11th November 2016

#019

Addressing hybrid mismatch arrangements
C/- Deputy Commissioner, Policy and Strategy
Inland Revenue Department
PO Box 2198
WELLINGTON 6140

Dear Sir or Madam,

Submission on Addressing hybrid mismatch arrangements

We thank you for the additional time granted to submit on this topic.

The focus of our submission is Submission point 7D relating to the OECD's Recommendation 5.2.

We disagree with the suggestion made in paragraphs 7.28 and 7.29 of the discussion document that trust classifieds as foreign trusts under part HC of the Income Tax Act 2007 represent "reverse hybrids". Accordingly, applying the OECD's Recommendation 5.2 the discussion document suggests foreign trusts should become taxable on their non-New Zealand sourced income "*to the extent that that income is not taxed in any other country*" (Paragraph 7.29).

We consider this proposal is based on an incorrect assumption that the Income Tax Act 2007 ("the Act") attributes trust income to the settlor (so therefore a trust has look through tax treatment and is fiscally transparent).

The Act treats a trust as a separate person for income tax purposes, and not as a fiscally transparent entity similar to a look-through company or the United States "Grantor Trust" regime. Under sections HC 6 and HC 7 of the Act, income derived by a trustee of trust may be distributed to a beneficiary in which case it is effectively treated as a deduction for the trustees. If no allocation is made, then the income is treated as that of the trustees. This is not the characteristic of a fiscally transparent entity. The trust is not a fiscally transparent entity but fiscally opaque. On that basis a foreign trust could not be a reverse hybrid and Recommendation 5.2 should not apply.

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We are also concerned that this proposal is contrary to current tax policy regarding the taxation of non-New Zealand sourced income derived by non-residents. Section BD 1(5) of the Act excludes such income from the definition of assessable income. With regard to trusts, section HC 26 treats foreign-sourced income derived by a New Zealand resident trustee as exempt income where no settlor of the trust is tax resident in New Zealand (other than a transitional resident).

Furthermore we note paragraph 4.18 of the recent *Government Inquiry into Foreign Trust Disclosure Rules* undertaken by Mr John Shewan commented:

> *"The Inquiry considers that the current tax treatment of foreign trusts is based on design considerations that are entirely consistent with the coherent set of core principles that underpin New Zealand tax policy."*

Mr Shewan's Inquiry had a very wide-ranging brief and given his endorsement of the current tax policy, we see no basis for what would be a dramatic change of established tax policy particularly as it appears to be based on a misunderstanding of how the Act currently regards a trust.

We would be pleased to discuss any of the issues raised in this submission with officials.

Yours faithfully,
BAUCHER CONSULTING LIMITED

Terry Baucher LLB M.ATAINZ TEP
Director