



White Paper - N^o 9

The IRD's Individual Residency Tax Grab

Covisory

Governments try to increase their revenue. In itself that is nothing new. Particularly in times of recession, governments often introduce new taxes or try to broaden the scope of existing ones. Whilst the New Zealand government has certainly brought in a raft of new tax provisions over the past decade, it is clear that the main growth in tax take in New Zealand has come from the broadening of interpretations of tax laws and the enforcement of general anti-avoidance provisions, rather than from new taxes.

One area where broader scope has been particularly evident can be seen in the IRD's new Interpretation Statement on individual tax residency. The old rules dated back to Public Information Bulletin no. 180, issued in June 1989. The IRD has been less than subtle in expanding its interpretation of the rules, despite an environment of minimal legislative and judicial change, in its latest epistle on individual tax residency, IS 14/01, issued in March 2014.

Whilst the law has not changed, the IRD's interpretation of it has. So why is this important?

Put simply, the rules about tax residency affect the following people:

- People trying to leave New Zealand and break their tax residency. They will now find New Zealand's tax grip on them harder to break than they previously thought.
- People moving to countries with which New Zealand does not have double tax agreements or countries that have lower tax rates than ours. For them the change is even more significant.
- People moving to or returning to New Zealand. They may inadvertently end up in New Zealand's tax net sooner than they would have thought the case, especially if they are not coming from a double tax agreement country.
- Transitional residents who are in New Zealand either temporarily, or are returning to New Zealand from overseas. They may find their four-year concessional tax window actually started a lot earlier than they thought.

As an example, consider an expatriate Kiwi couple who have retained a beach property in New Zealand. They are now at risk of being considered to be New Zealand income tax residents under the new interpretation statement, even if the property is owned in a family trust.

The IRD released IS 14/01 on 6 March 2014 after a couple of iterations in draft format. It is effective from 1 April 2014 onwards. This is the IRD's new view, so it is not necessarily supported by significant changes in case law. The good news is that up to 31 March 2014 the IRD will continue to apply its old rules under PIB 180. However, just because you were considered to be non-resident to 31 March 2014 doesn't mean that your position won't change after that date.

The relevance of New Zealand Tax Residency for individuals

New Zealand considers itself to be a capital-exporting country, and as such the government seeks to tax its residents on their worldwide income and assets. An individual New Zealand tax resident is taxed on their worldwide earnings and assets in New Zealand, whether or not the gains or profits are physically brought back to New Zealand. Some of these gains can be taxed on a phantom or unrealised basis before the actual income is physically received, as well.

By comparison, a non-resident is only taxed in New Zealand on what is considered to be New Zealand-sourced income. Specific rules identify what income is considered to be sourced in New Zealand or overseas.

Importantly, tax residence is not the same as permanent residence or citizenship for immigration purposes. A person may be a tax resident in New Zealand without being a permanent resident or a citizen for immigration purposes.

So what are the rules for tax residency?

Basically there are two tests for tax residency. The first is the physical presence test and the second is the permanent place of abode test.

According to the physical presence test, an individual will be tax resident in New Zealand if they are physically present in New Zealand for more than 183 days in any 365 day period. A 'day' means part of a day. Once the 183 days has been exceeded, a person is considered to be tax resident here from the first of those days.

The days do not need to be continuous and the physical presence test picks up all the time spent in New Zealand, irrespective of the purpose or intention of the person.

Once a person is tax resident, they need to be out of New Zealand for 325 days in any 365-day period to be considered non-resident, calculated on the same basis. They are considered to be non-resident from the first of the 325 days and the days need not be continuous. Note that there are special rules for individuals who travel overseas in the service of the New Zealand government: they are considered to be New Zealand tax residents.

Irrespective of whether a person has met the day test, they will be considered to be tax resident in New Zealand if they have a permanent place of abode in New Zealand. This is where the changes made in IS 14/01 are important. Whilst the day test rules have not changed, the IRD's interpretation of what constitutes a permanent place of abode has changed - and that is the issue. The new Interpretation Statement means that you may need to review your position under the new rules.

What is a 'permanent place of abode'?

First of all, it is necessary to consider whether an individual has a permanent place of abode in New Zealand - not whether they also have one overseas. The IRD will consider whether there is a permanent place of abode overseas if there is some question about whether a person is likely to return or not, as well as under double tax agreements (more on this later). The permanent place of abode test is the overriding residence test for individuals and is the one that the IRD will focus on, even if an individual is not resident under the physical presence test.

A permanent place of abode requires an individual to have access to a dwelling in New Zealand that is available and is not temporary. For example, anyone can book into a hotel or motel, but this isn't enough to be a permanent place of abode.

There are two steps involved: the first is to determine whether there is a place of abode in New Zealand or not, and the second is to assess the strength of the individual's ties to New Zealand to determine whether they are enough to give them a **permanent** place of abode rather than simply a place of abode.

A place of abode may be owned by an individual, rented, or owned by a family trust. It may also be a parent's house where the individual has lived in the past with parents or family members. However, just because your parents are alive and living in the house you grew up in doesn't necessarily mean that you have a permanent place of abode; for instance, if you have been absent from home for many years, and you are now aged 50 with a partner and children.

Many people believe that because their family home is owned in a family trust, it isn't available to them and is therefore not a permanent place of abode. This is not correct - and never has been.

The IRD's view remains that a trust-owned property is available for personal use. Moreover, one of the important extensions to the IRD's view is that even if you have rented out a property, whether or not it was your former home in New Zealand, that in itself could be considered to be available to you. This applies even if it is rented on a fixed-term basis. At paragraph 70, IS 14/01 states:

In addition, the requirement does not mean that the place of abode must be vacant or able to be occupied immediately. It is not uncommon for someone who is temporarily overseas to lease their property to a third party, or to enable someone else to use it during their absence. A place of abode can be someone's permanent place of abode even if it is rented to or otherwise used by someone else while the person is residing in a foreign jurisdiction.

And further at paragraph 72:

The above cases show that a property does not necessarily cease to be a person's permanent place of abode merely because the person is temporarily absent and during that period the dwelling is let out. If the person is able to use the property as a place to live in on an enduring basis, then it can still be a permanent place of abode, irrespective of whether the property is otherwise occupied for limited periods of time.

The IRD does concede, however, that an investment property would not ordinarily be viewed as a person's permanent place of abode, unless it had previously been their home or there were other significant factors.

All this shows that the IRD intends to look more carefully at instances where a place of abode is 'available' in New Zealand - even if it is rented out on a fixed-term basis.

Once the IRD has determined that a person has a place of abode available in New Zealand, it is then necessary to consider the strength of their ties to New Zealand to determine if it is a permanent place of abode.

There is no magic bullet here, no single test that can be applied to determine whether a person is resident or not, as is the case with the mechanically factual physical presence test. A permanent place of abode is a subjective interpretation. It involves the weighing up of a

person's ties to New Zealand by an IRD staff member and ultimately, in the case of a dispute, the courts. The strength of a person's ties to New Zealand is determined by looking at a whole range of factors.

In determining whether a person's place of abode is a permanent place of abode, the following things will be considered:

- a. **The person's intention.** This could include for instance a case where a person was taking a fixed term contract overseas for a period of up to say 3 years, with a job waiting in New Zealand upon their return. In this case the IRD would consider that they continued to have a permanent place of abode in New Zealand. However, this can be more difficult to apply when a person has been absent from New Zealand for a substantial period or is here only intermittently.

As a general rule, the longer a person is present in New Zealand, the more likely it is that their place of abode here is their permanent place of abode. Conversely, the longer a person is absent from New Zealand the less likely it is that their place of abode here will be their permanent place of abode. But if a person spent 3 to 6 months here every year, for instance, this could easily point to their having a permanent place of abode in New Zealand.

- b. **Links to New Zealand or to a location.** It is also necessary to determine whether a person has links to New Zealand or to a location. For example, the keeping of bank accounts with a bank points to a link to New Zealand, as opposed to the keeping of a property or physical things, which will often be a link to a location of property.

Again, the connection overseas is irrelevant. The consideration is the strength of one's ties to New Zealand, not whether they have stronger ties to another country. All that is required is for a person to have a place of abode in New Zealand, not whether or not they have one overseas. In 1988, there was a significant change to the tax law that brought about the current tax rules; previously, tax residence was based on where a person's home was.

- c. **The period of a person's absence is significant.** As noted earlier, if someone goes overseas for a period of up to three years with a job waiting upon their return, it is more likely that they will be considered to still be New Zealand income tax resident, as they will be considered by the IRD to have a permanent place of abode here. Also, whether regular trips are made back to New Zealand will weigh upon the decision reached by the IRD.
- d. **The location of a person's family is significant.** If a spouse travels overseas to work, but the rest of the family remains in New Zealand, then it is almost inevitable that they will be considered to have a permanent place of abode in New Zealand and be subject to tax here on their worldwide income. If a couple are separated, care needs to be taken with regular visits to New Zealand to see family, so that the IRD will not misinterpret matters and see it as an enduring connection to New Zealand, particularly where there is a property available. This was recently shown in the case *Diamond v CIR (2014) 26 NZTC 21,093*, in which the IRD tried to argue, ultimately unsuccessfully, that his ex-wife's house, or alternatively a rental property, was a permanent place of abode for Mr Diamond, despite the fact that he substantially lived and worked overseas.
- e. **Employment, business, and economic links to New Zealand are important.** If all or part of the person's employment, business, trade, or profession is carried out in New Zealand, this may indicate an enduring association with New Zealand. If a person is absent but

retains employment, business, trade, or professional ties to New Zealand, the retention of those ties may indicate an enduring association with New Zealand as well. Examples include university academics, who spend periods overseas but generally retain their employment with the university during their absence. When they take sabbatical leave, they are still employed and being paid by the university.

- f. **Bank accounts and credit card facilities** point to on-going links to New Zealand, as do investments, savings, and superannuation arrangements.
- g. **Personal property** is also another key indicator. If a person has left New Zealand but retained their furniture and property here in storage, that points to an enduring link to New Zealand. Again, it is not determinative in itself, but it will be a factor that is added together with others to get an overall indication of a person's links and ties to New Zealand.
- h. **Where an individual takes their holidays** may also be a telltale sign of an enduring link to New Zealand, especially if they regularly come back to New Zealand for holidays. Whilst the visits may be to see ageing parents or other family members, regular visits to New Zealand of themselves can point to an enduring link.

No single factor is enough to catch an individual and to give them a permanent place of abode, even if they have a place of abode in New Zealand. The IRD will look at the overall picture and see if there are enough links of sufficient strength to point to their being a permanent place of abode here.

Some case examples

IS 14/01 usefully provides several examples. The following cases may seem straightforward, but they give an insight into the IRD's thought process:

Example 1

123. **Facts:** Cate, who is normally resident in New Zealand, is seconded to Canada in connection with her employment for a fixed period of three years. Cate intends to return to New Zealand after the period of secondment, and the terms of her secondment are such that her job will definitely be available for her to return to. Cate's partner and children accompany her to Canada. The family home in New Zealand is owned by a family trust, of which Cate's parents and their solicitor are trustees. Cate, her partner and their children, together with Cate's siblings and their families, are the beneficiaries of the trust. The house is rented out while the family is in Canada. Cate and her family leave their furniture and most of their other personal belongings in storage in New Zealand during their absence. Cate retains her New Zealand investments and her connections with several professional and sporting associations here. Cate and her family return to New Zealand each year to spend Christmas with family and have a summer holiday here.

124. **Result:** Cate has a permanent place of abode in New Zealand during the period of her absence.

125. **Explanation:** Cate has a place of abode in New Zealand - being the house she and her family lived in before departing for Canada. Although the house is owned in trust, Cate's parents are trustees, and the family are all beneficiaries. It is reasonable to infer that the trustees will enable the family to resume living in the family home upon their return. Cate has retained ties with New Zealand - she still has a dwelling and most of

her personal property here, maintains membership of several professional and sporting associations, and has investments here. Cate also retains employment ties with New Zealand, as her secondment is in connection with her New Zealand employment. Cate has a definite intention to return to New Zealand at the end of the three-year secondment and to resume living in the family home here.

126. Although Cate will be absent from New Zealand for three years, this is not inconsistent with her place of abode here remaining a permanent place of abode. All of the relevant factors must be weighed up. In this case, the strength of Cate's enduring connections with New Zealand and with her place of abode here are sufficient to establish that her home here continues to be a permanent place of abode.

127. If Cate had not intended to return to New Zealand after the period of secondment, but rather to take up other work opportunities in Canada, and the terms of her secondment were such that her employer in New Zealand would make its best endeavours to have a position available for her to return to should she wish, but could not guarantee this, and if Cate and her family had taken most of their furniture and other belongings with them, then Cate would not have a permanent place of abode in New Zealand.

Example 2

132. **Facts:** Li is a New Zealand citizen who has extensive business interests in New Zealand and Australia. Li owns a house in each country, and both houses are continuously available for his use. Li spends most of his time in Australia, but he regularly travels to New Zealand in connection with his business here. In aggregate, Li spends up to five months of the year in New Zealand, staying in his house here most of the time he is here (except when his business requires him to be elsewhere in New Zealand). These trips vary in length from two days up to several weeks. Li has significant investments in New Zealand, and he is a member of a number of cultural and sporting associations here. Li's immediate family live in Australia.

133. **Result:** Li has a permanent place of abode in New Zealand.

134. **Explanation:** Li has a place of abode in New Zealand - being the house he owns here. He has significant connections with New Zealand because he has extensive business interests here, a house here continually at his disposal, and connections with New Zealand sporting and cultural associations.

135. Li's presence in New Zealand is generally for short periods; that is, his presence here is not of a continuous nature. However, the fact that Li has substantial connections with New Zealand, and that these connections are maintained through regular trips to New Zealand, indicate that his place of abode here is a permanent place of abode. It is a place in which he can (and does) live when required, with which he has a durable connection, and that is a current focal point of his living. Although he also has a place of abode in Australia, Li usually or typically lives in both of his places of abode on an enduring rather than temporary basis.

To summarise:

- A person must have a dwelling in New Zealand to have a permanent place of abode here. However, the existence of a dwelling in which the person could live will not, of itself, give rise to tax residence in New Zealand.
- A place of abode will be a person's permanent place of abode if it is a lasting or enduring place where they usually live, or a place in which they can live or dwell when required, showing that they have a durable connection with a location in New Zealand that is a current focal point of their living.
- It must also be an enduring link rather than a temporary one, so motels and hotels typically do not count.
- To determine whether a place of abode is a person's permanent place of abode, the continuity, durability, and duration of the person's presence in New Zealand must be considered.
- All relevant factors are weighed up and considered to determine whether a person has a permanent place of abode in New Zealand.
- Whether a person has a permanent place of abode overseas or not is not relevant.

Implications

If you consider that you have relinquished your permanent place of abode in New Zealand, you will need to reconsider your position under the new rules, as the old rules no longer apply.

We can manage a person's links, either to make them tax resident or cease their being tax resident, in terms of both the physical presence test and the permanent place of abode test, by working with them to strengthen or weaken their ties to New Zealand. By changing certain factors, a person's links to New Zealand can be altered and thus their tax residency.

Nigel Smith

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Contact details

TELEPHONE: +64 9 307 1777 EMAIL: enquiries@covisory.com

POST : PO Box 137215 Parnell, Auckland 1151