia/New Zealand Double Tax Agreement (the NZ Agreement) of a trustee of a trust established under the domestic law of New Zealand where the trustee:

- is a resident in New Zealand in their personal capacity (non-trustee capacity); and
- under New Zealand domestic law is only assessed, in their trustee capacity, on the portion of the trust net income that is derived from sources in New Zealand.

Whether or not the trustee is a resident under the NZ Agreement will impact upon the Australian taxation obligations of the trustee.

2. This Ruling deals with New Zealand trusts that are in receipt of income from Australian sources where, in relation to a particular trust:

- there is only one trustee of the trust at any particular point in time;
- the trustee of the trust is resident in New Zealand in their personal capacity for the purposes of New Zealand domestic law;
- no settlor of the trust is resident in New Zealand at any time during the income year;

- the trust is neither a superannuation fund (within the meaning of the New Zealand tax law)<sup>1</sup> nor a testamentary or inter vivos trust where the settlor (within the meaning of the New Zealand tax law)<sup>2</sup> died resident in New Zealand (at any time);
- no beneficiary is absolutely entitled to that income; and
- the trustee may be subject to tax in Australia under relevant provisions of the *Income Tax Assessment Act 1936* (ITAA 1936).

3. This Ruling does not apply to trustees who are trustees of a corporate unit trust (within the meaning of section 102J of the ITAA 1936) or a public trading trust (within the meaning of section 102R of the ITAA 1936).

## Date of effect

---

4. This Ruling applies to years of income commencing both before and after its date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

## Previous Rulings

---

5. This Ruling was previously released as, and replaces, draft Taxation Ruling TR 2004/D24.

## Ruling

---

6. New Zealand resident trustees of trusts, as described in paragraph 2, are not, in their capacity as trustees, resident in New Zealand for the purposes of the NZ Agreement.

7. For the purposes of determining residency under the NZ Agreement of a trustee of a New Zealand Foreign Trust, the relevant person is the trustee (and not the trust).

---

<sup>1</sup> The term 'superannuation fund' is defined in section OB 1 of the *Income Tax Act 2004* (NZ) as 'any superannuation scheme which is registered under the *Superannuation Schemes Act 1989*'.

<sup>2</sup> The term 'settlor' is defined in section OB 1 *Income Tax Act 2004* (NZ).

8. Article 4(2) of the NZ Agreement provides that a person is not a resident of a Contracting State where they are liable to tax in that State in respect of income from sources in that State only. It is considered that in applying Article 4(2) to these trustees we look to how they are taxed on trust income in their capacity as trustees in New Zealand. How the trustee may be taxed in respect of income derived in their non-trustee capacity is not considered relevant to this issue.

9. The trustees, in their capacity as trustees, are taxed in New Zealand only on income from sources in New Zealand. For this reason, they are not a treaty resident in respect of the trust income. Therefore, the NZ Agreement does not affect Australia's right to tax Australian source income to these trustees under sections 99 or 99A or Part IX of the ITAA 1936.

## Explanation

---

### New Zealand foreign trusts

10. Under New Zealand income tax law, a trustee of a New Zealand trust is, in some circumstances, taxed in respect of income from New Zealand sources only. Such trusts are known as 'New Zealand foreign trusts'.

11. Under the *Income Tax Act 2004* (NZ), trustees of New Zealand Foreign Trusts are taxable on income from New Zealand sources only. Subsection HH 4(1)<sup>3</sup> imposes on a trustee an income tax liability on the taxable income of the trustee in respect of trust income which has not vested absolutely in a beneficiary or which has not been paid to or applied for the benefit of a beneficiary.<sup>4</sup> However, section HH 4(3B) provides that where:

- a trustee is a resident in New Zealand;
- derives income from a source outside of New Zealand;
- at no time during the relevant income year was a settlor of the trust a resident in New Zealand; and
- the trust is neither a superannuation fund nor a testamentary or an inter vivos trust where a settlor of the trust died as a resident in New Zealand (at any time);

that income is exempt income.

---

<sup>3</sup> The *Income Tax Act 2004* (NZ) replaced the *Income Tax Act 1994* (NZ) with effect from the first day of the 2005-2006 New Zealand income year (see section A 2 of the *Income Tax Act 2004* (NZ)). In this Ruling, section references are to the *Income Tax Act 2004* (NZ). However, the Ruling equally applies to arrangements which were covered by the equivalent provisions in the *Income Tax Act 1994* (NZ).

<sup>4</sup> See definition of 'trustee income' in section OB 1 and subsection HH 4(1).

12. Where a trustee meets the conditions in paragraph 11, the trustee income does not include income derived from sources outside New Zealand and therefore the trustee will not be assessed in respect of that part of the accumulated trust income derived from sources outside New Zealand.

13. This is in contrast to the position under Australian law where income is accumulated in a trust. If a trustee is a resident of Australia then the trust estate is a 'resident trust estate' within the meaning of subsection 95(2). As such, the trustee will be assessed on that part of net income to which no beneficiaries are presently entitled, wherever derived.<sup>5</sup> Under Australian law, the residence of the settlor is irrelevant in this respect.

14. There has been an increase in the use of New Zealand foreign trusts by Australian residents as a vehicle for cross border tax planning. These arrangements seek to take advantage of the absence of taxation under New Zealand domestic law on non-New Zealand source income of the trust.

15. New Zealand foreign trusts have been marketed to Australian residents as a tax effective offshore trust structure which allows tax free accumulation of income and capital in an offshore entity. They may be used as a business entity, to provide retirement benefits or as a pre-migration trust. They may also be used as a treaty shopping vehicle to seek to take advantage of particular features in New Zealand's double tax treaties.

16. Australia's laws contain a number of provisions which will effectively prevent Australian residents using these structures to avoid Australian tax. For example:

- (a) the New Zealand trustee may be assessed on the Australian source income of the trust under Division 6 of Part III of the ITAA 1936, where no beneficiary is presently entitled;
- (b) the Foreign Investment Fund provisions contained in Part XI of the ITAA 1936 may apply to attribute income to an Australian resident beneficiary in respect of their interest;
- (c) Australian residents may be deemed to be presently entitled to a share of the net income of the trust under section 96B of the ITAA 1936;
- (d) the transfer pricing provisions contained in Division 13 of Part III of the ITAA 1936 can be applied to prevent profit shifting;
- (e) in some cases, Australian resident participants may be considered to be trustees (though not formally appointed) under the definition of 'trustee' in section 6 of the ITAA 1936, making the trust a resident trust estate;

---

<sup>5</sup> See sections 99 and 99A ITAA 1936.

- (f) where an Australian resident has settled the trust or has otherwise transferred property (including money) or services to the New Zealand foreign trust, the transferor trust provisions contained in Division 6AAA of Part III of the ITAA 1936 can apply to attribute the net income (or part thereof) to that Australian resident; and
- (g) Part IVA of the ITAA 1936 may also apply.

17. This Ruling is concerned with how the NZ Agreement applies to certain arrangements and as such whether the trustee can be assessed on Australian source income under Division 6 or Part IX.

18. The application of the NZ Agreement may impact on Australia's domestic tax laws. For example, if the trustee is deriving business profits from Australian sources and the NZ Agreement applies, Australia will only have a taxing right where the trustee is carrying on business in Australia through a permanent establishment.<sup>6</sup> Conversely, if the NZ Agreement does not apply, Australia's domestic taxing rights are unaltered by the Agreement and the trustee can be assessed under Division 6. The NZ Agreement may also restrict the rate at which Australia can tax certain income as the country of source. For example, Australian source dividends paid by a resident of Australia to which a resident in New Zealand is beneficially entitled can only be taxed in Australia at a maximum of 15%.

19. Therefore, a central issue to the application of Australian domestic law to these arrangements is whether the trustees of these New Zealand foreign trusts are residents in New Zealand for the purposes of the NZ Agreement and, as such, entitled to benefits under that Agreement.

#### **Purpose of the NZ Agreement and how it interacts with Australian domestic law**

20. The NZ Agreement is contained in Schedule 4 to the *International Tax Agreements Act 1953* (the Agreements Act). The purpose of the NZ Agreement, as with all Tax Treaties, is twofold:

- (a) to avoid double taxation; and
- (b) to prevent fiscal evasion.<sup>7</sup>

---

<sup>6</sup> See Article 7(1) of the NZ Agreement.

<sup>7</sup> The preamble to the NZ Agreement states the Agreement is 'for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income'.

21. The first is achieved by:

- allocating or distributing taxing rights over specified items of income between the country of residence and the country of source; and/or
- by requiring relief to be given for tax paid in the other country; and/or
- through the tie breaker tests that apply in cases of dual residence.

In respect of some items of income, the tax treaties may allocate taxing rights to both countries but impose a restriction on the amount of the income that can be taxed by the country of source. The second purpose is achieved by features such as limiting a person's treaty entitlement in certain circumstances and the exchange of information.

22. The residence of a person is a key factor in determining the tax treaties' application. The concepts of both a 'person' and a 'resident' are of central importance to the operation of tax treaties. Residence of a person determines:

- whether or not the treaty applies;
- how the treaty applies in cases of dual residence; and
- how the taxing rights are distributed between the country of residence and the country of source.

23. Australia's tax treaties broadly follow the same formula and determine residence:

- firstly by reference to the domestic law of each Contracting State;
- secondly, if the person is considered to be a resident of both Contracting States, the tax treaties will generally contain a set of tie-breaker provisions that assign residency to one Contracting State only for the purposes of the tax treaties on the basis of specified criteria such as permanent home or place of effective management; and
- finally, the tax treaty may contain a further criterion that the person is only considered to be a resident of a Contracting State for the purposes of the tax treaty if they are taxed in that Contracting State on income from worldwide sources.

24. For ease of explanation where a person is a resident under the domestic law this will be referred to as 'domestic residence'. In contrast a reference to 'treaty residence' is where the person is considered to be a resident of the Contracting State in accordance with the terms of the tax treaty.

25. In the NZ Agreement, Article 1 provides that:

This Agreement shall apply to *persons* who are *residents* of one or both of the Contracting States. [emphasis added]

26. Article 4(1) of the NZ Agreement defines the term 'resident' for the purposes of the treaty. It provides that:

For the purposes of this Agreement, a person is a resident of a Contracting State:

- (a) in the case of New Zealand, if the person is a resident in New Zealand for the purposes of New Zealand tax; and
- (b) in the case of Australia, if the person is a resident of Australia for the purposes of Australian tax.

27. The combined effect of Article 1 and Article 4(1) is that in order to obtain the benefits under the NZ Agreement the entity in question must be a 'person' who is either a resident in New Zealand or a resident of Australia under the respective domestic law of the two Contracting States.

28. Article 4(2) specifies that a person is not a resident of a Contracting State if they are 'liable to tax in that State in respect only of income from sources in that State'. Therefore, it is not sufficient that the person have a domestic residence. The person must also be liable to tax in respect of income from all sources in order to attain treaty residence under the NZ Agreement.

29. Subsection 4(1) of the Agreements Act provides that, subject to subsection 4(2) of the Agreements Act, the ITAA 1936 and the ITAA 1997 are incorporated and should be read as one with the Agreements Act. Further, subject to limited exceptions, the provisions of the Agreements Act have effect notwithstanding anything inconsistent with the provisions of the ITAA 1936 or the ITAA 1997 (see subsection 4(2)). This means that in the case of an inconsistency between a provision in a tax treaty and a provision in either the ITAA 1936 or the ITAA 1997, the tax treaty prevails where the exceptions do not apply.

30. The combined effect of subsections 4(1) and 4(2) is that where an Article of the treaty prescribes the extent of Australia's taxing rights, it has effect for the purposes of the ITAA 1936 and ITAA 1997. Australia's taxing rights are therefore subject to the application of the tax treaty. If the tax treaty applies, it may operate to remove Australia's taxing right over the Australian source trust income. Consequently, whether a New Zealand trustee can be assessed on the Australian source income under sections 99 and 99A or Part IX will depend, at least in some circumstances, on whether the NZ Agreement applies.



**Application of the NZ Agreement to New Zealand foreign trusts**

31. A trustee of a New Zealand foreign trust who is a resident in New Zealand under the *Income Tax Act 2004* (NZ) in their personal capacity is not a treaty resident in their capacity as trustee by reason of Article 4(2). The NZ Agreement does not therefore apply to the trustee in their trustee capacity and the taxing rights over the income derived by the trustee to which no beneficiary is presently or absolutely entitled are therefore unaffected by the treaty. This conclusion has been reached on the basis that the NZ Agreement applies to the person who is the trustee, as a separate person in relation to the trust income and, a separate person in respect of their personal income.

**Application of Article 4(1)**

32. As noted above, Article 4(1) of the NZ Agreement provides that:

For the purposes of this Agreement, a person is a resident of a Contracting State:

- (a) in the case of New Zealand, if the person is a resident in New Zealand for the purposes of New Zealand tax; and
- (b) in the case of Australia, if the person is a resident of Australia for the purposes of Australian tax.

33. The term 'person' is defined in Article 3(1)(j) of the NZ Agreement to include an individual, a company and any other body of persons. Clearly a trustee can be a person as a trustee will be either an individual or a company.

34. The terms of the NZ Agreement demonstrate that the treaty applies at the trustee level rather than at the trust level. Article 3(2) of the NZ Agreement deems a trustee who is subject to tax in relation to dividends, interest or royalties as being beneficially entitled to the dividends, interest and royalties for the purposes of Articles 10, 11 and 12. The Article makes it clear that the trustee can benefit from the reduced rates of tax available under the NZ Agreement where the trustee and not the beneficiary is taxed on the income.

35. On the assumption that the trustee is, as trustee, resident in New Zealand for the purposes of New Zealand tax, Article 4(1) is satisfied. (Note that the Ruling deals with trusts where there is only one trustee of the trust at a particular point in time.)

**Application of Article 4(2)**

36. The next step is to determine whether and how Article 4(2) applies.

37. Four issues arise:
- (a) whether a trustee is 'liable to tax', (see paragraph 38);
  - (b) whether Article 4(2) applies with regard solely to the tax liability of the trustee as trustee (paragraphs 39-46);
  - (c) whether the trustee, as trustee, is 'liable to tax' on worldwide income (paragraphs 47-48); and
  - (d) whether it is within the spirit and intent of Article 4(2) to apply the Article to New Zealand Foreign Trusts (paragraphs 49-61).

*(a) Can a trustee be 'liable to tax'?*

38. As a threshold question, the issue arises as to whether a trustee can ever be said to be liable to tax, given that they hold assets and derive income on behalf of the beneficiaries. However, as a trustee can be taxed in that capacity on income derived under the trust arrangement, they can be said to be liable to tax. The fact that they are not the beneficial owner of income does not alter this.

*(b) Whether Article 4(2) applies by reference solely to the tax liability of the trustee as trustee*

39. The competing arguments centre around whether Article 4(2) applies to the trustee having regard to how they are taxed on income derived in both their trustee and their personal capacity, or whether they are treated as a separate person in respect of their trustee capacity.<sup>8</sup>

40. The NZ Agreement uses the phrases 'a person is a resident' and 'a person is not a resident'. In an ordinary sense, a person would generally be understood to be a non-divisible entity. However, the domestic law of both Australia and New Zealand tax the person who is the trustee as a separate taxpayer in respect of trust income and again separately in respect of personal income. Under both Australian and New Zealand law, assessments made in respect of the trustee in their personal capacity and in their capacity as a trustee are independent and in no way does one tax liability depend on, or refer to the other. In fact, for the purposes of the rate of tax imposed on the net income assessed to the trustee it is irrelevant what type of entity the trustee is (corporate or individual). For example, under both regimes a corporate trustee can be assessed at marginal rates applying to individuals.<sup>9</sup>

---

<sup>8</sup> See Prebble J, 'Trusts and Double Taxation Conventions', eJournal of Tax Research, 2004, Vol 2, No 2, at pp 196-198 who takes the former view.

<sup>9</sup> For example see subsection 98(1) ITAA 1936 and subsection HH 4(1) *Income Tax Act 2004 (NZ)* which deems a trustee to be an individual for the purposes of imposing the tax liability.

41. Therefore, for tax purposes, a person who is a trustee can be treated as two different taxpayers.<sup>10</sup>

*Alternative view*

42. An alternative argument which has been put is that the focus of the tax treaties is on the taxpayer and not on items of income. As such, there is no basis to argue that a taxpayer can be a resident for some purposes and not for others. This being the case, the trustee must be treated as a non-divisible person.<sup>11</sup>

43. Under this view if the person (in whatever capacity) is liable to tax on at least some types of foreign source income then they are a resident for all treaty purposes, including in their capacity as trustee. If accepted, the exclusion in Article 4(2) would not apply because the trustee would, in their personal capacity, be taxable in respect of worldwide income and thus would be liable to tax on at least some non-New Zealand source income (if derived).

44. However, when applying the NZ Agreement to trust income, regard needs to be had to how the trustee is assessed under both Australian and New Zealand law. The complete separation for tax purposes of the assessments in respect of the trustee in their capacity as trustee and in their other capacity cannot be ignored. For this reason, it is more appropriate to treat the trustee as separate persons when applying the NZ Agreement.

45. Furthermore, there is nothing in the NZ Agreement that expressly allows or disallows a person to be a resident in one capacity and not another.

46. Given the manner in which trust income is assessed to the trustee at domestic law, Article 4(2) should be applied on the basis of whether the trustee in the capacity as trustee is liable to tax on worldwide income. As such, how the trustee is taxed in their non-trustee capacity is irrelevant for these purposes.

*(c) Is the trustee liable to tax on worldwide income?*

47. Under the NZ Agreement, Article 4(1) includes all persons who are resident under the domestic law. However, Article 4(2) excludes persons from being treaty residents of a Contracting State if they are liable to tax only on income from sources in that Contracting State. That is, whilst the person is, under domestic tax law, a resident, their tax liability is limited.

---

<sup>10</sup> See also subsection 960-100(3) of the ITAA 1997 which expressly recognises that a person can have a number of different capacities and in each capacity they are a different entity. The note to that subsection recognises that a person is one entity in their personal capacity and another entity in their trustee capacity.

<sup>11</sup> Prebble J, 'Trusts and Double Taxation Conventions', at 196-198.

48. In the case of New Zealand resident trustees of New Zealand Foreign Trusts, while the trustee may be a resident under New Zealand domestic law, as they are liable to tax in their capacity as trustees, on a domestic source basis only, they are, in that capacity, excluded by the words of Article 4(2). The trustee, in their personal capacity in relation to their personal income, would still qualify as a treaty resident as, in that capacity, they would be liable to tax on worldwide income.

*(d) Whether it is within the spirit and intent of Article 4(2) to apply the Article to New Zealand Foreign Trusts*

49. The second sentence of Article 4(1) of the Model Convention, like Article 4(2) in the NZ Agreement, provides that a person is not a resident of a Contracting State if they are liable to tax in respect only of income from sources in that State. The OECD Commentary in relation to the second sentence of Article 4(1) of the Model Convention provides, at paragraph 8:

In accordance with the provisions of the second sentence of paragraph 1, however, a person is not considered a 'resident of a Contracting State' in the sense of the Convention if, although not domiciled in that State, he is considered to be a resident according to the domestic laws but is subject only to a taxation limited to the income from sources in that State or to capital situated in that State. That situation exists in some States in relation to individuals, example in the case of foreign diplomatic and consular staff serving in their territory. *According to its wording and spirit the provision would also exclude from the definition of a resident of a Contracting State foreign-held companies exempted from tax on their foreign income by privileges tailored to attract conduit companies.* This, however, has inherent difficulties and limitations. *Thus it has to be interpreted restrictively* because it might otherwise exclude from the scope of the Convention all residents of countries adopting a territorial principle in their taxation, a result which is clearly not intended.<sup>12</sup> [*emphasis added*]

50. The second half of the above quoted paragraph was added in to the OECD Commentary in 1992<sup>13</sup> as a result of an OECD working party's report on conduit companies.<sup>14</sup> That report considered the issue of treaty shopping through the use of conduit companies. On page 9 of that report at paragraph 14 the working party refers to specific anti-avoidance provisions in the 1977 Model Convention precluding persons otherwise not entitled to treaty benefits from gaining them via the use of a conduit company. The report refers to the Model Convention and notes that the second sentence of Article 4(1) is one of the features in the Model Convention that can be

<sup>12</sup> The High Court in *Thiel v. FC of T* 90 ATC 4717 approved the use of the commentaries to the Model Convention as supplementary material under Article 32 of the Vienna Convention.

<sup>13</sup> The Revision of the Model Convention, adopted by the OECD Council on 23 July 1992.

<sup>14</sup> Double Taxation Conventions and the Use of Conduit Companies, adopted by the OECD Council on 27 November 1986.

used to prevent conduit companies being used to gain treaty benefits. That paragraph notes that the second sentence has 'inherent difficulties and limitations' and, because it was not intended to exclude residents of countries with territorial systems, that there was 'an element of uncertainty concerning its application against conduit companies'.

51. Nonetheless, the addition of the commentary to the OCED Commentary indicates an intention that Article 4(1) of the Model Convention can be used to exclude such conduit companies while recognising the attendant difficulties.

52. The report and the OECD Commentary identify at least two categories of persons to which the exclusion in Article 4(1) of the Model Convention would apply (foreign diplomatic and consular staff and conduit companies). When determining what other category of persons would also be treated as non-residents by reason of the exclusion, the OECD Commentary warns that caution should be exercised to ensure the exclusion is not extended too far. The OECD Commentary makes it clear, for example, that residents of countries that adopt a territorial principle of taxation should not be considered to fall within the exclusion.

53. The rationale for treating conduit companies as being within the exclusion is that they could be used as a vehicle for persons not intended to benefit from the treaty. The OECD Commentary refers to the 'wording and spirit' of the Article and finds that treating such companies as non-residents is within both.

54. There are parallels between conduit companies and the treatment of these trusts in New Zealand. In both cases foreign income may flow through the vehicle to foreign owners through an entity that is not taxed in the jurisdiction. Both Australia and New Zealand tax their residents on a worldwide income basis. The treatment of New Zealand Foreign Trusts is an exception to this general worldwide income approach and falls squarely within the type of situation that Article 4(2) was intended to cover.

55. We consider that it is within the wording and would also be within the 'spirit' of Article 4(2) to treat trustees of New Zealand trusts who are taxed on their New Zealand source income only as non-residents for treaty purposes. An Australian resident deriving Australian source income through a New Zealand foreign trust should not be able to use the treaty to get a result of double non-taxation.

#### *Alternative view*

56. It could be argued that Article 4(2) should be limited to the two categories mentioned in the exclusion in the OECD Commentary. It could also be argued that Article 4(2) should only be applied where it is not possible that any resident of the relevant Contracting State (in this case New Zealand), who is assessable on worldwide income, could receive the income whether in the same income year or a future income year.

57. In setting out two circumstances where the exclusion would apply and saying it was to be interpreted restrictively the OECD did not intend that those were to be the only two circumstances in which the exclusion should be applied. Rather, the OECD expresses caution in applying the exclusion lest it be applied to circumstances that are not within its 'spirit'.

58. This view is consistent with that contained in Taxation Ruling TR 97/19 in which the Commissioner accepts that the exclusion applies to a wider category of persons than the conduit company and consular service situations listed in the OECD Commentary. TR 97/19 discusses the application of the tax treaty between Australia and China to residents of Hong Kong. The Ruling concludes that the taxes imposed on Hong Kong residents are not covered by the treaty as they are not imposed by the Central People's Government of China, nor are the Hong Kong taxes 'identical or substantially similar' to the taxes imposed by the Central People's Government of China. However, the Ruling goes on to state that even if this view is not accepted and consequently Hong Kong is treated as part of the territory of China for the purposes of the tax treaty, Hong Kong residents would not be residents of China under the treaty because of Article 4(2).<sup>15</sup> This is because, as residents of China, people residing in the Hong Kong Special Administrative Region are taxed on income from sources in Hong Kong only<sup>16</sup> (see paragraph 41 of TR 97/19).

59. Similarly, Norfolk Island and Cocos (Keeling) Islands residents who are generally subject to Australian tax on Australian source income only are not residents of Australia for the purposes of the NZ Agreement by reason of Article 4(2). There is therefore a clear intention that the Article is not restricted to the two categories mentioned in the OECD Commentary.

60. We further consider that the wording of Article 4(2) cannot be limited to only cover situations where not only will the resident receiving the income not be liable to tax but any other resident who may subsequently receive that income in a later year, for example, as a distribution, will not be liable to tax.

61. We note that New Zealand residents who have an interest in New Zealand Foreign Trusts may ultimately, in future years receive Australian source income initially derived, but not distributed in the year it is received by a trustee of a New Zealand Foreign Trust. However, we consider that upon a subsequent assessable distribution of that income to a New Zealand resident beneficiary, that beneficiary may apply to the New Zealand Competent Authority under the Mutual Agreement Procedure in Article 25 of the NZ Agreement for consideration of whether tax has been applied in accordance with the Agreement.

---

<sup>15</sup> Article 4(2) of the Australia/China Agreement is substantially similar in its wording to Article 4(2) of the NZ Agreement.

<sup>16</sup> Note that China adopts a worldwide basis of taxation (and not a territorial basis).

***Conclusion on whether a trustee is a resident for the purposes of the treaty***

62. A New Zealand trustee taxed only on New Zealand source income under subsection HH 4(3B) is not, in that capacity of trustee, considered to be a resident in New Zealand under Article 4 of the treaty. This interpretation is consistent with the OECD Commentary, the working party report and Taxation Ruling TR 97/19.

***Impact of denying treaty benefits to the trustee***

63. As the trustee of a trust described in paragraph 2 is not a resident in New Zealand for the purposes of the treaty, the treaty does not have any application when determining Australia's taxing rights over the Australian source income. Therefore, where the whole or part of the net income of the trust estate consists of Australian source income, Australia is able to tax that income to the trustee where the conditions in sections 99 or 99A or Part IX of the ITAA 1936 are met without regard to the NZ Agreement.

64. Where the income is subject to withholding tax, the applicable withholding tax rates for dividend, royalty and interest income paid by an Australian resident to the trustee will be the rates set out in the *Income Tax (Dividends, Interest and Royalties Withholding Tax) Act 1974*. Currently those rates are 30% in respect of gross dividends and royalties and 10% in respect of gross interest. Note that where withholding tax has applied, section 128D provides that the income is non-assessable and non-exempt.

65. If the New Zealand Foreign Trust subsequently makes a distribution to a New Zealand resident which is assessable, as noted in paragraph 61, we consider that the beneficiary may apply to the New Zealand Competent Authority under the Mutual Agreement Procedure in Article 25 for consideration of whether the New Zealand resident is taxed in accordance with the NZ Agreement.

---

**Alternative views**

---

**Liable to tax**

66. On the issue of how Article 4(2) applies, the alternative view is that the Article applies by looking at the person who is the trustee without making a distinction between their personal and trustee capacity. This alternative view is discussed at paragraphs 42 to 46 and for the reasons discussed there we do not agree with this view.

**Application of Article 4(2)**

67. There is an alternative view that it is not within the spirit and intention of Article 4(2) to apply it to trustees of New Zealand Foreign Trusts. This view is discussed at paragraphs 56 to 61 and for the reasons set out in these paragraphs we do not hold this view.

**Example**

68. *ABC Pty Ltd, a resident in New Zealand, is the trustee for the EFG Trust. Mr S, a resident of Hong Kong (and not a resident of New Zealand), is the sole settlor of the trust. The EFG Trust is not a superannuation fund (within the meaning of the Income Tax Act 2004 (NZ)) nor a testamentary trust or an inter vivos trust where any settlor died resident in New Zealand.*

69. *EFG trust derives \$1 million from sources in New Zealand and \$500 000 of business profits which has an Australian source. The EFG Trust does not carry on business in Australia through a permanent establishment (within the meaning of the NZ Agreement) in Australia.*

70. *No beneficiary of the EFG Trust is presently entitled to any of the income or absolutely to any capital gain derived by the EFG Trust.*

71. *ABC Pty Ltd, in respect of the trust income, is liable to tax in New Zealand on the New Zealand source income only under subsection HH 4(3B) of the Income Tax Act 2004 (NZ). Therefore, it is not, in its capacity as trustee, a resident in New Zealand for the purposes of the NZ Agreement by reason of Article 4(2). As such, the NZ Agreement does not affect Australia's taxing rights in respect of the Australian source income.*

72. *ABC Pty Ltd, in its capacity as trustee, is therefore liable to be assessed in respect of the income attributable to sources in Australia under subsection 99A(4C) of the ITAA 1936.*

**Detailed contents list**

73. Below is a detailed contents list for this Taxation Ruling:

	<b>Paragraph</b>
<b>What this Ruling is about</b>	<b>1</b>
Class of person/arrangement	1
<b>Date of effect</b>	<b>4</b>
<b>Previous Rulings</b>	<b>5</b>
<b>Ruling</b>	<b>6</b>
<b>Explanation</b>	<b>10</b>



New Zealand foreign trusts	10
Purpose of the NZ Agreement and how it interacts with Australian domestic law	20
Application of the NZ Agreement to New Zealand foreign trusts	31
<i>Application of Article 4(1)</i>	32
<i>Application of Article 4(2)</i>	36
(a) <i>Can a trustee be 'liable to tax'?</i>	38
(b) <i>Whether Article 4(2) applies by reference solely to the tax liability of the trustee as trustee</i>	39
<i>Alternative view</i>	42
(c) <i>Can the trustee be liable to tax on worldwide income?</i>	47
(d) <i>Whether it is within the spirit and intent of Article 4(2) to apply the Article to New Zealand Foreign Trusts</i>	49
<i>Alternative view</i>	56
<i>Conclusion on whether a trustee is a resident for the purposes of the treaty</i>	62
<i>Impact of denying treaty benefits to the trustee</i>	63
<b>Alternative views</b>	<b>66</b>
Liable to tax	66
Application of Article 4(2)	67
<b>Example</b>	<b>68</b>
<b>Detailed contents list</b>	<b>73</b>

**Commissioner of Taxation**

27 July 2005

*Previous draft:*

TR 2004/D24

*Related Rulings/Determinations:*TR 92/1; TR 92/20; TR 97/16;  
TR 97/19*Subject references:*- double tax agreements  
- net income of a trust  
- non-resident trusts*Legislative references:*- TAA 1953 Pt IVAAA  
- ITAA 1936 6  
- ITAA 1936 Pt III Div 6  
- ITAA 1936 95(2)  
- ITAA 1936 96B  
- ITAA 1936 98(1)  
- ITAA 1936 99  
- ITAA 1936 99A  
- ITAA 1936 99A(4C)  
- ITAA 1936 Pt III Div 6AAA  
- ITAA 1936 102J  
- ITAA 1936 102R  
- ITAA 1936 Pt III Div 13  
- ITAA 1936 Pt IVA  
- ITAA 1936 Pt IX

- ITAA 1936 Pt IX Div 6
  - ITAA 1936 Pt XI
  - ITAA 1997 960-100(3)
  - International Tax Agreements Act 1953 4(1)
  - International Tax Agreements Act 1953 4(2)
  - International Tax Agreements Act 1953 Sch 4
  - International Tax Agreements Act 1953 Sch 4 Art 1
  - International Tax Agreements Act 1953 Sch 4 Art 3(1)(j)
  - International Tax Agreements Act 1953 Sch 4 Art 3(2)
  - International Tax Agreements Act 1953 Sch 4 Art 4
  - International Tax Agreements Act 1953 Sch 4 Art 4(1)
  - International Tax Agreements Act 1953 Sch 4 Art 4(2)
  - International Tax Agreements Act 1953 Sch 4 Art 7(1)
  - International Tax Agreements Act 1953 Sch 4 Art 10
  - International Tax Agreements Act 1953 Sch 4 Art 11
  - International Tax Agreements Act 1953 Sch 4 Art 12
  - International Tax Agreements Act 1953 Sch 4 Art 25
  - International Tax Agreements Act 1953 Sch 28 Art 4(2)
  - Income Tax (Dividends, Interest and Royalties Withholding Tax) Act 1974
  - Income Tax Act 1994 (NZ)
  - Income Tax Act 2004 (NZ) A 2
  - Income Tax Act 2004 (NZ) HH 4(1)
  - Income Tax Act 2004 (NZ) HH 4(3B)
  - Income Tax Act 2004 (NZ) OB 1
- Case references:*
- Thiel v. FC of T 90 ATC 4717; (1990) 21 ATR 531; (1990) 171 CLR 338
- Other references:*
- Double Tax Conventions and the Use of Conduit Companies (adopted by the OECD Council on 27 November 1986)
  - Prebble J, 'Trusts and Double Taxation Conventions' [2004] 2(2) eJournal of Tax Research

**ATO references**

NO: 2004/10228  
 ISSN: 1039-0731  
 ATOLaw topic: Income Tax ~~ Assessable income ~~ trust income - other