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Our ref

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Dear Susan,

**Unit trusts - whether more than one unit holder is required  
(Issues paper No. 8 - ref: IRRUIP8)**

We have reviewed the issues paper entitled *Unit trusts – whether more than one unit holder is required* and strongly agree with the Commissioner’s preliminary conclusion that the definition of “unit trust” in section YA 1 of the Income Tax Act 2007 (“the Act”) may encompass a trust with a single subscriber, purchaser or contributor (i.e. unit holder). We note that this is contrary to the Commissioner’s previously published view in BR Pub 95/5A, that a unit trust may have more than one unit holder.

While we note that the issues paper sets out a range of different arguments for and against the view that a single subscriber trust falls within the Act’s definition of “unit trust”, we comment on specific aspects of the issues paper, below.

**Key conclusion – facilities to participate**

Paragraph (a) of the definition of “unit trust” in section YA 1 states:

**unit trust—**

- (a) means a scheme or arrangement that is made for the purpose or has the effect of providing facilities for subscribers, purchasers, or contributors to participate, as beneficiaries under a trust, in income and capital gains arising from the property that is subject to the trust; and [emphasis added]

We agree with comments made in the issues paper that on an ordinary reading of paragraph (a), the focus is on whether a scheme or arrangement is made for the purpose, or has the effect, of providing facilities for subscribers, purchasers or contributors. We consider the choice of wording in paragraph (a), and more specifically, the inclusion of the word “facilities” supports the view that a single subscriber trust can be a unit trust for income tax purposes as long as the trust provides the requisite means to enable more than one subscriber, purchaser or contributor to participate.

### **Key question – what constitutes facilities?**

The key question is how to ascertain whether the requisite “facilities” exist. As noted in the issues paper, whether the requisite facilities exist can be tested by looking at the legal relations and constituting documents to determine whether the facilities exist legally. Other approaches involve considering whether there is an intention that the scheme or arrangement have more than one subscriber irrespective of how many there are in practice or considering whether there are in fact multiple subscribers under a specific arrangement or scheme.

We agree that the reference to “a scheme or arrangement made for the purpose” in paragraph (a) supports the view that intention may be relevant in determining whether the relevant facilities exist.

We note that the tests outlined above could lead to different outcomes in certain situations. For example, a special purpose vehicle may be established as a unit trust with the trust deed providing for more than one subscriber but in practice there is only one subscriber and there is no intention for the unit trust to have more subscribers. In this scenario, the vehicle would be a unit trust under the Act using the legal relations test but not under the intention test. We note that this is a relatively common investment holding structure, particularly overseas, where the investor is often but not always a widely-held collective investment vehicle.

Another example might be a trust that has a single subscriber but a clear intention to have more subscribers in the future (e.g. during the start-up phase of a unit trust). In this case, the vehicle would be a unit trust under both the legal relations and the intention tests.

We consider the better view is that both the legal relations and intention needs to be tested due to the inclusion of “or” in “*made for the purpose or has the effect of providing facilities*”. We note and acknowledge that the intention test is an objective test to be applied consistently with how intention is determined for other provisions of the Act.

### **Plural and singular import**

Section 33 of the Interpretation Act 1999 states that “[w]ords in the singular include the plural and words in the plural include the singular”. The issues paper considers that section 33 of the Interpretation Act 1999 is insufficient to be able to conclude that a unit trust can have only a single unit holder. This is because section 4(1)(b) of the Interpretation Act 1999 requires the context of the Income Tax Act 2007 to be considered.

The Commissioner’s draft analysis shows that the context does not require the plural only to apply (i.e. the use of the plural can mean that a single unit holder trust can be a unit trust). We agree with this conclusion.

### **Further legislative context (the definition of “public unit trust”)**

We note that the issues paper discusses the PIE rules as relevant legislative context to the interpretation of the definition of “unit trust”. In particular, the paper refers to sections HM 3 and HM 9, which both use the phrase “that would be a unit trust if there were more than 1 subscriber, purchaser or contributor”. The issues paper suggests that these references are

potential evidence that more than one unit holder is required. (For completeness, it considers that this evidence is not conclusive.)

However, the draft analysis does not consider the definition of “public unit trust” (which, prior to the rewrite, was called a “qualifying unit trust”) in section YA 1. The definition of “qualifying unit trust” was first inserted into the Income Tax Act 1994 in 2001, before the introduction of the PIE rules and after the issue of BR Pub 95/5A.

For example, paragraph (b) of the definition of “public unit trust” states:

**public unit trust** means—

...

- (b) a unit trust whose unit holders are 1 or more of the following:
- (i) a public unit trust as described in paragraph (a) or this paragraph:
  - (ii) a group investment fund:
  - (iii) a life insurance company:
  - (iv) a superannuation fund:
  - (v) a unit trust manager, trustee, or person nominated by the manager or the trustee who holds units in the ordinary course of management activities in relation to the unit trust:
  - (vi) a person with an interest of 25% or less in the unit trust, treating all associated persons as 1 person, if regulated offers in respect of the unit trust are made under the Financial Markets Conduct Act 2013:
  - (vii) a person with an interest of 25% or more in the unit trust, treating all associated persons as 1 person, if their interest is 25% or more because of unusual or temporary circumstances, such as the recent establishment or forthcoming termination of the unit trust, and if the unit trust would meet the requirements of any of paragraphs (a), (c), (d), and (e), and if regulated offers in respect of the unit trust are made under the Financial Markets Conduct Act 2013; or [emphasis added]

(We note that paragraph (e) of the public unit trust definition also refers to “*a unit trust whose unit holders are 1 or more of the following...*”)

We consider the public unit trust definition contemplates the existence of a single unit holder trust.

Our analysis is that:

- the definition requires the existence of a unit trust as defined in section YA 1;
- it requires that 1 or more unit holders is of the specified type;
- the first four types of holders could all be the sole unit holder of such a trust. For the remaining types,
  - A unit trust manager/trustee/other person is unlikely to be the sole unit holder;

- By definition a person holding less than 25% of a unit trust cannot be the sole unit holder;
- By implication, a person holding more than 25% as a result of certain circumstances suggests that at some point they have held less than 25% and so cannot be the sole unit holder.

Paragraph (b) of the public unit trust definition therefore contemplates that another public unit trust, a group investment fund, a life insurance company or a superannuation fund could be a single unit holder of a unit trust. At a minimum it does not preclude such a situation, which would be expected if Parliament intended for a unit trust to have more than one unit holder.

We have not researched the history of the definition in any detail. We are therefore unable to explain why this legislative drafting is different to that of the PIE rules. (It may be that the assumption was that as a public unit trust is intended for collective investment purposes, a single unit holder that is itself a collective investment vehicle meets this wider policy objective.)

However, we consider that the paragraph (b) and (e) of the public unit trust definition provides further support for the Commissioner's draft view.

#### **The wider context for use of unit trusts**

(We note that we use unit trust in this section to mean a trust which issues units to investors but not necessarily a trust which meets the ITA definition.)

As noted in the issues paper, unit trusts are established at law and not under statute, though they are regulated in New Zealand. The draft focuses on the Unit Trusts Act 1960 ("the UTA"). It is referred to extensively in the issues paper as legislative context in the interpretation of the tax definition of "unit trust".

Although that is useful, we note that this focus may be of limited use when considering the application of the unit trust definition in an international context. For example, the Foreign Investment Fund rules have traditionally treated foreign superannuation funds as unit trusts. These superannuation funds have never been considered to be within the UTA's scope.

Further, a foreign unit trust is often used for cross-border investment to better meet (compared to a company or other business structure) commercial and tax objectives – for example, Australian unit trusts. In that context, a unit trust is not always a collective investment vehicle.

In short, we consider that the analysis should consider both the international context and how the use of unit trusts has developed since 1960. In our view, they have become more commonplace and have been used beyond the original collective investment vehicle use.

### **BR Pub 95/5A as a basis for the PIE drafting**

The Issues Paper appears (at paragraph 193) to dismiss the validity of using the position in BR Pub 95/5A as the reason why sections HM 3 and HM 9 of the PIE rules are drafted as they are.

The logic seems to be that:

- BR Pub 95/5A states the law incorrectly;
- Parliament has mistakenly assumed that BR Pub 95/5A is a correct statement of the law;
- The mistaken assumption is not the law so that it does not affect the interpretation of the unit trust definition;
- Therefore, the drafting approach used in the relevant PIE provisions was not in fact needed to achieve the desired effect.

In our view, this logic has significant implications for the development of tax policy and the interpretation of subsequently enacted legislation. In other words, any interpretation of a new provision would necessarily have to consider whether the interpretation of previous or other provisions on which it is based is incorrect so that a mistaken assumption can be identified and ignored.

There are a number of recent examples where the “mischief” being corrected is based on the Commissioner’s view of the law. At best, this approach would confirm that an amendment is not needed but is still effective to state the law as intended. At worst, this approach would create confusion as to whether understanding the “mischief” is a reasonable basis from which to interpret the new provision.

We acknowledge that this may be what the relevant cases provide (we have not considered them in detail) and may also be of advantage to taxpayers but this approach does not appear to be particularly efficient or certain.

We suggest that the Commissioner give some further thought to the apparent approach in paragraph 193 and to its wider impact.

### **Interim position**

The issues paper states that the Commissioner will continue to apply her existing position that a unit trust must have more than one unit holder until she finalises her technical view, with any change in view applying prospectively.

We understand that transitional measures will be put in place so that taxpayers who have adopted a tax position based on the Commissioner’s existing view will have time to change their arrangements if the Commissioner changes her view. We consider that if there is a change in view, taxpayers should be allowed to preserve their existing arrangements where they have relied on the Commissioner’s current published position as set out in BR Pub 95/5A – *Relationship between the “unit trust” and “qualifying trust” definitions.*

We also consider that the Commissioner should consider the position where taxpayers have taken a contrary view to that in BR Pub 95/5A. We assume that the Commissioner will confirm that those positions are correct.

If you wish to discuss this submission in any further detail, please contact me on 04 816 4518 or by email at [jfcantin@kpmg.co.nz](mailto:jfcantin@kpmg.co.nz).

Yours sincerely



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