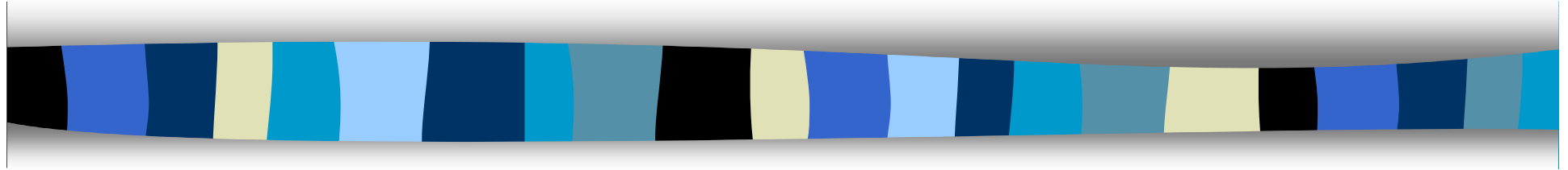


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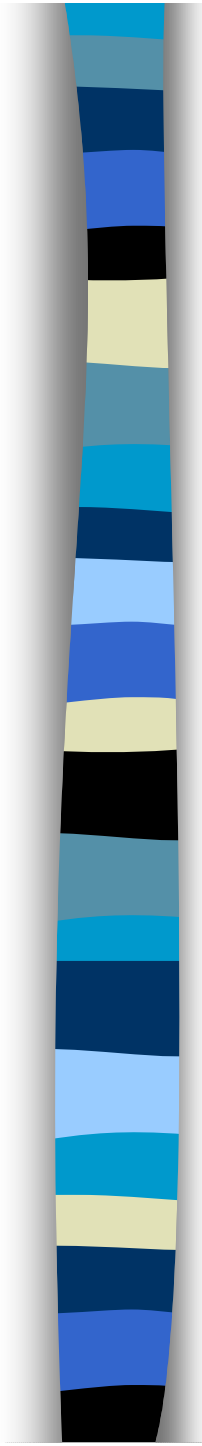


New Associated Persons
Rules



Introduction

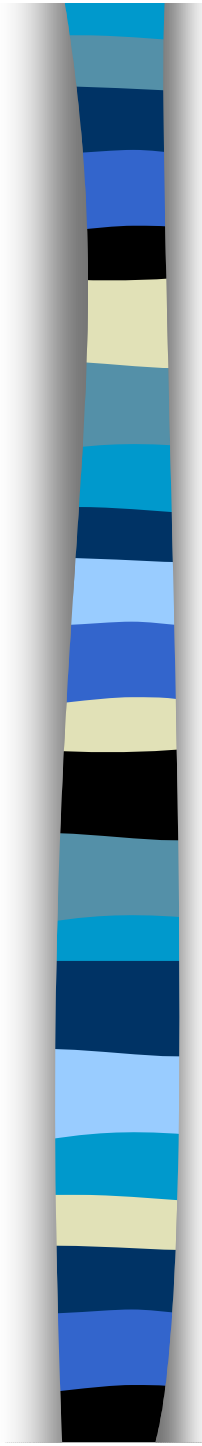
- Why are the associated persons rules important?
- Overview of the current rules
- Shortcomings of the current rules
- The new rules explained
- Problems with the new rules



Why are the associated persons rules important?

Because they make gains taxable that otherwise would not have been, especially in relation to land. Broadly speaking the following categories can arise:

- Landfill elections;
- Disposal within 10 years where associate deals in land, is developer or has a subdivision business;
- Disposal within 10 years where improvements are made and associate carried on business of erecting buildings;



Why are the associated persons rules important?

- Certain cases where land is sold by an associate.
- There are other reasons why the associated persons tests are important, but we do not cover these in the present seminar. Very briefly, these are for deemed dividend purposes, the international tax rules, and also Fringe Benefit Tax rules.



Overview of the current rules

Who are currently associated persons for the purposes of land transactions?

- Two companies if a group of persons holds more than 50% of the voting or market value interest in the company, or control the company.
- A company and shareholder if the shareholder holds a voting or market value interest of at least 25%.



Overview of the current rules

- Two relatives if they are spouses, civil union partners, one is the infant child of the other, or they are in a de facto relationship.
- A trustee and a person if the person's relative (usually spouse or infant child) can benefit under the trust.
- Partnership and partner.
- Partnership and person associated with partner.



Shortcomings of the current rules

The following tests are absent:

- trustee-beneficiary test;
- trustee-settlor test;
- two trustees with a common settlor test;
- settlor-beneficiary test;
- universal tri-partite test;
- aggregation of interest of associated persons in two companies and company-shareholder tests



The New Rules

- The ambit of associated persons rules are significantly widened under the new rules.
- Most of the above weaknesses are removed, and planning opportunities have been minimized, if not eliminated altogether.
- It is important to understand the new rules in their entirety, as they have been almost totally recast. I therefore cover them below.



Summary of the New Rules – Land Only

- Company Rules (YB 2 – 50%, YB 3 – 25%)
- Relatives (YB 4)
- Trusts (YB 7 - Common settlor; YB 8 - Trustee and Settlor; YB 11 - Trustee and POA)
- Partnerships (YB 12 – Partnership and partner)
- Tripartite (YB 14)



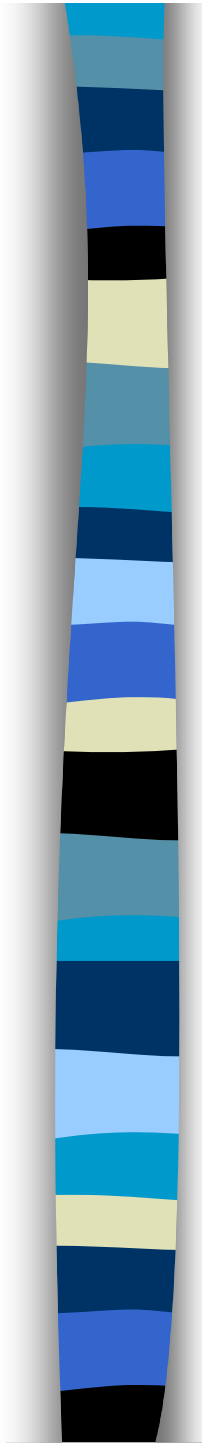
New Section YB 2 - Two Companies

- Two companies are associated persons if a group of persons exists whose total voting or common market value interests are 50% or more.
- They will also be associated if there is common control by other means.
- The “other means” test survives from the old wording. Submission on the Bill requested this be removed, but the submission was not accepted. It is not clear how much this adds to the test, but the IRD considered that it was useful to retain it as a backstop.



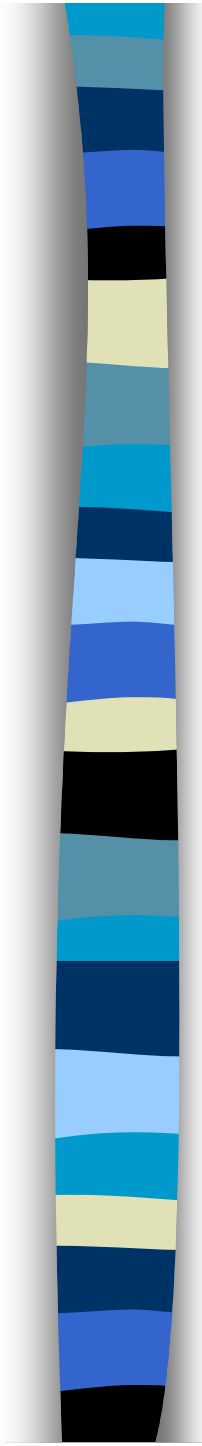
Aggregation rule in section YB 2

- This rule operates by treating a person as holding all the shares held by anyone they are associated with.
- There is a similar rule in s YB 3, but that rule is limited where land transactions apply. A same limitation was missing at in the Bill reported back at select committee stage, but has been rectified by SOP see SOP 4 August 2009.
- There are exemptions for managed funds and the international tax rules.



New Rules - YB 3 A company and a person with 25% or greater interest

- Fairly simple in that if you own at least 25% of the shares (voting or market value interest) then you are associated with the company.
- However, there are two aggregation of interest rules in the section. The first section applies to all transactions, and the second applies only to land transactions.
- From the commentary on the Bill it is clear that the first test is intended to be switched off for the land provisions, and general principles of statutory interpretation would confirm this, although it is not explicit.



New Rules - YB 3 A company and a person with 25% or greater interest

- For the purposes of the land rules only those associated with you will be counted as holding your shares, and you holding theirs if you are associated under sections YB 4(1)(b) and (2) to (4), YB 7, YB 8, and YB 10 to YB 14.
- The ambit of this aggregation of interest rule is further explained in the example below.
- The rule only applies once per person. In other words, if this rule deems you to hold shares, then when the rule is applied in relation to another person, you will not be deemed to hold those shares.
- One other point, this section refers to a person other than a company, and it makes it clear that it includes a company where that company is a corporate trustee.



New Rules - YB 4 Two relatives

- For the purposes of the land rules this merely reenacts the old law.
- Here a person, their spouse etc and infant natural and adopted children are associated.



New Rules - YB 5 Person and trustee for relative

- Does NOT apply for the land provisions.



New Rules - YB 6 Trustee and Beneficiary

- This provision does NOT apply for the land provisions.
- In earlier drafts of the law this provision did apply to the land provisions. However, it was quickly withdrawn when it came to light that all customers of a North Island electricity supplier would become associated with the electricity supplier because it was structured as a trading trust.



New Rules - YB 7 Two Trustees with Common Settlor

- This test is self explanatory, and does exactly what it says. Where the settlor of two trusts are the same, the trusts will be associated.
- Note here that nominee settlors are not settlors for the purposes of the law. For example, where a firm of solicitors settle a trust for a client, it is still the client that will be the real settlor.
- Also note the very wide ambit of the special tax definition of settlor.
- For the purposes of this section a person and their spouse, etc are treated as the same settlor.



New Rules - YB 8 Trustee and Settlor

- This is a new rule, and could increase the number of associates dramatically.
- Here the trustee and the settlor are associated person.
- The common situation is that either one of these could be a developer, in which case the one will taint the other.
- A specific exclusion for charitable trusts has been inserted. The specific issue here is not so much that charities are associated with land developers, but that through the operation of the tri-partite test all those making donations to charities could be associated, with obvious ridiculous results.
- See also the GST definition of associated persons is being updated to make better provision for charities.



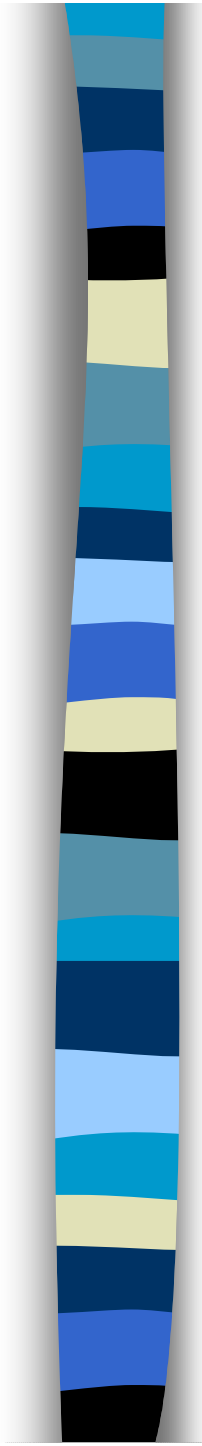
New Rules - YB 9 Settlor and beneficiary

- This section does NOT apply for the purposes of the land provisions.



New Rules - YB 10 Settlor excludes service provider

- This rule is included for clarification to exclude professional service providers from the ambit of the rules.



New Rules - YB 11 Trustee and person with power to appoint them

- This section raises interesting and difficult questions, and its interpretation is not clear.
- It seems clear enough on the face of it. If you have the power to appoint trustees then you are associated with the trustees.
- But, what if the power of appointment is vested in the majority of the trustees of the trust. Will each trustee have the power to appoint? And if so, will it be that trustee in their personal capacity, or in their capacity as a trustee?



New Rules - YB 11 Cont.

- Case law gives some guidance in this context. See *Case L 72* (1989) 11 NZTC 1,419.
- The main points from the judgment is this: Trustees are liable to tax, and are therefore taxpayers under the Act. They are separate taxpayers from the taxpayers that the trustees are in their own capacity.
- In *L 72* the question was whether the trustees as one taxpayer carried on the business of trading in land when one of the trustees did so in his personal capacity.
- The Court held that the trustees did not carry on the business, as they were a separate taxpayer from the person, and they did not carry on the business of trading in land.



New Rules - YB 11 Cont.

- The usefulness of *Case L 72* is therefore limited. That case is more about the trustees as a taxpayer, and the new section YB 11 is all about the trustees as a person.
- Person is not defined in the ITA 2007, so the default provision in the Interpretation Act 1999 would apply. That Act includes unincorporated bodies as persons, and trustees would qualify as such.
- There is no doubt that trustees, acting in their capacity as trustees, are a separate person from the trustees acting in their personal capacity.
- So, when the majority of trustees have the power of appointment of trustees, are they acting in their capacity as trustees, or in their capacity as private persons?



New Rules - YB 11 Cont.

- There could be three alternatives. (1) They are a separate person in their capacity as trustees; (2) They are not a separate person, as they are acting in their personal capacity; or (3) a whole new person is created, vis, the majority of trustees acting in their capacity as appointors of the trust.
- If option (1) or (3) are selected then situations where the majority of trustees have the power of appointment should not create difficulties. However, if (2) is correct, then professionals acting as trustees with the power of appointment of trustees need to either retire from the trust, or amend the trust deed to ensure that they have no power of appointment.
- The matter is clear-cut where a professional advisor holds the power of appointment personally as protector.



New Rules - YB 12 Partnership and partner

- Simple rule, a partnership and a partner in the partnership are associated persons.
- But what about joint venture partners and the joint venture?
- There is no mention of this in the associated persons rules.
- Perhaps because the ITA does not consider an unincorporated joint venture to be a person or a taxpayer. However, it may be a person, cf the Interpretation Act definition.
- If it is a person, then the joint venture partners would not be associated with it.
- The question may only be academic, but it does deserve further consideration.
- Note, the GST Act definition of a person includes joint ventures.



New Rules - YB 12 Partnership and partner

- There is a special rule aggregating limited partnerships and their limited partners.
- The rule is akin to the rule for association between a company and a person other than a company in that it provides for a 25% interest threshold.
- In addition, an aggregation rule is also included which aggregates associates' interest.
- An SOP also amends the drafting oversight that did not limit the aggregation rule here for land transactions.



New Rules - YB 14 Tripartite Test

- Section YB 13 was repealed before it even passed.
- Section YB 14 contains the dreaded tripartite test.
- It says that if A is associated with C, and C is associated with B under a different test, then A and B will be associated.
- Excluded from the question regarding association are persons associated by virtue of the tripartite test.
- In addition, it does not apply where person B is associated with person C under section YB 2, and person C is associated with person A under section YB 3.
- The effect of this is rather wide ranging, and is best explained by way of example. See below.



New Rules - YB 15 and YB 16 exemptions

- Section YB 15 contains some exceptions for employee trusts and YB 16 for charitable organisations and some other cases.



New Rules, when do they come into force?

- The Bill is currently in the House, and some SOPs have been added. The Bill is at the Committee of the Whole House Stage, so should go through any minute (perhaps 8 or 9 September 2009).
- For land provisions the new rules will apply to all land purchased after Royal Assent. Where section CB 11 applies (improvements to land), if the time the improvements were begun was after Royal Assent then the new rules will also apply.



Contact Persons

Sybrand specializes in tax law and is based in our City office.

He can help with:

- Complex disputes and liaising with the IRD;
- Second opinions on technical issues (especially international tax and GST);
- Structuring;
- Making submission to the IRD on policy issues.

He can be reached on 03 379 4383.

For up to date tax commentary see Sybrand's postings on <http://www.talktax.co.nz/>



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