TA 2012/2 - New Zealand Foreign Trust arrangements

Australian Government
Australian Taxation Office

Taxpayer Alert

TA 2012/2

FOI status: may be released

TITLE: New Zealand Foreign Trust arrangements

Taxpayer Alerts are intended to be an "early warning" of significant new and emerging higher risk tax planning issues or arrangements that the Australian Taxation Office (ATO) has under risk assessment, or where there are recurrences of arrangements that have been previously risk assessed.

Taxpayer Alerts provide information that is in the interests of an open tax administration to taxpayers. Taxpayer Alerts are written principally for taxpayers and their advisers and they also serve to inform tax officers of new and emerging higher risk tax planning issues. Not all potential tax planning issues that the ATO has under risk assessment will be the subject of a Taxpayer Alert, and some arrangements that are the subject of a Taxpayer Alert may on further examination be found not to be of concern to the ATO. In these latter cases, the Taxpayer Alert will be withdrawn and a notification published which will be referenced to that Taxpayer Alert.

Taxpayer Alerts give the title of the issue (which may be a scheme, arrangement or particular transaction), briefly describe the issue and highlight the features which are of concern to the ATO. These issues will generally require more detailed analysis to provide the ATO view to taxpayers.

Taxpayers who have entered into or are contemplating entering into an arrangement similar to that described in this Taxpayer Alert can seek a formal determination of the ATO's position through a private ruling (noting that the Taxation Administration Act 1953 sets out circumstances where the Commissioner may decline to issue such a ruling). Such taxpayers might also contact the tax officer named in the Taxpayer Alert and/or obtain their own advice.

Where a Taxpayer Alert provides guidance that a particular arrangement is or will be ineffective and that guidance is subsequently found to be incorrect and the taxpayer had relied on that guidance, the taxpayer is protected from paying a shortfall penalty and any interest charge that would otherwise be payable under the law.

This Taxpayer Alert is issued under the authority of the Commissioner.

Overview

This Taxpayer Alert describes arrangements where a New Zealand based foreign discretionary trust (New Zealand Foreign Trust) is used to avoid taxation on Australian sourced income. These arrangements may involve the provision of services, at a mark up, to an Australian resident business, or the diversion of Australian sourced income. The ATO is investigating these arrangements, including through Project Wickenby. **The ATO view on the arrangement is set out in Taxation Ruling TR 2005/14.**

This Alert addresses an arrangement similar to that described in Taxpayer Alert TA 2004/4 but also highlights additional features of concern. TA 2004/4 and TR 2005/14 continue to apply while new versions have been detected which warrant the issue of this Taxpayer Alert.

Context for the arrangement

Under New Zealand income tax law, a New Zealand resident trustee is not taxed on foreign source income if there is no New Zealand resident settlor of the New Zealand Foreign Trust.

Promoters of New Zealand Foreign Trust arrangements have marketed these structures on the basis that the trusts can accumulate Australian sourced income and capital on a tax-free basis. The promoters argue that:

- the New Zealand Foreign Trust is not assessable on Australian sourced income under New Zealand domestic tax laws, and
- Australian sourced income of the New Zealand Foreign Trust is not assessable in Australia due to the provisions contained within the Australia/New Zealand Double Tax Agreement (NZ Agreement).

However, the ATO view as set out in TR 2005/14 states that Australia's right to tax Australian sourced income derived by the trustee of a New Zealand Foreign Trust is unaffected by the NZ Agreement. 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 of the *Income Tax Assessment Act* 1936 (ITAA 1936) are met, without regard to the NZ Agreement.

General provisions within Australia's domestic tax legislation which relate to the assessable income, allowable deductions, trust income, transfer pricing, personal services income, Goods & Services Tax (GST), PAYG withholding and superannuation may also be relevant to the arrangements covered in this Taxpayer Alert.

Description

Core arrangement

The alert applies to arrangements with features substantially equivalent to the following (or a combination of parts):

1. A New Zealand Foreign Trust (the trust) is established by a New Zealand based promoter with a settlor which is an entity that is not a resident of New Zealand. To date we have identified trusts being settled in countries such as the Republic of Panama, Samoa, Vanuatu and Hong Kong. However, this may be replicated in other jurisdictions.
2. The trust may be:
   - administered by a trustee which is either the promoter, an associate of the promoter or a New Zealand company in which the promoter or an associate holds a controlling interest. "Controlling interest" includes, but is not limited to, a direct or indirect shareholding in the company;
   - represented in Australia by an Australian resident who is associated with the promoter. The trustee may grant a General Power of Attorney to the Australian resident; and/or
   - registered for GST in Australia and lodge Business Activity Statements

(BAS).

3. A business located and operating in Australia (the Australian business), which is ultimately controlled by an Australian individual, enters into an agreement with the trust under which the trust provides resources or services to the Australian business. This may include staff, business equipment or motor vehicles, and/or services such as administration. *Refer (a) in Diagram 1.*

4. The fees paid by the Australian business for the provision of resources or services may include a "mark up" (typically of 20-30% above cost) and are deposited into a bank account of the trust. The income is not reported or assessed in Australia or New Zealand for tax purposes. *Refer (b) in Diagram 1.*

5. The funds deposited into the bank account may be used to pay for expenses relating to the resources provided under the agreement (e.g. wages) or to pay expenses of the Australian business on its behalf. *Refer (d) in Diagram 1.*

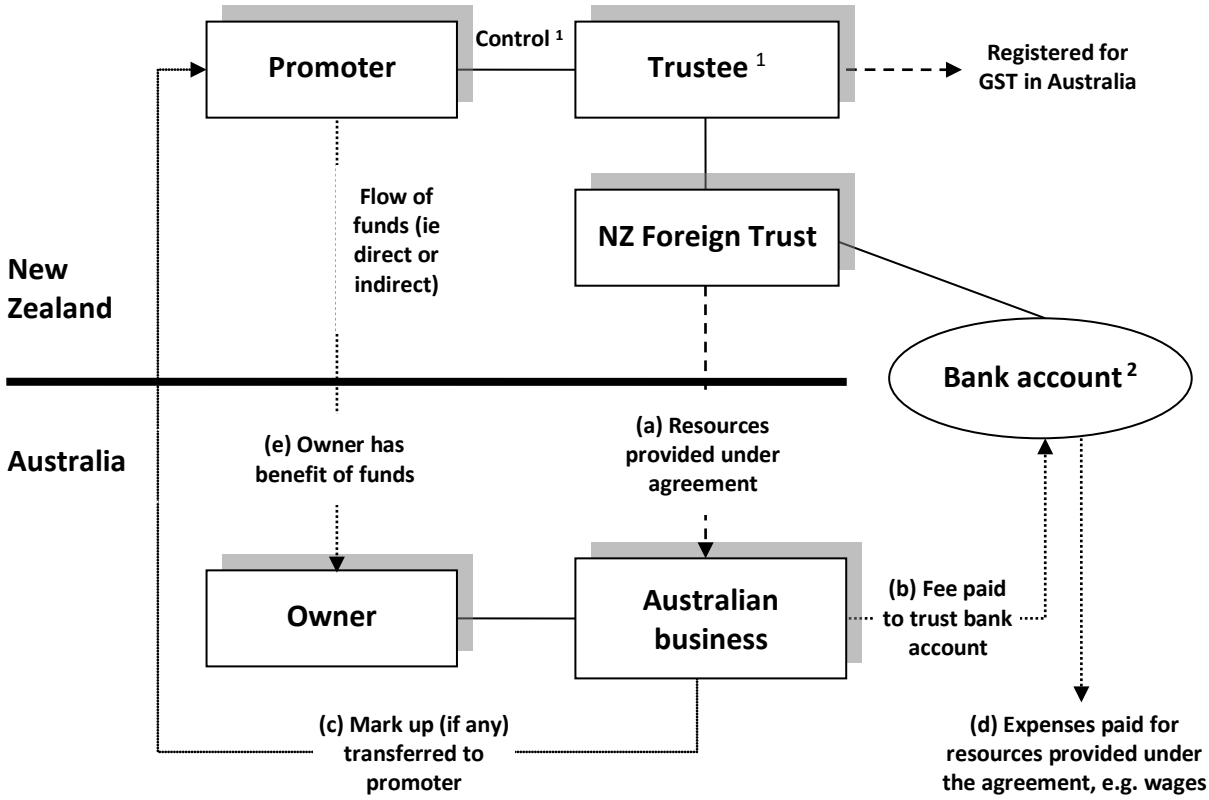
6. As an alternative to depositing the mark up into the bank account, the mark up may instead be transferred offshore to the promoter, after which the Australian business, or its owner or associates, appear to have the benefit of the funds. For example, the funds may be "loaned" back to the owner on non-commercial terms with no interest or principal repayments made, or the owner may, by some other means, have direct or indirect access to the funds. The mark up is not reported or assessed in Australia or New Zealand for tax purposes. *Refer (c) and (e) in Diagram 1.*

7. The Australian business claims a deduction for the fees and mark up (if any).

Diagram of core arrangement

The basic structure of the core arrangement can be summarised diagrammatically as follows. Not all of the features shown in the following Diagram will necessarily exist in practice.

Diagram 1



1. The trustee may either be the promoter, an associate of the promoter or a New Zealand company in which the promoter or an associate holds a controlling interest. "Controlling interest" includes, but is not limited to, a direct or indirect shareholding in the company.
2. The bank account need not be located in Australia or New Zealand.

Variation

The following is a **variation of the core arrangement** (i.e. replacing features 3 to 7 with 8 to 11):

8. Under a service agreement, the trust engages an Australian individual to provide services (service provider), such as consultancy services, to the Australian business. These services may be provided in Australia or offshore. *Refer (a) and (b) in Diagram 2.*

9. The fees paid for the services are deposited into a bank account of the trust. *Refer (c) in Diagram 2.*

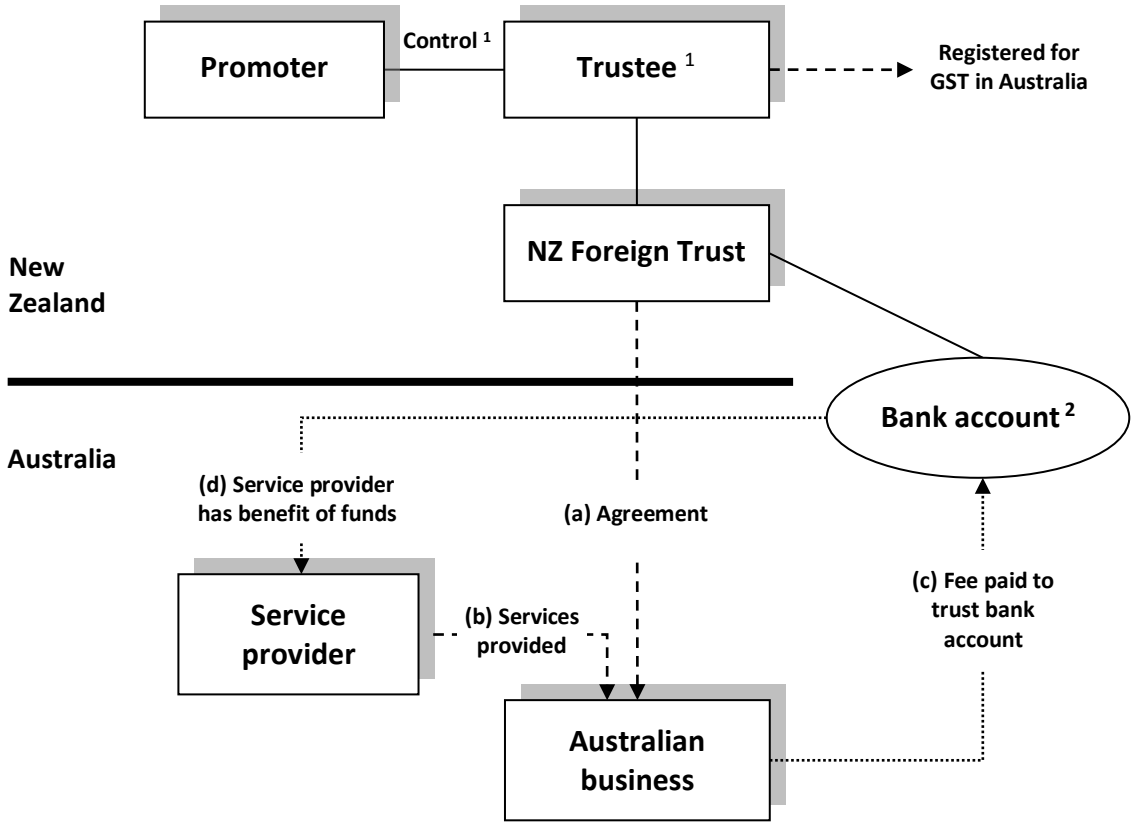
10. The service provider appears to have the benefit of the funds, e.g. they may have access to the funds in the bank account or the funds may be used to pay the service provider's expenses on their behalf. *Refer (d) in Diagram 2.*

11. The income is not reported or assessed in Australia or New Zealand for tax purposes.

Diagram of variation

The basic structure of the variation of the core arrangement can be summarised diagrammatically as follows. Not all of the features shown in the following Diagram will necessarily exist in practice.

Diagram 2



1. The trustee may either be the promoter, an associate of the promoter or a New Zealand company in which the promoter or an associate holds a controlling interest. "Controlling interest" includes, but is not limited to, a direct or indirect shareholding in the company.
2. The bank account need not be located in Australia or New Zealand.

Features which concern us

The ATO considers that arrangements of this type give rise to the following issues relevant to taxation laws, being **whether**:

(a) the arrangement, or certain steps within it, may constitute a sham at general law,

(b) any income derived may be assessable under section 6-5 or section 6-10 of the *Income Tax Assessment Act 1997* (ITAA 1997),

(c) any expenses incurred may not be deductible under section 8-1 of the ITAA 1997,

(d) the trust may have a permanent establishment in Australia,

(e) the trustee, in its capacity as trustee, may not be a resident of New Zealand for the purposes of the Australia/New Zealand Double Tax Agreement (despite being a New Zealand resident under New Zealand domestic tax law), as it will only be liable to tax under New Zealand domestic tax law in respect of New Zealand sourced income. It would therefore not be entitled to treaty benefits under the Australia/New Zealand Double Tax Agreement,

(f) the Australian sourced income of the trust may be assessable to the trustee under Division 6 of Part III of the ITAA 1936, where no beneficiary is presently entitled,

(g) any income that has been alienated may be income of the service provider under section 6-5 of the ITAA 1997,

(h) amounts should be withheld under the PAYG(W) rules in Part 2-5 of Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953),

(i) a minimum level of superannuation support may be required under the *Superannuation Guarantee (Administration) Act 1992* (SGAA 1992),

(j) the arrangement may constitute an arrangement which avoids payment of the superannuation guarantee charge to which section 30 of the SGAA 1992 may apply,

(k) the mark up, i.e. the inflated portion of the service fee, may not be considered a creditable acquisition for GST purposes. Therefore, the Australian business may not be entitled to input tax credits under section 11-20 of the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act 1999). Similarly, the trust may be required to be registered for GST in Australia and remit GST on taxable supplies made with respect to services provided to the Australian business under section 9-5 of the GST Act 1999,

(l) the transfer pricing provisions in Division 13 of Part III of the ITAA 1936 may apply,

(m) the general anti-avoidance provisions in Part IVA of the ITAA 1936 may apply to the arrangement, and

(n) any entity involved in the arrangement may be a promoter of a tax exploitation scheme for the purposes of Division 290 of Schedule 1 to the TAA 1953.

Note 1: *You may have already sought advice from the ATO in respect of your arrangement by way of a private ruling or class ruling. If you have received a private ruling or class ruling in respect of your arrangement, you can rely on that ruling. A private or class ruling is legally binding on the Commissioner who will be bound to act in the way set out in the ruling, even if the ruling is later found to be incorrect. However, a private ruling only applies to a particular entity identified and the particular scheme described in the ruling. Similarly, a class ruling only applies to a specified class of entities and the particular scheme described in the ruling. If there is a material difference between the scheme described in the ruling, and the scheme that was actually implemented, the ruling will not be legally binding on the Commissioner. Also, other entities cannot rely on a private ruling issued in respect of a different entity.*

Note 2: *If you have received a private ruling in respect of your arrangement, please check that the application of Part IVA of the ITAA 1936 is considered in that ruling. The applicant may not have sought for us to rule on the application of Part IVA to the arrangement ruled upon, or to an associated or wider arrangement of which that arrangement is part. If you want us to rule on whether Part IVA applies to your arrangement, we will first need to obtain and consider all the relevant facts about the arrangement, including (if relevant) the manner in which it has actually been implemented.*

Note 3: Base penalties of up to 50% of the tax avoided can apply where Part IVA is applied. Base penalties of up to 75% of the tax avoided can apply where you make a false or misleading statement to the Commissioner.

Reductions in base penalty will be available if the taxpayer makes a voluntary disclosure to the ATO. If you have any information about the current arrangement, phone us on 1800 060 062.

*Tax agents wanting to provide information about people or companies who may be promoting arrangements covered by this Alert should call 13 72 86 (Fast Key Code **3 4**).*

***Note 4**: Penalties of up to 5,000 penalty units for individuals, 25,000 penalty units for bodies corporate or up to twice the amount of consideration received or receivable may apply to promoters of tax exploitation schemes under Division 290 of Schedule 1 to the Taxation Administration Act 1953. The Commissioner can also apply to the Federal Court of Australia for restraining and performance injunctions against promoters where prohibited conduct has occurred, is occurring or is proposed.*

***Note 5:** In appropriate cases possible sanctions under criminal law may also apply. Where a taxpayer makes a voluntary disclosure and that disclosure indicates possible criminal offences, the Commonwealth Director of Public Prosecutions has indicated that favourable consideration will be given to granting an indemnity from criminal prosecution in relation to the taxpayer's involvement in the scheme where:*

- *the case does not exhibit a significant degree of criminality by the taxpayer*
- *the taxpayer provides information about how the arrangements worked, including the role and identity of the promoter, and*
- *the taxpayer co-operates with the investigation and consequential proceedings.*

***Note 6**: Where appropriate, section 167 of the ITAA 1936 may be used to determine the amount of taxable income upon which the taxpayer should be assessed, see Law Administration Practice Statements, PS LA 2007/7 and PS LA 2007/24.*

***Note 7:** A registered tax agent may have their registration cancelled or suspended by the Tax Practitioners Board under the Tax Agent Services Act 2009 for breach of a condition of registration including being penalised for being a promoter of a tax exploitation scheme.*

***Note 8**: The Commissioner may amend an assessment at any time where he is of the opinion there has been fraud or evasion. See Law Administration Practice Statement PS LA 2008/6.*

Amendment history

Date	Comment
3 May 2024	Updated Tax Agent tip off hotline number
19 January 2024	Updated ATO tip-off hotline numbers

References

Subject references:

- Double Tax Agreements
- New Zealand foreign trusts
- Source

- Non-resident trusts

Legislative references:

Income Tax Assessment Act 1936
- Section 99
- Section 99A
- Part III Division 6
- Part III Division 13
- Part IVA

Income Tax Assessment Act 1997
- Section 6-5
- Section 6-10
- Section 8-1

Taxation Administration Act 1953
- Division 290
- Part 2-5

Superannuation Guarantee (Administration) Act 1992
- Section 30

A New Tax System (Goods and Services Tax) Act 1999
- Section 9-5
- Section 11-20

Related Practice Statements:
- PS LA 2008/15

Related Ruling:
- TR 2005/14

Related Taxpayer Alerts
- TA 2004/4

Other references
- Australia/New Zealand Double Tax Agreement

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