KPMG

TaxMail

1 March 2016

Regular commentary from our experts on topical tax issues

Issue 1

The Diamond case confirms that mere availability of a NZ property is not sufficient to create a continuing taxable connection to NZ. It is how that property is used, or intended to be used, that is important.

A *Diamond* in the rough: taxpayer wins residence case

Snapshot

A New Zealand Court of Appeal decision, Diamond v CIR (2015), impacts New Zealanders looking to move overseas, current expatriates, and those looking to invest or spend time here.

Mr Diamond was a New Zealand citizen who left to work as an overseas security consultant in 2003 (and continues to live overseas). Inland Revenue sought to treat him as tax resident due to ownership of a New Zealand rental property which, in the Commissioner's view, amounted to a "permanent place of abode" (PPOA) here. Inland Revenue argued that a PPOA arose as Mr Diamond *could* live in the property. This was regardless of whether it was his home or whether he had actually lived there previously.

The Court of Appeal found that a New Zealand property which a person owns, but has never lived in, nor intends to live in, cannot be the foundation of their PPOA. Mr Diamond had insufficient connection to New Zealand for him to have a PPOA and be tax resident here. He was therefore not subject to tax in New Zealand on his worldwide income.

Contact us

Rebecca Armour
Partner, Head of Global Mobility
T: +64 9 367 5926
E: rarmour@kpmg.co.nz

Darshana Elwela
National Tax Director
T: +64 9 367 5940
E: delwela@kpmg.co.nz

The Court of Appeal decision is a welcome confirmation of the limits of the PPOA rule. We understand Inland Revenue will not be appealing this latest decision to the Supreme Court.

Why the Diamond case matters

Broad implications for those with New Zealand connections

The Diamond case has broad implications. It goes to the heart of whether someone has sufficient connection to New Zealand, even though living offshore.

The concern for those with investment properties in New Zealand, or renting out their family home while away, is that such property could give them a PPOA in New Zealand. This would give New Zealand taxing rights over their worldwide income.

Permanent Place of Abode – the Inland Revenue view

A person is tax resident if they are here for more than 183 days in a 12 month period, or have a PPOA.

To have a PPOA, the Commissioner of Inland Revenue (the "Commissioner") requires the availability of a dwelling in New Zealand.

In the Commissioner's view:

- A dwelling does not need to be directly owned in order to be objectively regarded as available.
- Properties held in trust, through corporate vehicles, or owned by other family members (e.g. accommodation at a parent's house) may constitute a dwelling.
- Investment properties could be considered a dwelling depending on the circumstances. Objectively, the property could be used as a place to live. Factors such as the property's location, suitability and whether the person has previously lived there would need to be considered.

The New Zealand Courts focussed on the latter criterion in the Diamond case.

The Diamond Case – a history

First the pertinent facts:

- Mr Diamond left New Zealand in 2003 to work overseas as a security consultant. He currently resides overseas.
- Mr Diamond was separated from his wife at the time of leaving (and later divorced) and has children. His ex-spouse and children remained in New Zealand.
- Financial support was provided by Mr Diamond. He also visited New Zealand every five to six months to see his immediate and extended family.
- Mr Diamond holds New Zealand property investments (including some jointly with his ex-wife).

The scorecard

Taxation Review Authority (Commissioner wins)

The Taxation Review Authority (TRA), in 2013, ruled in favour of the Commissioner. It held that one of Mr Diamond's rental property investments was an available dwelling. This, along with his other New Zealand connections, meant he had a PPOA.

Despite Mr Diamond never having lived there, the TRA held that the rental property theoretically could be made available at short notice to him.

Further, the property was close to where Mr Diamond's ex-wife and his children lived. Other links to New Zealand emphasised by the TRA were Mr Diamond's

Contact us

Rebecca Armour
Partner, Head of Global Mobility
T: +64 9 367 5926
E: rarmour@kpmg.co.nz

Darshana Elwela
National Tax Director
T: +64 9 367 5940
E: delwela@kpmg.co.nz

family connections: his continuing relationship with his children and financial relationship with his ex-wife, including provision of financial support and regular visits.

High Court (Taxpayer wins) and Court of Appeal (Taxpayer wins)

Mr Diamond successfully appealed to the High Court in 2014. The Commissioner appealed that decision last year.

Both the High Court and the Court of Appeal ruled in favour of Mr Diamond. They held that to have a PPOA means essentially to have a home, which on the facts he did not, in New Zealand.

We understand that the Commissioner is not appealing the Court of Appeal decision to the Supreme Court.

Our view

What are the important takeaways?

The Court of Appeal decision contains a number of important principles for determining a person's New Zealand tax residence:

- The mere availability of a property in New Zealand is not sufficient to create a PPOA. How that property is used or intended to be used is what is important. Based on the decision, a property which a person has never lived in and only ever intends to use as an investment will not constitute a place with which they have enduring and permanent ties.
- The focus of the analysis should be whether the person, not members of their family, have a PPOA. The fact the person provides a home for their family in New Zealand, while they live elsewhere, is not necessarily sufficient to establish a PPOA for them.
- The Court recognised that the consequences of having tax residence in New Zealand could be serious. An interpretation beyond the ordinary and natural meaning of PPOA should not be adopted. In particular, the Court cautioned against widening connections establishing residence to protect the New Zealand tax base against erosion.

KPMG submission on PPOA

In its review of the legislative history, the Court referred to a KPMG submission on a proposed 2007 legislative change to replace PPOA with "permanent home".

KPMG argued that this change should not proceed on the basis the law would no longer include various nuances concerning how the term PPOA applies in practice.

The Court found the retention of the PPOA wording to be instructive. Parliament did not intend the test should depart from the concept of a "home" to broaden the tax base. We support this very prescient view by the Court.

Care still needs to be taken

With the Commissioner not appealing, we expect Inland Revenue to update its tax residence interpretation statement and operational guidance accordingly.

Although the Diamond case provides some welcome clarity, it does not remove the uncertainty about tax residency completely.

For example, expatriates that have rented out their New Zealand family home, or who buy property which could be used as the family home, are still arguably at risk. Their status will depend on past and prospective ties to the New Zealand property, the time away, as well as other links to New Zealand.

Contact us

Rebecca Armour
Partner, Head of Global Mobility
T: +64 9 367 5926
E: rarmour@kpmg.co.nz

Darshana Elwela
National Tax Director
T: +64 9 367 5940
E: delwela@kpmg.co.nz

This will necessarily involve a holistic understanding and consideration of a person's facts and circumstances. Therefore, care still needs to be taken when applying the residence rules.

For further information

Rebecca Armour
Partner, Head of Global Mobility Services
Auckland
Phone: +64 9 367 5926
Email: rarmour@kpmg.co.nz

Darshana Elwela
National Tax Director
Auckland
Phone: +64 9 367 5940
Email: delwela@kpmg.co.nz

kpmg.com/nz
twitter.com/KPMGNZ