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Diamond case - CIR's appeal unsuccessful

The CA, in December, dismissed an appeal by the CIR and held that the HC was correct in concluding that Mr Diamond did not have a permanent place of abode (PPA) in NZ for the years in question.

In my opinion, this appeal should not have been pursued - therefore, the CA's decision is very welcome.

By way of background, Mr Diamond is a former NZ solider who worked in PNG and Iraq providing security services for the period 31 March 2004 to 31 March 2007.

During the years in question, he owned a half share in a number of properties and his ex-wife held the other share. He did not live in any of the properties but he did stay with his ex-wife for 2 to 5 days to visit his children. Most of his foreign income was spent in NZ on mortgage payments and on his children.

The CIR held the view that Mr Diamond had a PPA in NZ and was therefore a NZ tax resident.

The HC, and now the CA, has held that Mr Diamond did not have a PPA and was therefore not a NZ tax resident for the years in question.

Legal Privilege vs Tax Advice Privilege

Case study

A NZ trust holds various assets (cash, shares, property). The trustees of the trust wish to distribute the assets equally between the two beneficiaries.

One beneficiary lives in NZ and the other in Australia. The trustees approach their tax practitioner, by email, requesting structuring advice to ensure that the proposed distribution occurs in a tax effective manner.

The practitioner provides the trustees with three different structure options and the advice includes the following elements:

(a) tax advice on which beneficiary should receive specific assets (for instance, Australian equity to be distributed to the Australian beneficiary etc);

(b) advice (tax and commercial) on different holding structures - for instance, company law requirements, administration of the structure and compliance obligations (for accounting and tax);

(c) tax implications - the tax obligations/implications under each option; and

(d) Appendix One includes the three options depicted as structure diagrams and Appendix Two provides a numerical example to illustrate the practical tax implications.

Inland Revenue, a couple of years later, as part of a risk review of the trust, sends an information demand to the trustees relating to the distribution of assets - requesting all information pertaining to that transaction.

If the practitioner is a tax lawyer:

The advice (and all communication for the purpose of obtaining this advice) will be legally privileged. As such, while the various legal documents giving effect to the distribution may need to be provided, the underlying tax structuring advice and communications relating to the same will not be disclosed.

If the practitioner is a tax accountant:

The following information has to be disclosed:

- written communication from the trustees to the advisor setting out their request for advice;
- facts and assumptions in the advice - including assumptions etc made when setting out the three structure options;
- all advice not relating to tax laws - company law advice, advice on compliance obligations, discussion regarding trust law etc;
- any tax advice/discussion relating to Australian tax laws; and
- the appendices - structure diagram and numerical example.

The above is a (very) simple illustration of the practical difference between legal and tax advice privilege.

The example shows how beneficial legal privilege is particularly when tax advice relates to structuring or other complex transactions (such as setting up or the sale of a business, restructuring existing asset ownership structures, raising capital, etc).

Outlined below is a summary of legal privilege compared to tax advice privilege.

Legal advice privilege

Applies to all communications a person has with their legal advisor:

(a) which are intended to be confidential; and

(b) are made in the course of or for the purpose of obtaining professional legal services.

"Legal advisor" is a lawyer, being a person who holds a current practising certificate as a barrister or as a barrister and solicitor.

This privilege belongs to the client, and not the lawyer. As such, only the client can waive privilege.

Tax advice privilege

Is a statutory non-disclosure right that attaches to "tax advice documents". To be eligible, the document must have been intended to be confidential and:

(a) created by the client to instruct the tax advisor; or

(b) created by the tax advisor to to provide confidential advice on the operation and effect of tax laws; or

(c) record previous tax advice, or research or analysis, by the tax advisor for the main purpose of providing tax advice.

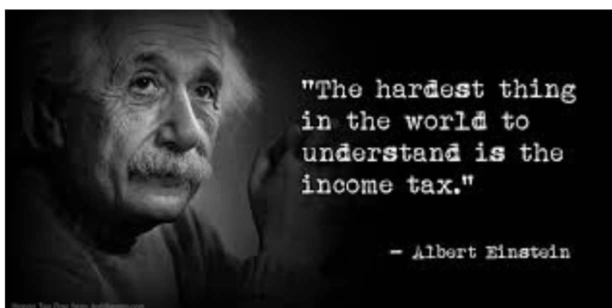
When an information demand is made by Inland Revenue, the client (or their tax advisor) must advise the Commissioner that the document is a tax advice document and disclose tax contextual information (see below) contained in that tax advice document.

Tax contextual information - what do you have to disclose?

- Facts and assumptions relating to the transaction identified in the information demand - this transaction can be one that has occurred, will occur, or expected to occur;
- A description of steps involved in performing the transaction;
- Advice on the operation of laws, other than tax laws, to the transaction;
- Advice on the operation or effect of tax laws relating to the collection of debt owed by the taxpayer to Inland Revenue; and
- All workpapers, calculations, etc relating to the preparation of financial statements and tax returns.

Who is a tax advisor?

A natural person who belongs to an "approved advisor group". The organisations currently approved by the Commissioner as being part of this group are: Accountants + Tax Agents Institute of New Zealand, CPA Australia and Chartered Accountants Australia and New Zealand.



What is NOT a tax advice document?

Documents that simply record or state: facts, transactions, content of transactions, structure diagrams, calculations, summary of facts, transfer pricing reports - even if these documents form part of an overall package of tax advice.

Start ups - cashing out tax losses

While not enacted as yet, a Bill currently before Parliament has proposals allowing start-ups to claim up to 28% of their tax losses in any given year, subject to specified criteria. Once enacted, these provisions will apply with effect from 1 April 2015.

To benefit from this, the start-up must be NZ tax resident corporate, incur R&D expenditure and have a tax loss in the year in question. There is also, what is being referred to as the wage industry criteria which requires that at lease 20% of the labour costs of the start up has to be R&D labour.

Under the current proposal, post-development expenditure is excluded from the definition of R&D - the definition mimics NZIAS 38.

If a start-up is eligible, the tax losses that can be cashed out is limited to the lesser of:

(a) $500,000 of tax losses multiplied by 28%;

(b) The company's net loss for the year multiplied by 28%;

(c) The company's R&D expenditure multiplied by 28%; or

(d) The company's R&D labour expenditure multiplied by 1.5 and then multiplied by 28%.

This cashing out mechanism is intended to be simply a cashflow timing benefit - the start up has to repay the cashed out losses when specific events happen - such as, if the R&D asset is sold or transferred thereby realising a return on the investment, if the company is would up, if 90% of the company is sold, etc. The amount to repay is adjusted for any income tax paid by the start-up until the trigger event occurs.