

A guide to associated persons definitions for income tax purposes



Contents

Glossary	4
PART A	6
Introduction	6
Why are the rules required?	6
What types of transactions could be involved?	6
What are the rules designed to do?	6
How have the rules been changed?	6
When do the new rules apply?	7
What are the tests?	7
PART B	8
Overview of each test	8
Associating 2 companies – test 1	8
Associating a company and a person other than a company – test 2	8
Associating 2 relatives – test 3	9
Associating a person and a trustee for a relative – test 4	9
Associating a trustee and beneficiary – test 5	9
Associating 2 trustees with common settlor – test 6	9
Associating a trustee and settlor – test 7	10
Associating a settlor and beneficiary – test 8	10
Associating a trustee and person with power of appointment – test 9	10
Associating a partnership and partner – test 10	10
Associating under the tripartite relationship – test 11	10
Association in certain situations involving limited partnerships – test 12	10
PART C	11
Associating 2 companies YB 2	11
Test 1	11
A company and person other than a company YB 3	14
Test 2	14
Associating 2 relatives YB 4	18
Test 3	18
Associations with trusts YB 5 to YB 11	20
Test 4	20
Test 5	21
Test 6	22
Test 7	23
Test 8	24
Test 9	24
Associating a partnership and partner YB 12	26
Test 10	26
The tripartite (third person) test YB 14	27
Test 11	27
Association in certain situations involving limited partnerships YB 16B	30
Test 12	30

PART D	33
Associated persons in more detail	33
Key features of the reforms	33
Application date	34
Detailed analysis	34
Two companies test (section YB 2)	34
Aggregation rule 2 companies	35
Other features	39
Company and person other than a company test (section YB 3)	39
Aggregation rule company and individual	39
Corporate trustees	43
Relatives test (section YB 4)	43
Narrower application of relatives test in certain cases (section YB 4(2))	43
Trustee for relative test (section YB 5)	45
Trustee and beneficiary test (section YB 6)	46
Two trustees with common settlor test (section YB 7)	48
Trustee and settlor test (section YB 8)	50
Settlor and beneficiary test (section YB 9)	51
Definition of settlor (section YB 10)	52
Trustee and person with power of appointment or removal test (section YB 11)	53
Partnership and partner test (section YB 12)	54
Limited partnerships	55
Tripartite test (section YB 14)	56
Different associated persons requirement	59
Exception for companies tests (section YB 14(2))	61
Exceptions for certain trusts and charitable organisations	61
Energy consumer trusts and bonus bonds unit trust	61
Charitable organisations	62
Charitable trusts	63
Rationalising associated persons references in operative provisions	63
Section CD 6(1)(a)(iii) repealed	64
Section CD 22(9) amendment	64
Section DB 42(2) amendment	64
Omitted tests	65
Rationalisation of other income tax provisions	65
Replacing company control definition with associated persons definition	65
Replacing related person definition with associated person definition	65
Definition of 'relative'	66
Non Resident Withholding Tax and Approved Issuer Levy	66
Application of changes to other Acts	66
Legislative references	67

Glossary

Aggregation rule general (for non-land transactions)

The **tests for 2 companies and for a company and a non-company** contain a general aggregation rule to prevent circumvention of the 50% and 25% interest thresholds in a company. If any of the other tests prove that a person (person A) and another person (person B) are associated, person A is treated as holding the interests of person B for tax purposes.

Aggregation rule for land provisions

For land transactions, the rule determines that a person (person A) and another person (person B) are associated if they're:

- married, in a civil union, or in a de facto relationship
- a parent and infant child
- trustees of separate trusts with the same settlor
- a trustee and a settlor
- a trustee and a person with power to appoint or remove a trustee
- a partner and a partnership
- associated through the tripartite test.

Beneficiary

Generally this is a person who has benefited from or is eligible to benefit from a trust.

Infant child

A child by blood, adoption or marriage under the age of 20 years.

Land provisions

Land provisions are specific rules relating to land transactions. These principally address tax avoidance arrangements and structures that are used to alter the tax status of land transactions. The following areas have specific provisions relating to land transactions: 2 companies, a company and a person other than a company, 2 relatives, Portfolio Investment Entities (PIEs) and entities eligible to be PIEs. The land provisions do not apply to the tests for person and trustee for relative (section YB 5), trustee and beneficiary (section YB 6), settlor and beneficiary (section YB 9).

Market value circumstance

A person's interest in a company is generally measured by their voting interests in the company. If, in certain circumstances, these voting interests do not accurately reflect the person's economic interest in a company, then the person's interests are also measured by their market value interests in the company.

Generally this means looking outside the market value interest to see if voting rights are affected by shares, options, debentures or arrangements.

Market value interest

A person's market value interest in a company is measured where a market value circumstance exists. At any time, a person's market value interest equals their share of the total market value of shares and options held in the company.

Narrow relatives test

The definition under the 2 relatives test has a narrower application for the purposes of the land provisions (see 'Aggregation rule for land provisions' above).

Non-arm's length

This generally refers to persons who for personal or family reasons enter into a transaction at a different value from the amount that would be paid by 2 independent persons. A non-arm's length transaction is one that isn't freely entered into between a willing vendor and purchaser.

Person

A person can be an individual, company, trustee of a trust, limited partnership, a partnership and any other separate entity.

Portfolio investment entity (PIE)

A type of managed fund that makes and holds investments on behalf of its investors.

Purpose trust and community trust

These types of trusts do not have beneficiaries and therefore are not associated under the beneficiary-related tests.

Relative

The definition of 'relative' in section YA 1 of the Income Tax Act 2007 has been simplified so that it extends only to the second degree of blood relationship. Previously the definition also extended for the purposes of some provisions to the fourth degree of blood relationship. The new definition of relative includes a trustee of a trust under which a relative has benefited or is eligible to benefit—this continues the effect of paragraph (c) (v) of the old relative definition.

Settlor

The term settlor has a wide meaning and broadly means a person who transfers value to a trust. This includes both an initial settlement and at any other time.

For the purposes of the associated persons definitions, the term settlor has the modification that it does not include a person who provides services to a trust for less than market value. Consequently, a professional advisor who provides free services to a trust will not be treated as a settlor of the trust. There is also an exception for the settlor of a charitable trust.

Trustee

A person who is responsible for the trust operating within the guidelines set out in the trust deed and trustee law. The trust is not a legal entity so everything the trust does is carried out by the trustee of the trust. The trustees are for the most part legally responsible for the actions of the trust.

PART A

Introduction

The associated persons rules in the Income Tax Act 2007 are designed to ensure the tax treatment of transactions involving associated persons do not:

- create a tax benefit
- use the tax system to subsidise the cost of what are effectively private transactions
- disguise the nature of a business or private transaction
- disguise the person(s) involved in the transaction.

Generally transactions that are non-arm's length need to be considered under the associated persons rules to ensure that they are treated the same from a tax perspective as if the transaction was made by 2 independent parties.

Why are the rules required?

The rules ensure the tax status of any transaction is not changed when the parties involved are associated.

For example, tax avoidance arrangements could be structured through associated persons to hide or disguise the true nature of a transaction. A transaction made by a person in business has a tax consequence. The same transaction, if conducted by someone for personal or non-business reasons, may not have a tax consequence. Therefore there could be an incentive to move transactions out of the business environment.

What types of transactions could be involved?

- Persons involved in property development could use associated structures such as trusts to move property transactions from their own taxable business environment to a capital (non-taxable) investment in a trust. This is 1 of the main areas of concern.
- A tax deduction could be claimed for the loss made on the sale of an item that was heavily discounted when sold to a family member.
- Employment-related benefits are often included in an employee's overall salary package. The benefit could be provided to an associate of the employee so the employee avoids paying tax.

What are the rules designed to do?

The rules have been designed to:

- prevent changes to the tax treatment of a transaction by flowing it through an associated person or conducting the transaction with an associated person
- ensure that a transaction between related parties is afforded the same tax treatment as if the transaction was conducted between arm's length parties.

Transactions between associated persons are often required to be valued at market value and not at a price agreed between the parties. This is particularly relevant in a situation where the transaction is part of a business for only 1 of the parties.

Under the land provisions, if a person associated to a property developer sells a property within 10 years of purchase, this transaction will generally be considered to be part of a business activity for tax purposes.

How have the rules been changed?

Amendments have been made to strengthen and rationalise the definitions of 'associated persons' for the purposes of the Income Tax Act 2007.

The key changes include:

- strengthening the definitions relating to trusts
- aggregating the interests of associates to prevent the tests for associating 2 companies and a company and an individual being circumvented by the fragmentation of interests among close associates
- implementing a tripartite test associating 2 persons if they are each associated with the same third person.

This booklet provides an overview of the associated person provisions outlined in section YB of the Income Tax Act 2007 including the changes made in the Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009.

Scenarios and examples have been included to help you determine if a person is associated under the associated person definitions. This is not an exhaustive list of scenarios and examples.

When do the new rules apply?

Transactions involving land

For persons and associated persons who are involved in a building business, the new rules apply for land on which improvements started on or after 6 October 2009.

For other persons and associated persons, the provisions apply for land acquired on or after 6 October 2009.

Transactions other than land

The changes to the other provisions apply to transactions occurring in 2010–11 and later income years.

What are the tests?

There are 11 tests to determine if 2 persons are associated.

- | | |
|---------|---|
| Test 1 | Two companies (section YB 2): <ul style="list-style-type: none"> – common voting interests – common market value interests – control by any other means – aggregation rule—non-land provisions – aggregation rule—land provisions. |
| Test 2 | Company and person other than a company (section YB 3): <ul style="list-style-type: none"> – common voting interests – common market value interests – aggregation rule—non-land provisions – aggregation rule—land provisions. |
| Test 3 | Two relatives (section YB 4): <ul style="list-style-type: none"> – degrees of relationship—non-land provision – degrees of relationship—land provisions. |
| Test 4 | Person and a trustee for a relative (section YB 5). |
| Test 5 | Trustee and a beneficiary (section YB 6). |
| Test 6 | Two trustees of separate trusts with a common settlor (section YB 7). |
| Test 7 | Trustee and a settlor (section YB 8). |
| Test 8 | Settlor and a beneficiary (section YB 9). |
| Test 9 | Trustee and a person with power of appointment or removal (section YB 11). |
| Test 10 | Partnership and a partner (section YB 12). |
| Test 11 | Tripartite relationship (section YB 14). |
| Test 12 | Association in certain situations involving limited partnerships |

PART B

The following is an overview of each test. See Part D for further details

Overview of each test

Associating 2 companies – test 1 (a more limited version of the aggregation rule applies to land transactions)

The primary test provides that 2 companies are associated if there is a group of persons whose total voting interests in each company are 50% or more.

If the primary test does not apply the second part of the test provides that 2 companies are associated if a market value circumstance exists for either company and there is a group of persons whose total market value interests in each company are 50% or more.

A person's interest in a company is generally measured by their voting interests in the company. If these voting interests in certain circumstances do not accurately reflect the person's economic interest in a company, then the person's interests are also measured by their market value interests in the company.

Finally, 2 companies are associated if a group of persons controls both companies by any other means. For example a director of 2 companies who has virtual control of both companies.

An aggregation rule provides that, in determining whether 2 companies are associated, a person is treated as holding the interests of the other person if tests 3 to 11 prove they are associated. This aggregation rule is designed to prevent the 2 companies test being circumvented by the fragmentation of interests among associated persons, resulting in the 50% interest threshold not being reached.

A unit trust is a company for the purposes of the associated persons rules.

Exceptions

The control by any other means test does not apply to a company that is a state enterprise, Crown Research Institute, Crown Health Enterprise or a company that is part of the same group of companies as one of the Crown-related entities.

In the international tax rules, 2 companies are not associated if one, but not both, is a non-resident.

Associating a company and a person other than a company – test 2

The primary test provides that a company and a person other than a company are associated if the person has a voting interest in the company of 25% or more.

If the primary test does not apply the second part of the test provides that a company and a person other than a company are associated persons if a market value circumstance exists for the company and the person has a market value interest in the company of 25% or more.

An aggregation rule applies for the purposes of determining whether a company and a person other than a company are associated. A person is treated as holding the interests of the other person if tests 3 to 11 prove they are associated.

As with the 2 companies test, the aggregation rule in the company and a person other than a company test is designed to prevent the test being circumvented by the fragmentation of interests among associated persons, resulting in the interest threshold of 25% not being reached.

A more limited version of the aggregation rule applies for land transactions.

The holdings of the other person are only aggregated when the other person who is not a company is associated by being:

- a relative by marriage, civil union, or a de facto relationship under the relatives test (test 3), or
- an infant child (under 20 yrs) under the relatives test (test 3), or
- a person associated under tests 5, 6, 9, 10 or 11, or
- a combination of the person and the other persons referred to above.

A PIE or an entity eligible to be a PIE is not included for the aggregation purposes of the test.

A person other than a company includes a company acting in its capacity as a trustee of a trust.

Associating 2 relatives – test 3

There are 3 aspects to this test: blood relation, relation by marriage and relation to in-laws.

1 Blood relationship

This now extends only to the second degree of blood relationship, instead of the fourth degree as previously stipulated. This means that grandparents and siblings are included but not nephews and nieces (third degree) and cousins (fourth degree). An adopted child is treated as the natural child of the adoptive parents.

2 Relationship by marriage

Two persons who are married, in a civil union, or in a de facto relationship are associated.

3 Relationship to in-laws

Two persons are associated if one person is within 2 degrees of blood relationship to the other person's spouse, civil union partner, or de facto partner. This aspect associates persons with their in-laws and step-children.

The first and third aspects of this test do not apply for land transactions. Instead, persons are associated because of a blood relationship only if one is the infant child (under 20 years) of the other. This rule applies for the other tests, particularly when considering if the tripartite test applies.

Associating a person and a trustee for a relative – test 4

A person (first person) and a trustee of a trust are associated persons if a relative of the first person (as proven by 2 relatives test 3) has benefited or is eligible to benefit under the trust.

For example, a husband and a trustee of a trust under which the husband's wife is a beneficiary would be associated under this test.

Associating a trustee and beneficiary – test 5

A trustee of a trust and a person who has benefited or is eligible to benefit under the trust will be associated persons.

This test doesn't apply for:

- land transactions
- certain employee trusts such as an employee superannuation fund
- certain trusts such as energy consumer trusts and the trust administering bonus bonds.
- beneficiaries that are charitable trusts.

Associating 2 trustees with common settlor – test 6

A trustee of a trust and a trustee of another trust are associated persons if the same person is a settlor of both trusts.

There is an exception to this test for certain employee trusts.

Associating a trustee and settlor – test 7

A trustee of a trust and a settlor of the trust are associated persons.

There is an exception to this test for certain employee and charitable trusts.

Associating a settlor and beneficiary – test 8

A settlor of a trust and a person who has benefited or is eligible to benefit under the trust are associated persons.

This test doesn't apply for:

- land transactions
- certain employee trusts
- beneficiaries that are charitable trusts.

Associating a trustee and person with power of appointment – test 9

A trustee of a trust and a person who has the power to appoint or remove a trustee are associated persons.

Associating a partnership and partner – test 10

A partnership and a partner in the partnership are associated persons.

A separate test applies in the case of a limited partnership and a limited partner in that they are associated only if the limited partner has a share of 25% or more in the limited partnership. This includes a partnership share of 25% or more in a right, obligation, or other property, status, or thing of the limited partnership.

A partner is not associated to the other partners in the partnership under this test, but may be associated by one of the other tests.

Under the aggregation rule, which applies only for limited partnerships in this test, anything held by one limited partner is treated as being held by the other limited partner if any of the tests have proved them to be associated.

Associating under the tripartite relationship – test 11

The tripartite relationship (tripartite test) will associate 2 persons if they are each associated with the same third person under different tests.

The tripartite test acts as an important buttress to the other associated persons tests and makes the associated persons definition as a whole more difficult to circumvent.

The requirement that the 2 persons cannot be associated with the same third person under the tripartite test itself is necessary to prevent the tripartite test operating in a reiterative manner.

Association in certain situations involving limited partnerships – test 12

Limited partnerships are treated as if they were companies under tests 1, 2 and 10 if any of the following circumstances apply:

- A company is a limited partner in a limited partnership,
- A limited partnership is a limited partner of another limited partnership (count both as if they were companies)
- A limited partnership has a voting or market value interest in a company.

The look-through provisions in section YC 4 would apply to these limited partnerships, just as they would to companies.

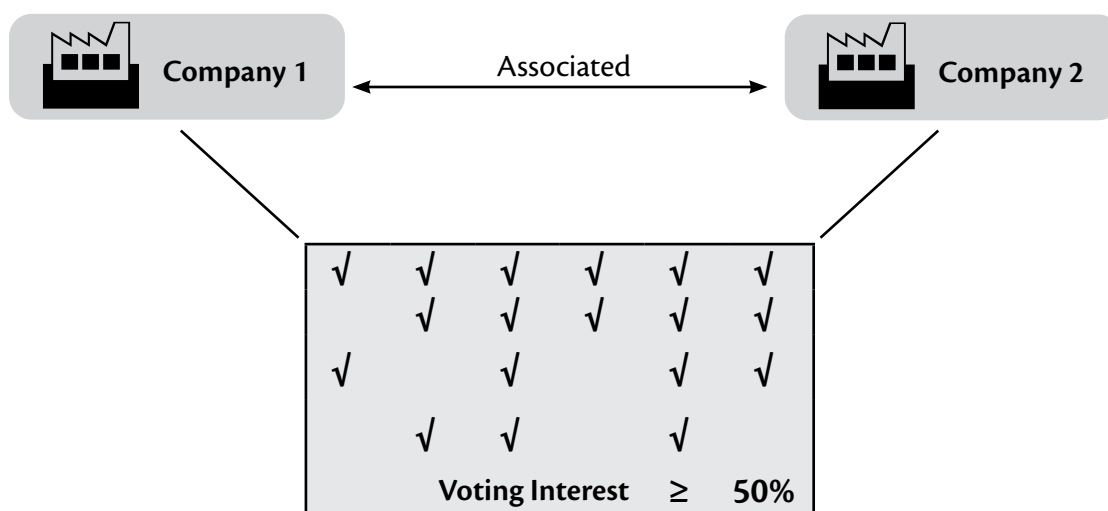
PART C

Associating 2 companies YB 2

Test 1

Common voting interests YB 2(1)

If 50% or more of the voting interests in 2 companies is held by the same group (a 'group' could include companies, individuals, trusts, partnerships, unit trusts, PIEs, or any combination of these entities or one person), the 2 companies are associated.



Example 1

There are 2 companies, Company 1 and Company 2.

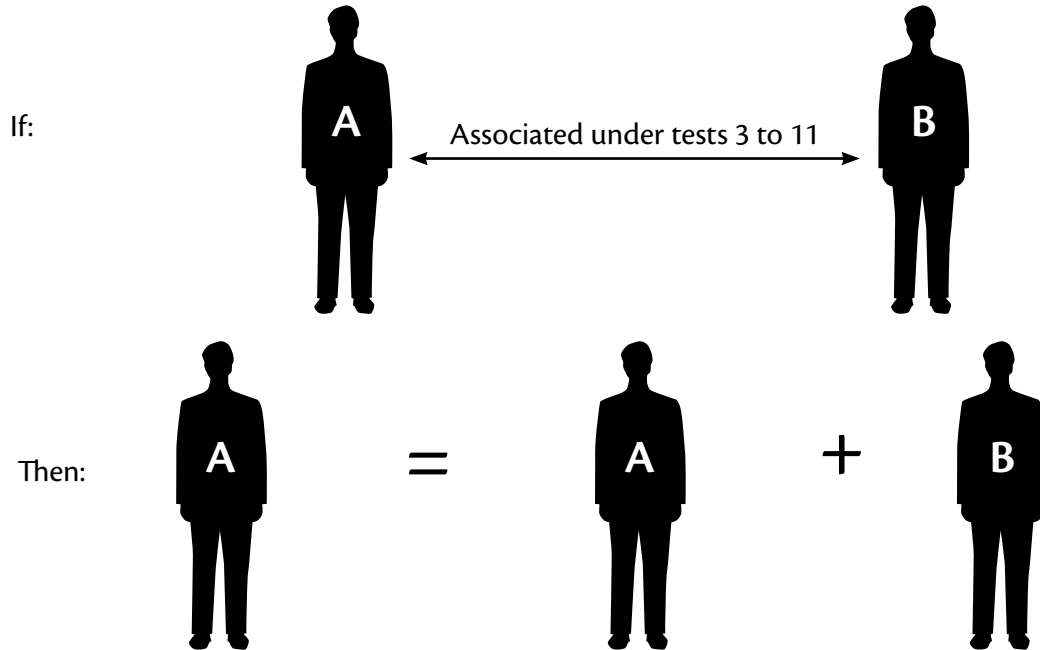
The AEC Trust and John hold between them 50% of the voting power for decisions made by Company 1, and 55% of the voting power for decisions made by Company 2.

As the group (consisting of the AEC Trust and John) has a common voting interest of at least 50% in Company 1 and Company 2, Company 1 and Company 2 will be associated to each other.

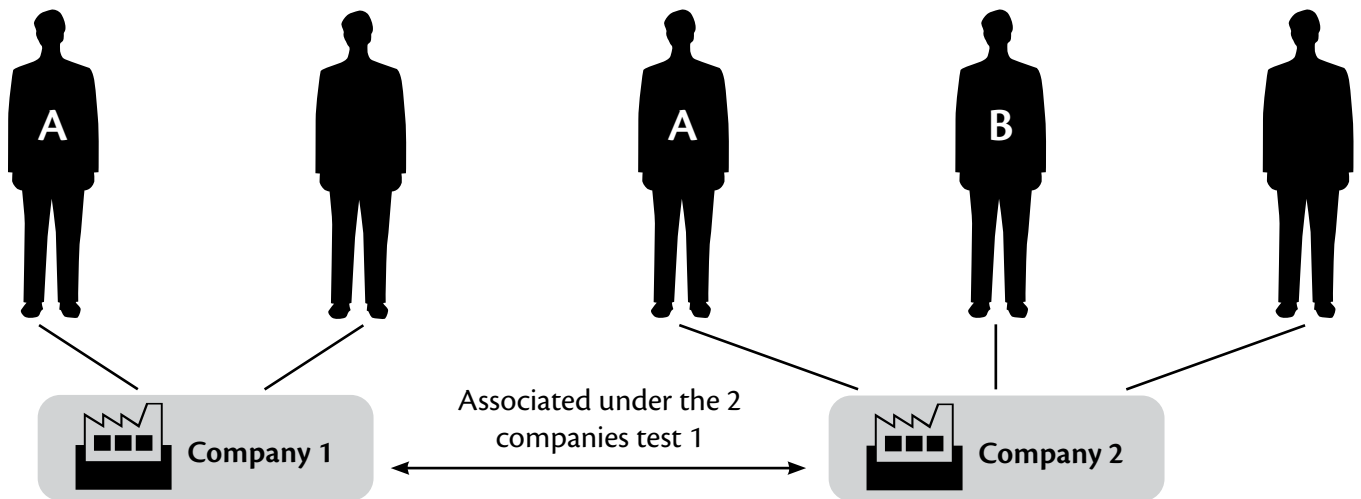
This will mean for example, if either Company 1 or Company 2 is a property developer and the other is not, any land transactions carried out by either associated party will generally be taxable.

Section reference: YB 2(1)

General aggregation rule – non-land provisions YB 2(4)



If a 'person' (this could be a company, individual, trust, partnership, unit trust, or a PIE) is associated to another 'person' under any of the tests 3 to 11, each will be treated as holding the same interests.



Example 2

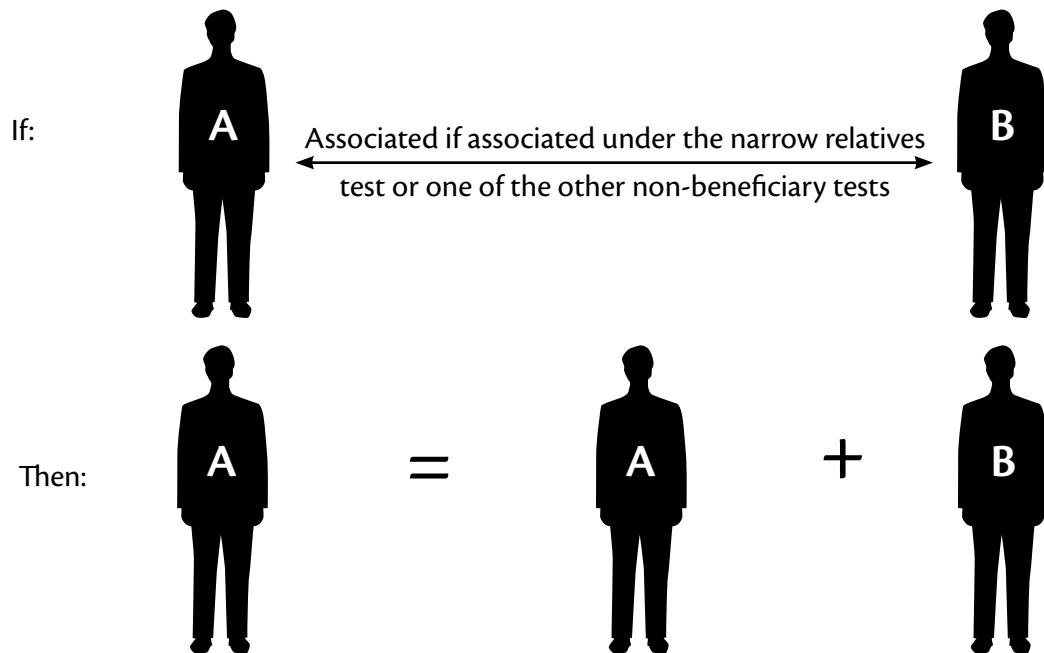
Alan (person A) and an unrelated person each own 50% of the shares in Company 1.

Alan, Alan's wife Betty (person B) and an unrelated second person each own 33% of the shares in Company 2.

As Alan and Betty are associated to each other under the 2 relatives test (test 3), Alan is treated as holding Betty's shares in Company 2 giving him a total of 66% of the shares. Alan therefore holds 50% in Company 1 and 66% in Company 2 making the 2 companies associated.

Section reference: YB 2(4)

Aggregation rule – land provisions YB 2(5)



If a 'person' (this could be a company, individual, trust, partnership, PIE, or a company acting in its capacity as a trustee of a trust) and another 'person' are associated under the narrow relatives test and the trustee and settlor tests, 2 trustees with common settlor, trustee and settlor, trustee with power to appoint/remove, partnership and partner, and the tripartite tests, each will be considered to hold what the other person holds.

Example 3

Marie owns 5 shares in Company 1.

Marie also settled a trust that Mark is a trustee of. Mark owns 22 shares in Company 1.

As Marie is associated to Mark under the trustee and settlor test (test 7), Marie and Mark are each deemed to hold 27 shares in Company 1.

Section reference: YB 2(5)

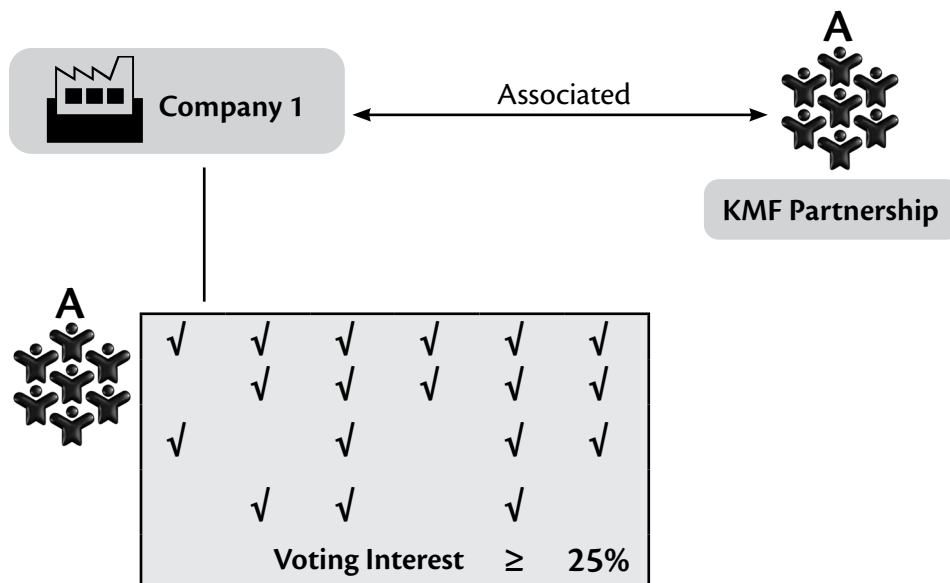
A company and person other than a company YB 3

Test 2

Common voting interests YB 3(1)

If a 'person other than a company' (this could be an individual, trust, partnership, or a company acting in its capacity as a trustee of a trust) has 25% or more of the voting interest in a company, the non-company and the company are associated.

Example 4



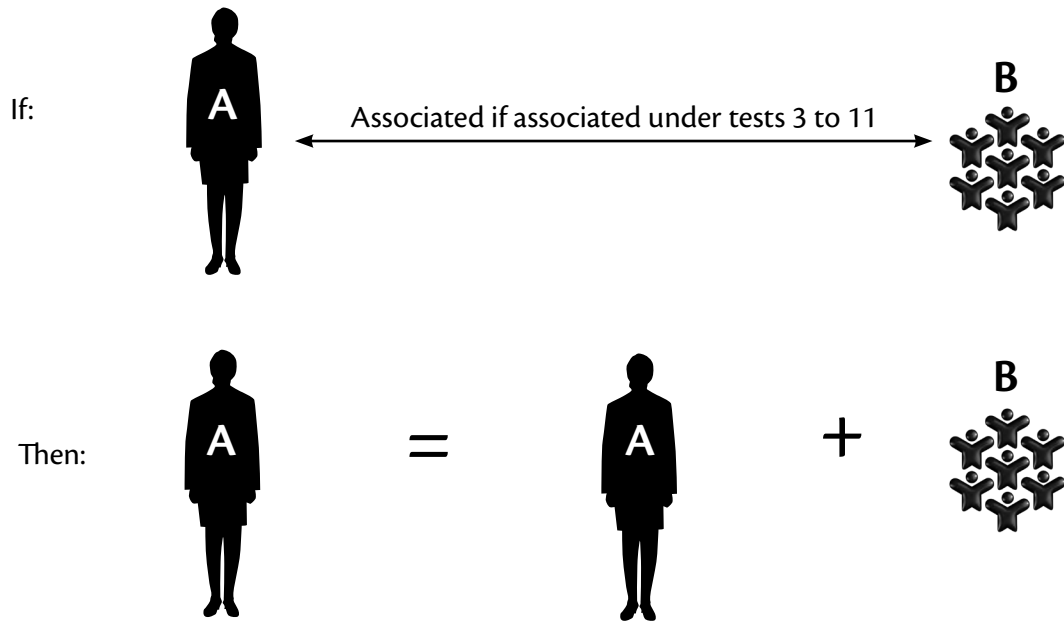
The KMF Partnership (A above) has a 40% voting interest in Company 1.

As the KMF Partnership has a voting interest in Company 1 of more than 25%, the partnership and the company will be associated.

This will mean for example, if either the company or the partnership is a property developer and the other is not, any land transactions carried out by either party will generally be taxable.

Section reference: YB 3(1)

General aggregation rule – non-land provisions YB 3(3)



If a 'person' (this could be an individual, trust, partnership, unit trust, PIE, or a company acting in its capacity as a trustee of a trust), is associated to another 'person' under the non-company tests 4 to 11, each will be treated as holding what the other person holds for the purpose of the previous example.

Example 5

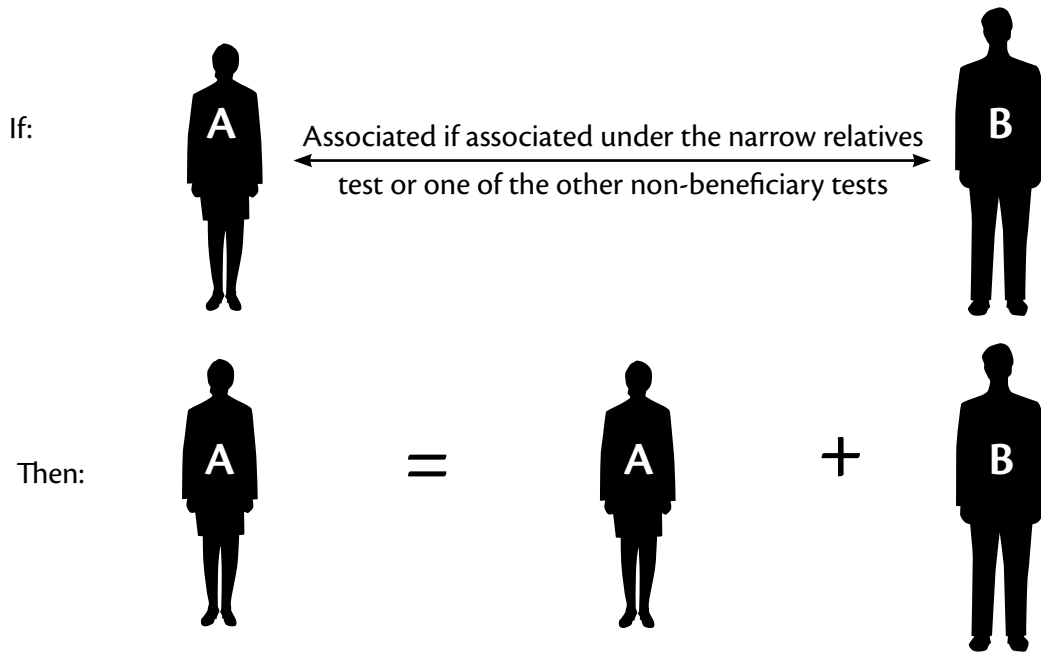
Marie holds 5 shares in Company 1.

Marie is also a partner in the KMF Partnership which holds 27 shares in Company 1.

As Marie is associated to the partnership under the partnership and partner test (test 10), both she and the KMF Partnership are deemed to hold 32 shares in Company 1 for the purposes of example 4 (see page 14).

Section reference: YB 3(3)

Aggregation rule – land provisions YB 3(4)



If a 'person' (this could be a company, individual, trust, partnership, PIE, or a company acting in its capacity as a trustee of a trust) and another 'person' are associated under the narrow relatives test, 2 trustees with common settlor, trustee and settlor, trustee with power to appoint/remove, partnership and partner, and the tripartite tests, each will be considered to hold what the other person holds.

Example 6

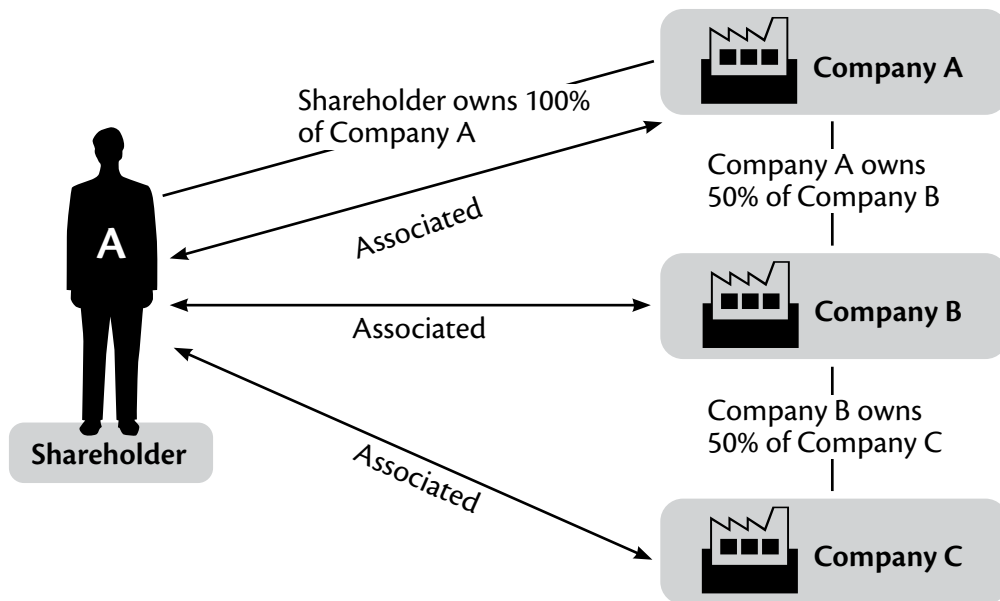
Marie owns 5 shares in Company 1.

Marie also settled a trust that Mark is a trustee of. Mark owns 22 shares in Company 1.

As Marie is associated to Mark under the trustee and settlor test (test 7), Marie and Mark are each deemed to hold 27 shares in Company 1.

Section reference: YB 3(4)

Look-through provisions YB 3 and YC 4



Example 7

Shareholder owns 100% of Company A. Company A owns 50% of Company B. Company B owns 50% of Company C.

The shareholder is associated to Company C as he holds 25% in Company C (100% Company A x 50% Company B x 50% Company C = 25%).

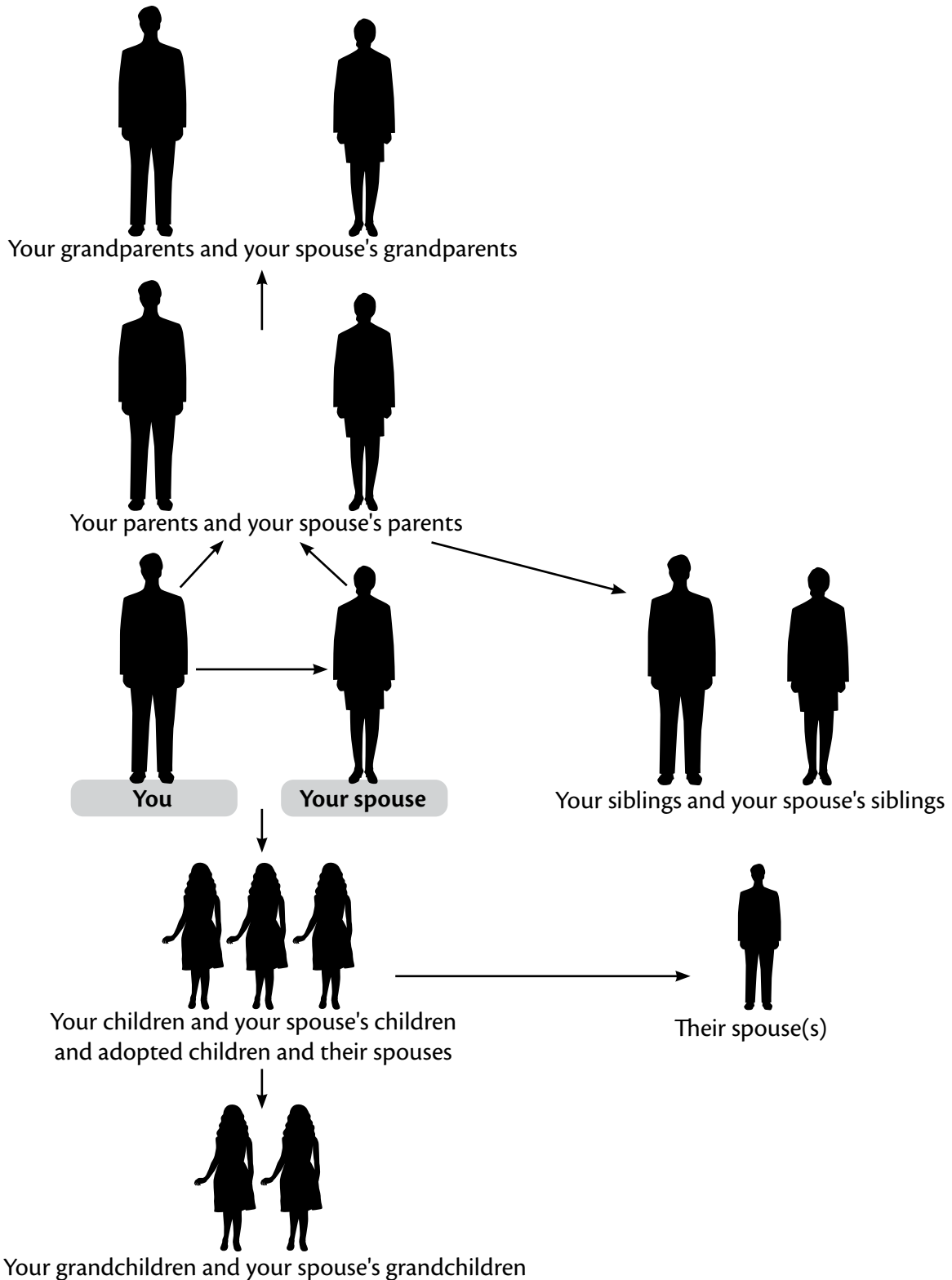
The shareholder is associated to each of the companies.

Section reference: YC 4

Associating 2 relatives YB 4

Test 3

Relationship tree – non-land provisions YB 4(1)



For non-land provisions, a person is an associated family member if:

YB 4(1)(a): Blood relationship – the other person is their parent, grandparent, child, grandchild, or sibling

YB 4(1)(b): Marriage – the other person is their spouse, civil union partner, or de facto partner

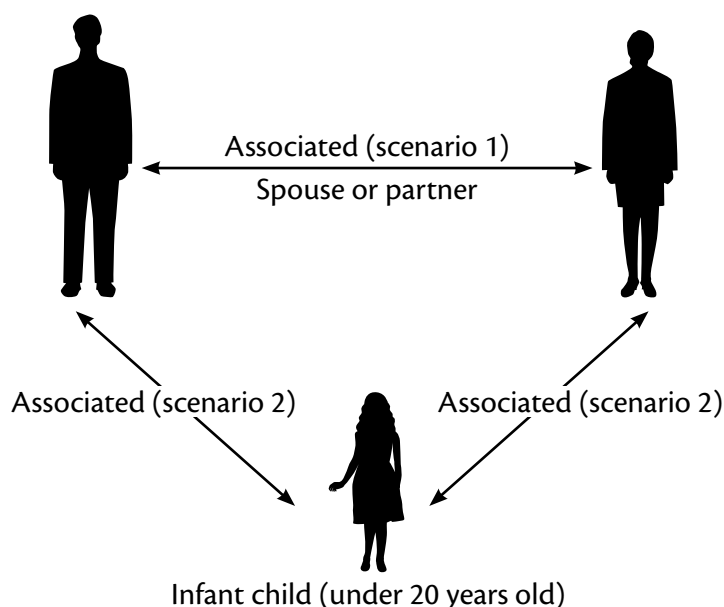
YB 4(1)(c): In-laws – the other person is their spouse, civil union partner, or de facto partner's parents, grandparents, children, grandchildren, or siblings.

YB 4(3): Adoption – a child by adoption is treated as the natural child of the adoptive parents.

This section does not apply if the person cannot be reasonably expected to know that the other person exists.

Section reference: YB 4(1)

Relatives test – land provisions (narrow relatives test) YB 4(2)



For the purpose of the land provisions (and sections EB 13 and EC 5 of the Income Tax Act 2007) a person is associated to another person if that person is their spouse, civil union partner, or de facto partner, or their child who is under 20 (including if the child is adopted).

This means there are only 2 scenarios where 2 relatives are associated for the purpose of the land provisions:

Scenario 1: A person is related to their spouse, civil union partner or de factor partner

Scenario 2: A person is related to their child who is under 20 (including an adopted child).

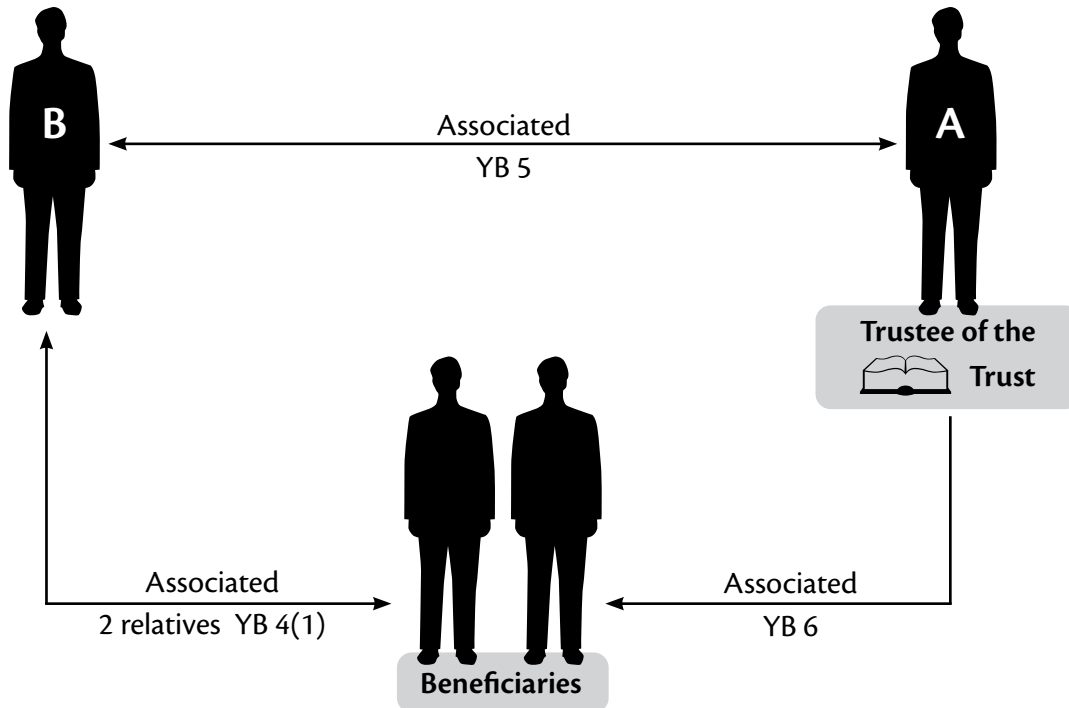
Note: This section does not apply if the person cannot be reasonably expected to know that the other person exists.

Section reference: YB 4(2)

Associations with trusts YB 5 to YB 11

Test 4

Person and a trustee for a relative YB 5



Note: This does not apply to land transactions

Other than for the land provisions, 2 persons are associated if one is the trustee of a trust, and the other is associated under the 2 relatives test to a person who has benefited or is eligible to benefit from that trust.

Example 8

Person A is a trustee of a trust set up for the benefit of person B's children. Person A is associated to person B under this test.

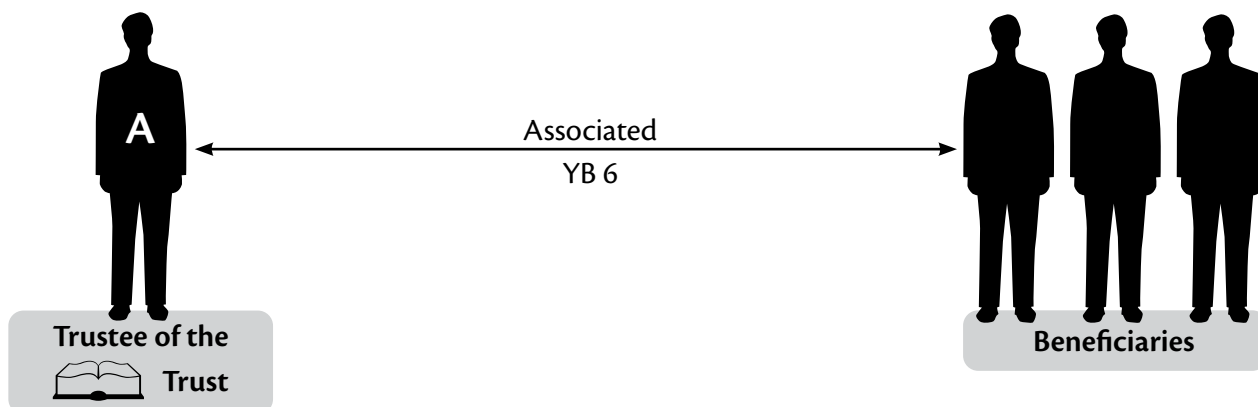
The trustee will be associated to the beneficiary's spouse, civil union partner, or de facto partner, parents, grandparents, children, grandchildren, siblings and in-laws as they are related to the beneficiary.

Exceptions are certain trusts (energy consumer trusts and bonus bonds unit trust) YB 16(1).

Section reference: YB 5

Test 5

Trustee and beneficiary YB 6



A trustee of a trust is associated to the beneficiaries of a trust.

There are exceptions for certain employee trusts YB 15, certain trusts (energy consumer trusts and bonus bonds unit trust) YB 16(1) and charitable organisations YB 16(2).

Note: This does not apply to land transactions

Section reference: YB 6

Test 6

Trustees with common settlor YB 7

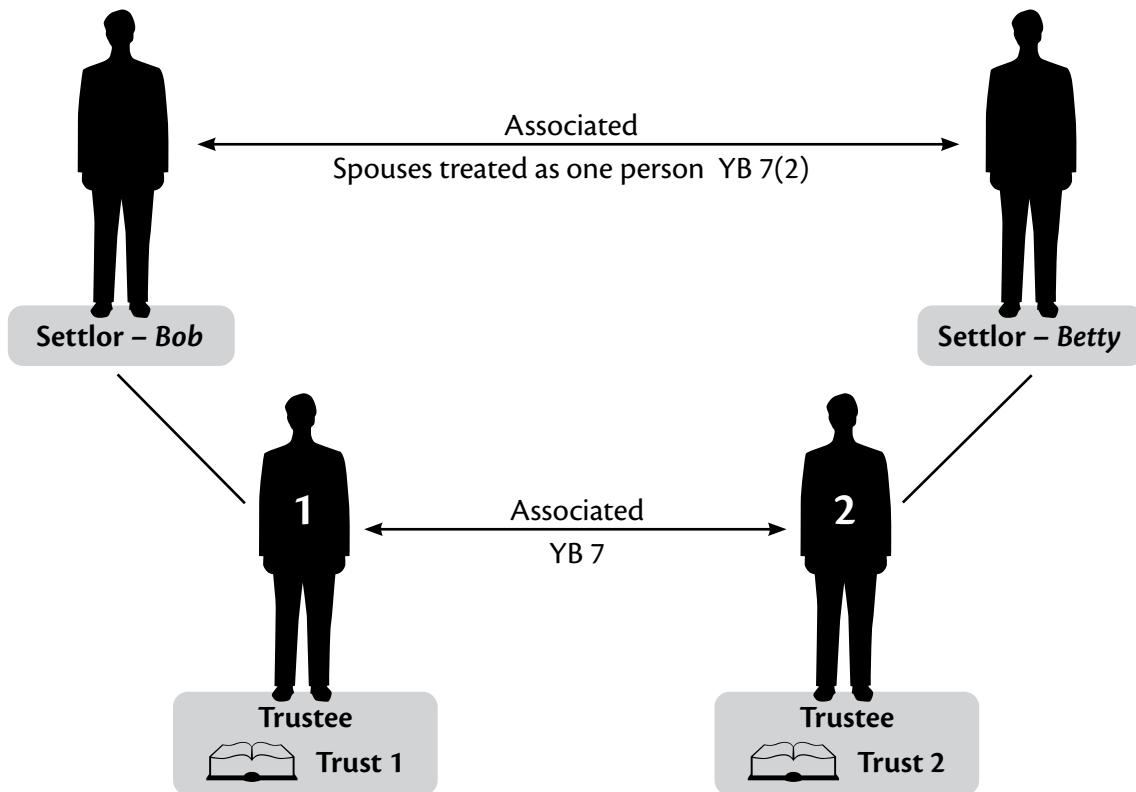
A trustee of a trust and the trustee of another trust will be associated with each other where the 2 trusts are settled by the same person.

Note: For the purposes of this section, 2 persons who are married, in a civil union, or in a de facto relationship are treated as the same person.

This test does not apply to a settlor that settles a trust for the benefit of employees YB 15.

A settlor does not include a person who provides services to a trust for less than market value YB 10.

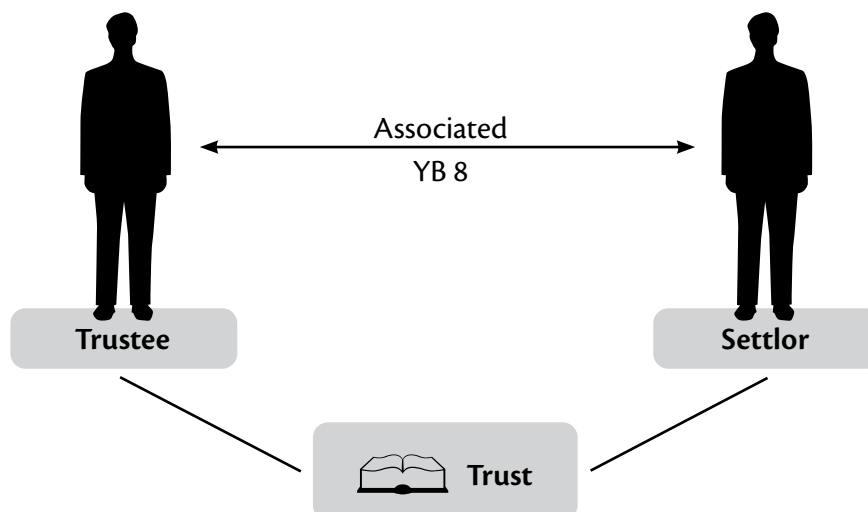
Scenario: A person settles 2 trusts, Trust 1 and Trust 2. The trustees in each trust, trustee 1 and trustee 2 will be associated.



Example 9: Bob settles a trust, Trust 1. His wife Betty settles another trust Trust 2. The trustees in each trust, trustee 1 and trustee 2 above, will be associated as Bob and Betty are treated as being the same person for the purposes of this section and therefore the 2 trusts are treated as having the same settlor.

Test 7

Trustee and settlor YB 8



A trustee and the settlor of the trust are associated.

There are exceptions for certain employee trusts YB 15 and charitable trusts YB 8(2).

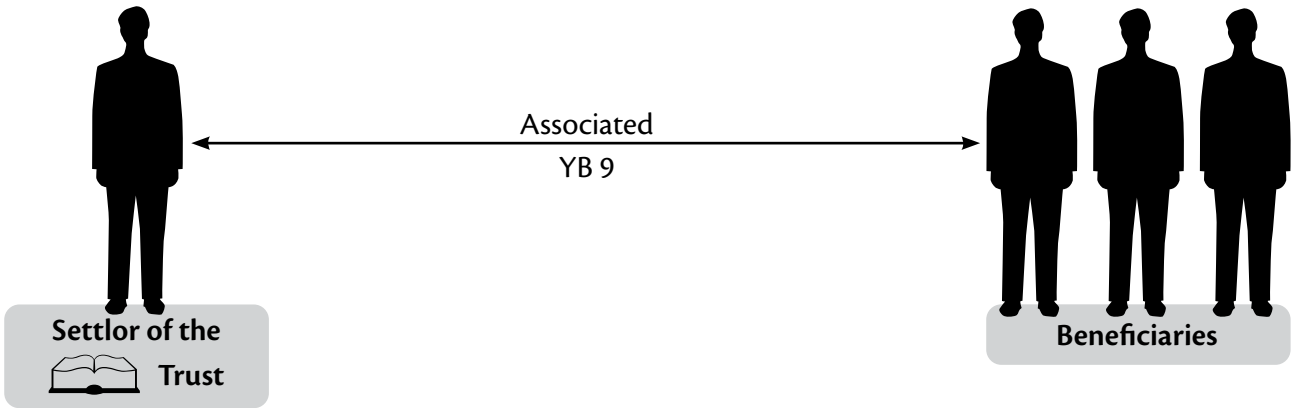
Note: For the purposes of this section, 2 persons who are married, in a civil union, or in a de facto relationship are treated as the same person.

A settlor does not include a person who provides services to a trust for less than market value.

Section reference: YB 8

Test 8

Settlor and beneficiary YB 9



A settlor and the beneficiaries of the trust are associated.

There are exceptions for certain employee trusts YB 15 and charitable organisations YB 16(2).

This test does not apply to the land provisions.

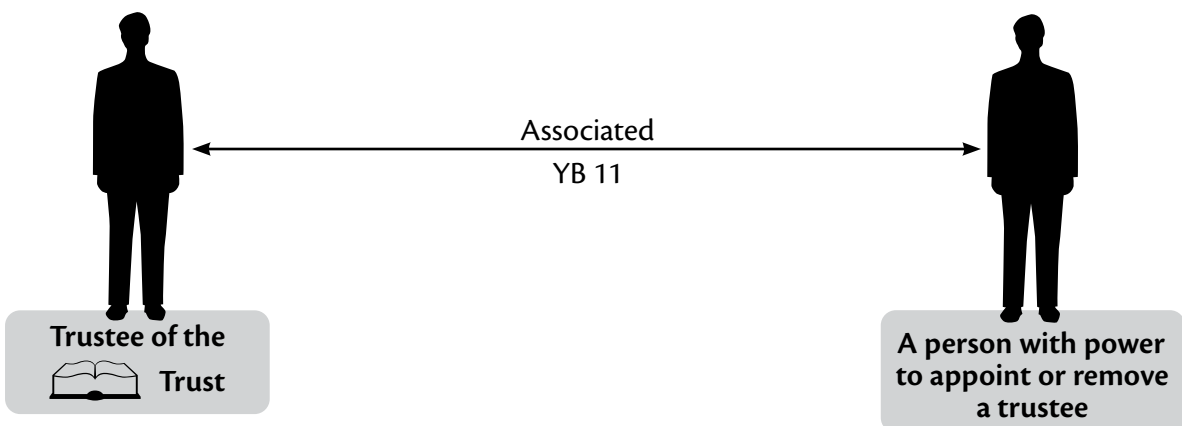
Note: For the purposes of this section, 2 persons who are married, in a civil union, or in a de facto relationship are treated as the same person.

A settlor does not include a person who provides services to a trust for less than market value.

Section reference: YB 9

Test 9

Trustee and a person with power to appoint or remove a trustee YB 11

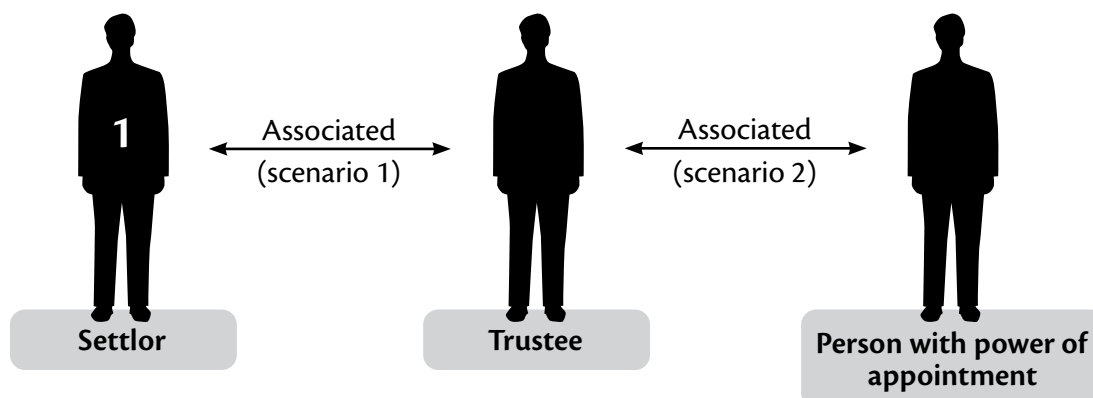


A person with the power to appoint or remove a trustee is associated to the trustees of the trust. This power will generally exist from the establishment of the trust.

There is an exception for certain employee trusts YB 15.

Section reference: YB 11

Associations with trusts – land provisions



The 2 people in each of the following scenarios will be associated under the new trust rules:

Scenario 1: One person is the settlor of the trust and the other is a trustee of that trust

Section reference: YB 8

Scenario 2: One person is the trustee of a trust and the other has the power to appoint and remove trustees in that trust

Section reference: YB 11

If either person in each of the scenarios is in the building industry, any land transactions of the other person are likely to be taxable.

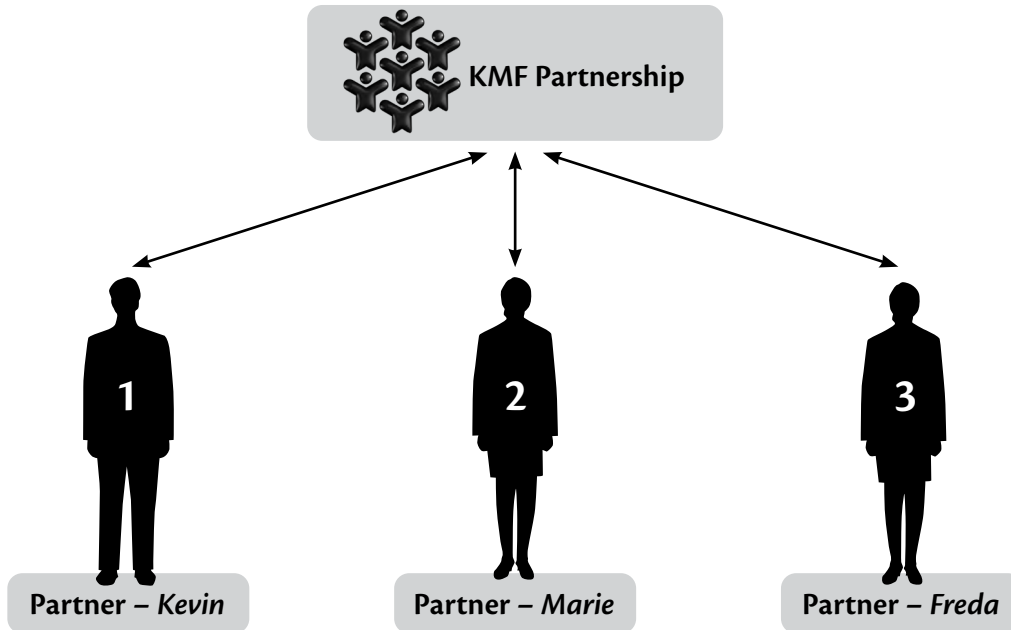
Note: For the purposes of this section, 2 persons who are married, in a civil union, or in a de facto relationship are treated as the same person.

A settlor does not include a person who provides services to a trust for less than market value.

Associating a partnership and partner YB 12

Test 10

Partnership and partner YB 12



A partnership and a partner in the partnership are associated.

Scenario: The KMF Partnership has 3 partners: Kevin, Marie and Freda.

- Kevin is associated to the partnership
- Marie is associated to the partnership
- Freda is associated to the partnership.

Notes: There are special association rules for limited partnerships.

The partners in the partnership are not associated to each other under this test.

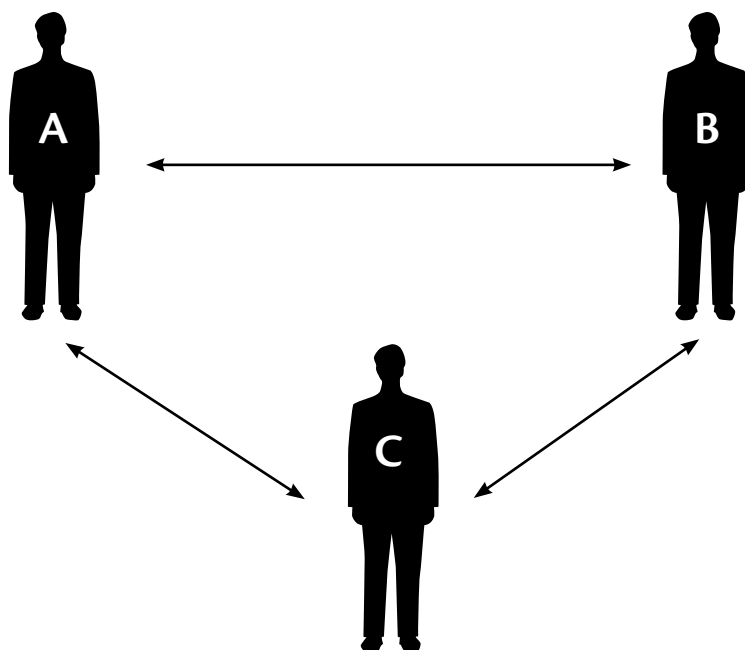
Association in certain situations involving limited partnerships can be found under test 12.

Section reference: YB 12

The tripartite (third person) test YB 14

Test 11

Tripartite test YB 14



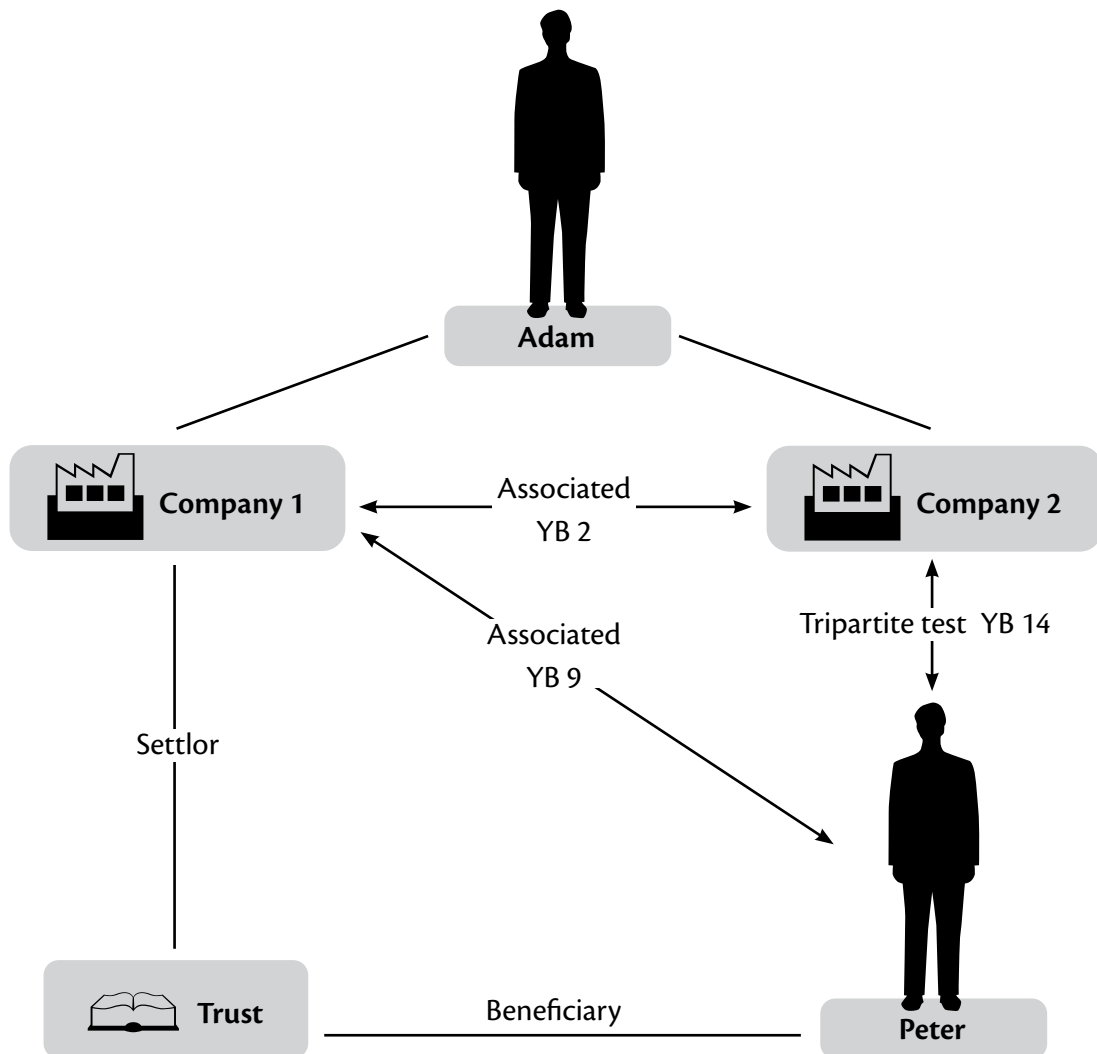
Two 'persons', person A and person B ('person' could be a company, individual, trust, partnership, unit trust, or a PIE) are associated if person A is associated to a third person, person C, under any of the tests 1 to 10, and person B is associated to the same third person, person C, under any of the tests 1 to 10, excluding the test under which person A is associated to person C.

Note: This test will not associate 2 persons if they are each associated with the same third person using a combination of both the 2 companies test 1 and a company and a person other than a company test 2.

If person A owns 50% of Company B (test 2) and Company B owns 40% of Company C (test 1), person A is not associated with Company C under the tripartite test.

The look-through rule also does not apply as person A's holding in Company C is less than 25%.

Section reference: YB 14

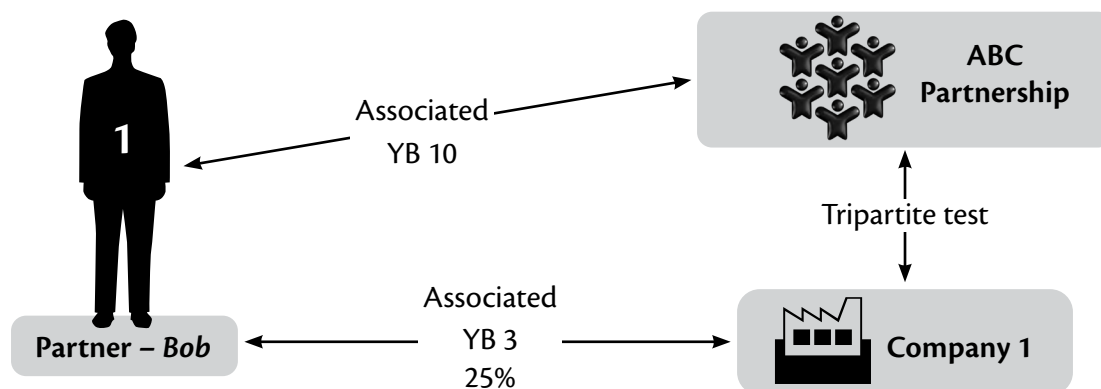


Tripartite test examples

Example 10: Adam has control over Company 1 and Company 2. These 2 companies will be associated to each other under the 2 companies test (test 1).

Company 1 also settled a trust where Peter is the beneficiary. Peter will be associated to Company 1 under the settlor and beneficiary test (test 8).

As Peter is associated to Company 1, and Company 2 is associated to Company 1, Peter and Company 2 will also be associated.



Example 11: Bob owns 25% of the market value in Company 1. Bob will be associated to Company 1 under the company and a person other than a company test (test 2).

Bob is also a partner in the ABC partnership. Bob will be associated to the partnership under the partnership and partner test (test 10).

As Company 1 is associated to Bob, and Bob is associated to the ABC Partnership, Company 1 and the ABC Partnership will also be associated.

Section reference: YB 14

Association in certain situations involving limited partnerships YB 16B

Test 12

Limited partnerships will be associated to other limited partnerships or with companies where 50% or more of the partnership share/voting interest is held by the same group (a 'group' could include companies, individuals, trusts, partnerships, unit trusts, PIEs, or any combination of these entities or 1 person) and at least 1 of the following conditions applies:

- The limited partnership is a limited partner of another limited partnership or has a limited partnership that is a limited partner.
- A company is a limited partner of a limited partnership
- A limited partnership has a voting or market value interest in a company

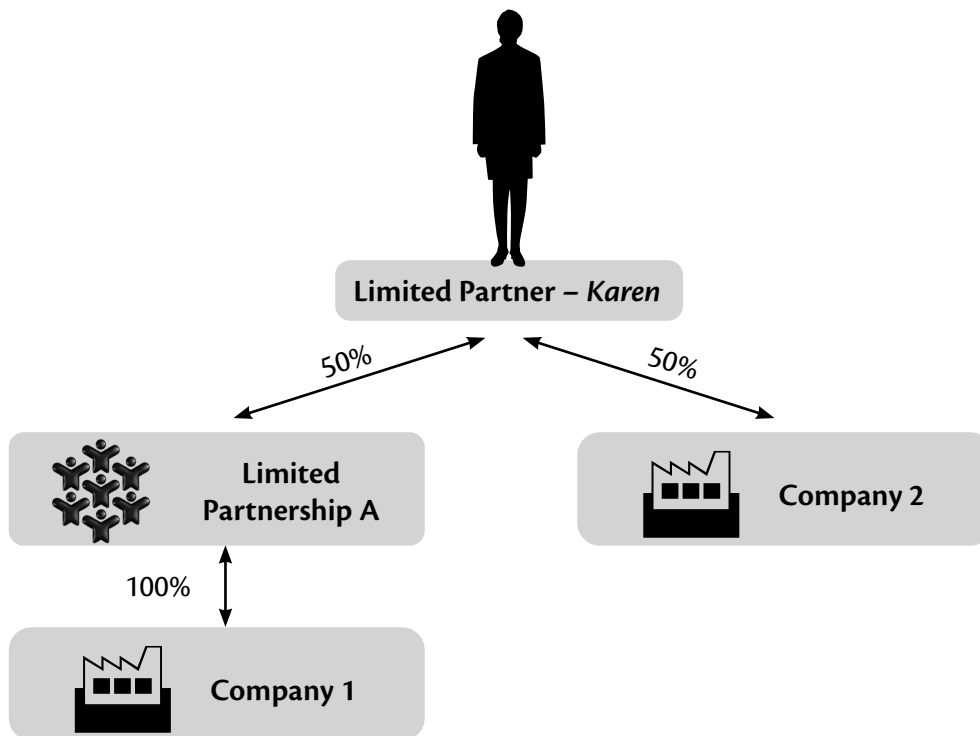
If 1 of the 3 above conditions applies, a limited partnership will be associated with another person (other than a company or limited partnership) if the person has a partnership share of 25% or more.

Section YB 16B effectively treats limited partnerships (if 1 of the conditions mentioned applies) as if they were companies for the purposes of sections YB 2, YB 3 and YB 12 (2), (3) and (4), and YC 4. Therefore, the following detailed analysis under part D (including the look through and aggregate rules) can also be applied to these limited partnerships,

- Two companies test (section YB 2),
- Company and person other than a company test (section YB 3),
- Partnership and partner test (section YB 12) with regard to the Limited Partnership section.

Example 1

Karen is a limited partner with a 50% partnership share in Limited Partnership A. She also has a 50% share in Company 2. Limited Partnership A holds 100% voting interest in Company 1.



As Limited Partnership A has voting interests in a company, it is treated as if it were a company (YB 16B) for the associated person tests dealing with companies (YB 2, test 1), other people (YB 3, test 2) and other limited partnerships (YB 12(2),(3) and (4)), it is also looked through (YC 4).

Limited Partnership A and Company 2 are associated under YB 2 through Karen (as she holds 50% partnership share/voting interest in each).

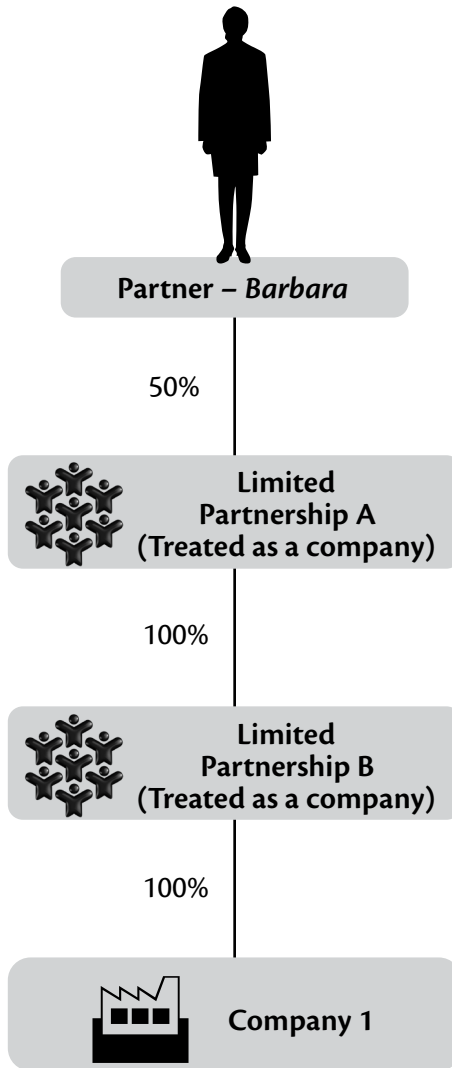
Karen and Limited Partnership A are associated under YB 3 as Karen has over 25% partnership share in the limited partnership.

Karen and Company 1 are associated as she holds 50% partnership share in Limited Partnership A and the look through provisions under YC 4 apply (50% Limited Partnership A x 100% Company 1 = 50%). (see example under test 2).

Limited Partnership A and Company 1 are associated as the voting interest/partnership share would be 100% held by the group of people who are limited partners in Limited Partnership A (Limited Partnership A holds 100% of Company 1 and is looked through to the same group of people).

Example 2

Barbara is a limited partner with 50% partnership share in Limited Partnership 1. Limited Partnership 1 is a limited partner with 100% partnership share in Limited Partnership 2. Limited Partnership 2 has 100% voting interest in Company 1.



Both limited partnerships are treated as if they are companies (YB 16B). Barbara is associated with Company 1 because she has a 50% shareholding in the company (YB 3), applying the look through provisions (YC 4) (50% Limited Partnership A x 100% Limited Partnership B x 100% Company 1 = 50%).

The 2 limited partnerships and the company are all associated with each other because they are 100% held by the same group of people (YB 2) (all the limited partners of Limited Partnership A also have 100% ownership of Limited Partnership B and Company 1).

PART D

Associated persons in more detail

This part provides more detailed commentary on the reform of the definitions of associated persons.

Key features of the reforms

The reforms to the associated persons definitions generally involve replacing the definitions with the objective of strengthening them. The other major part of the reforms involves rationalising these definitions and other income tax provisions which employ a similar concept.

The changes aim to give effect to the policy intention of capturing non-arm's length transactions, while not applying more widely than is necessary to protect the tax base.

The 11 associated persons tests generally apply for the purposes of the Income Tax Act. The main exception is in the land provisions where modifications are made so the associated persons definitions cover situations under the effective control of property dealers, developers and builders, but do not apply to other situations.

The tests for determining whether 2 companies, or a company and a person other than a company, are associated persons include rules that aggregate the interests of associates. This prevents the company-related tests being circumvented by the fragmentation of interests among associated persons.

The test for associating relatives is reduced from 4 degrees of blood relationship to 2 degrees only. This test is further limited to spouses and parents and their infant children for the purposes of the land provisions and compliance cost-saving provisions relating to low turnover traders and adverse event livestock transfers.

The weaknesses in the previous general associated persons definition in relation to trusts have been addressed by including tests associating a trustee and beneficiary, trustee and settlor, 2 trustees with common settlor, settlor and beneficiary, and a trustee and a person with the power to appoint or remove the trustee. A number of modifications apply to the trust-based tests to ensure that the associated persons definitions do not apply more widely than is necessary to protect the tax base. They include:

- Not applying the beneficiary-based associated persons tests (the trustee-beneficiary and settlor-beneficiary tests), and the test associating a person and a trustee for a relative in the case of land sales. It is not necessary to apply these tests to catch the type of structures being used to circumvent the land sale tax rules; the structures causing concern can be caught by other associated persons tests—in particular, the settlor-based trust and tripartite tests.
- Not treating charitable organisations as beneficiaries for the purposes of the trustee and beneficiary, and settlor and beneficiary tests and excluding charitable trusts from the trustee and settlor test.
- The definition of 'settlor' that applies for the purposes of the associated persons tests will not include a person who provides services to a trust for less than market value.

Persons who are married, in a civil union, or in a de facto relationship are treated as the same single person for the purpose of identifying a common settlor under the 2 trustees with a common settlor test in section YB 7. This treatment prevents the new associated persons definition being circumvented by the use of 'mirror trusts'.

The new associated persons definition introduces a tripartite test which associates 2 persons if they are each associated with the same third person, under different associated persons tests. The tripartite test acts as an important buttress to the other associated persons tests and makes the associated persons definition as a whole more difficult to circumvent.

The reforms also rationalise the current income tax definition of associated persons and other income tax provisions that employ a similar concept, such as the definition of 'related person' in the dividend rules. This represents a significant simplification and makes the associated persons concept in the Income Tax Act more coherent.

Application date

The general application date for the reforms (excluding those applying for the land provisions) is the 2010–11 and later income years. For the purposes of the land provisions (as defined in section YA 1), except for the section which relates to disposal of land within 10 years of completing improvements (section CB 11), the reforms apply to land acquired on or after 6 October 2009, the date of enactment. Given that association is tested in the land provisions at the time of acquisition, this means that for land acquired before 6 October 2009 the former associated persons definitions are the relevant provisions in determining whether the sale of such land is taxable. For the purposes of section CB 11, the reforms apply to land on which improvements started on or after 6 October 2009. Therefore, in the case of the land provisions, the relevant application date is 6 October 2009 irrespective of a person's balance date.

Detailed analysis

Subpart YB containing the associated persons definition rules in the Income Tax Act 2007 has been substantially replaced.

New section YB 1(4) states the general rule that the various associated persons tests in subpart YB apply for the purposes of the whole Act unless a provision expressly states otherwise. The main situation where certain exceptions will apply in the new associated persons tests is the land provisions, which are defined in section YA 1. For example, a narrow range of relatives (namely, spouses, civil union partners, de facto partners and infant children) applies in the new associated persons definitions for the purposes of the land provisions.

New sections YB 1(5) to (8) contain cross-references to several special rules that modify the associated persons definitions for the purpose of specific provisions. These special rules are contained in sections DS 4 (Meaning of film reimbursement scheme), EB 13 (Low-turnover valuation), EX 4 (Limits to requirement to include associated person interests in the controlled foreign company rules), and LP 2 (Tax credits for supplementary dividends). These special rules have not been changed as part of this reform.

Two companies test (section YB 2)

Section YB 2 contains the test for associating 2 companies. Two companies will be associated if:

- there is a group of persons whose total voting interests in each company are 50% or more—this is the primary test for associating 2 companies. The concept of voting interests is defined in subpart YC.
- a market value circumstance exists for either company and there is a group of persons whose total market value interests in each company are 50% or more. A 'market value circumstance' is defined in section YA 1 and a 'market value interest' is defined in subpart YC. Under the measurement of company ownership rules in subpart YC, a person's interest in a company is generally measured by reference to the person's voting interests in the company. If these voting interests in certain circumstances—coming within the definition of 'market value circumstance' in section YA 1—do not reflect accurately the person's economic interest in a company then the person's interests are also measured by reference to the person's market value interests in the company.
- there is a group of persons who control both companies by any other means.

Aggregation rule 2 companies

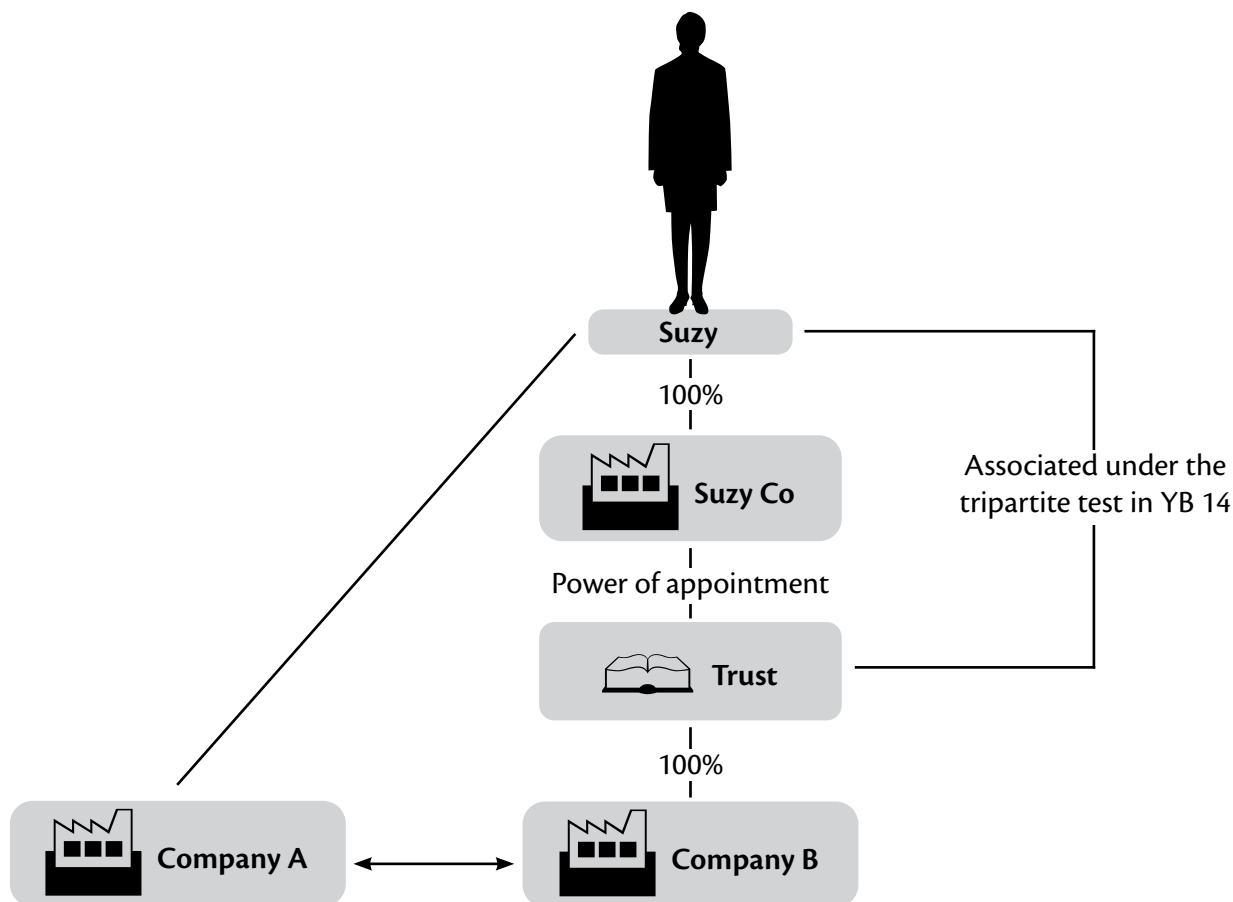
The test associating 2 companies contains a general aggregation rule which provides that in determining whether 2 companies are associated, a person is treated as holding anything held by persons associated with that person under sections YB 4 to YB 14 (section YB 2(4)). This rule applies for the purposes of the whole Act except the land provisions. The aggregation rule is designed to prevent the 2 companies test being circumvented by the fragmentation of interests among associated persons, resulting in the 50% interest threshold not being reached.

The 2 companies test contains a separate rule which aggregates the interests of associates for the purposes of the land provisions (section YB 2(5)). Under this rule, a person is treated as holding anything held by persons associated with them under the limited relatives definition in section YB 4 (namely, spouses, civil union partners, de facto partners and infant children) and under the tests in sections YB 7, YB 8, and YB 10 to YB 14. This modification ensures that for the purposes of the land provisions, the general relatives test and the beneficiary-related trust tests do not apply in the aggregation rule for the test associating 2 companies.

When applying the rules aggregating the interest of associates, the rule is applied afresh to each person and it is irrelevant that a person does not directly hold any shares in a company before the application of the aggregation rule.

Example

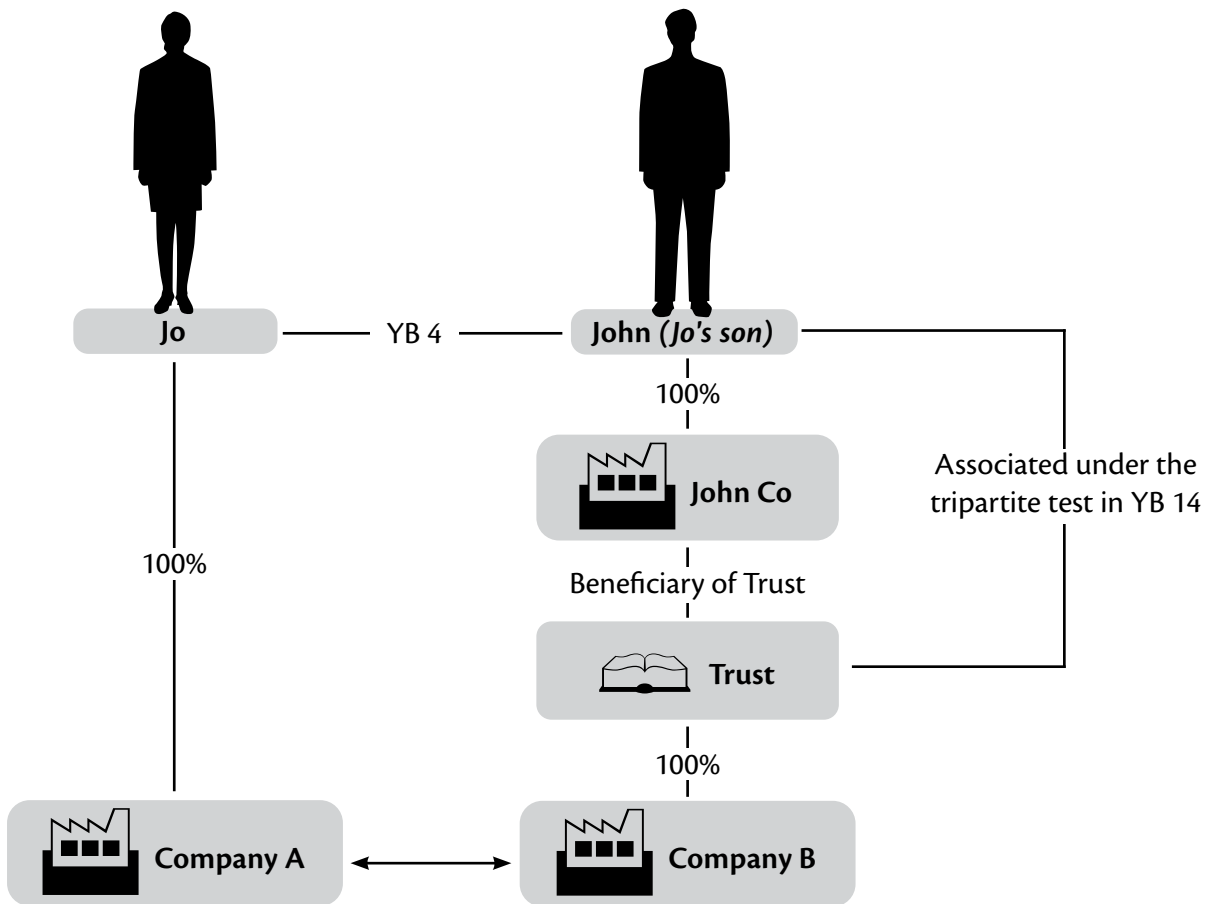
Application of general aggregation rule in 2 companies test



In this example the aggregation rule, in conjunction with the tripartite test, can be applied to treat Suzy as holding Trust's shares in Company B. Specifically, Suzy is associated with Suzy Co under the company and person other than a company test in section YB 3, and Suzy Co (with power of appointment of the trustees of Trust) is associated with Trust under section YB 11. Therefore, Suzy and Trust are associated under the tripartite test, and the aggregation rule in section YB 2(4) treats Suzy as holding Trust's shares in Company B. Taking into account the shares Suzy holds directly in Company A, Company A and Company B are associated under the 2 companies test in section YB 2.

Example

Application of general aggregation rule in 2 companies test



In this example, the question is whether Company A and Company B are associated.

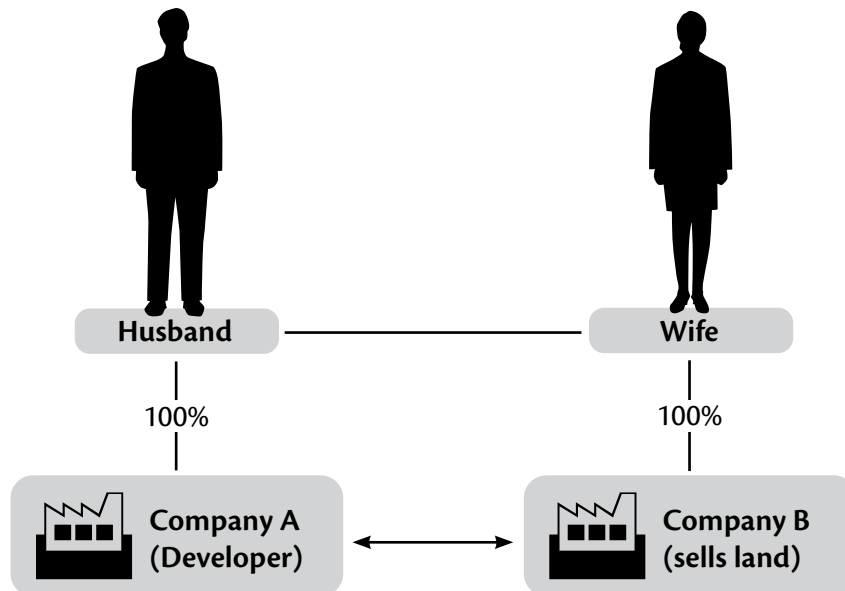
First, in conjunction with the relatives test in section YB 4, the aggregation rule in section YB 2(4) is applied so that John is treated as holding anything held by his associates. In this case, John is treated as holding Jo's shares in Company A through his association with Jo under the relatives test in section YB 4.

Secondly, the aggregation rule, in conjunction with the tripartite test, can also be applied to treat John as holding Trust's shares in Company B. This is because John is associated with Trust under the tripartite test in section YB 14. Specifically, John is associated with John Co under the company and person other than a company test in section YB 3, and John Co (as beneficiary of Trust) is associated with Trust under the trustee and beneficiary test in section YB 6. Therefore, John and Trust are associated under the tripartite test, and the aggregation rule in section YB 2(4) treats John as holding Trust's shares in Company B. As a result, because John is treated as holding all the shares in Company A and Company B under section YB 2(4), Company A and Company B are associated under section YB 2.

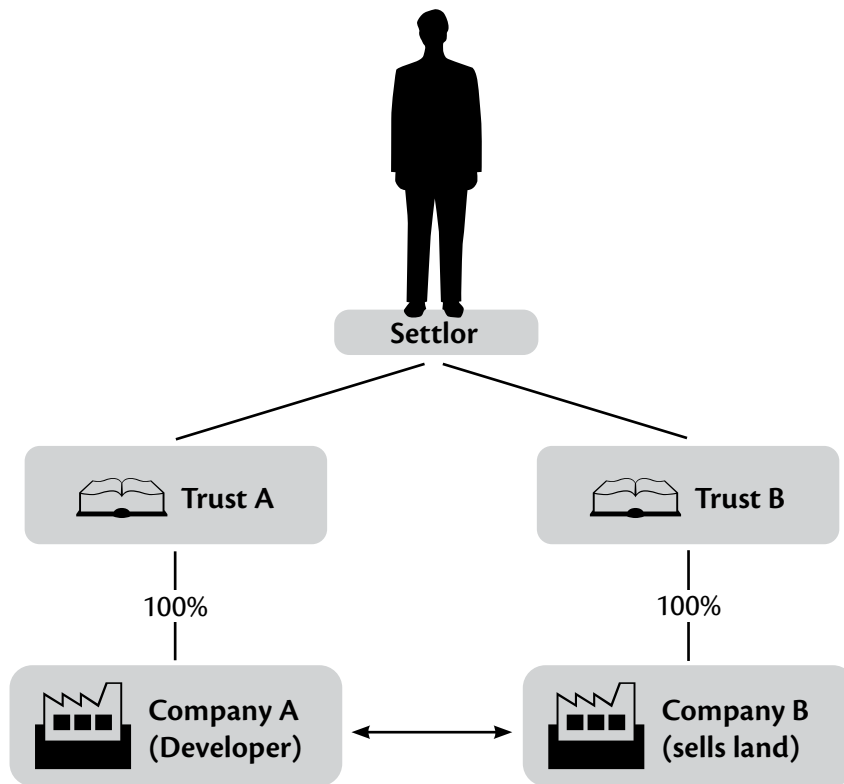
It is irrelevant that John does not directly hold shares in Company A and Company B before the application of the aggregation rule in section YB 2(4).

Example

Application of aggregation rule in 2 companies test in the context of the land provisions



In this example, the husband owns 100% of the voting interests in Company A, which is a property developer, and his wife holds 100% of the voting interests in Company B, which sells some land within 10 years of acquisition. Without the aggregation rule in section YB 2(5), the 2 companies would not be associated despite their close community of interests. The application of the aggregation rule ensures that the 2 companies are associated under section YB 2, resulting in Company B being liable to tax on the sale of the land.

Example**Application of aggregation rule in 2 companies test in the context of the land provisions**

In this example, Trust A and Trust B are associated under the 2 trustees with common settlor test in section YB 7. Trust A owns 100% of the voting interests in Company A, which is a property developer, and Trust B owns 100% of the voting interests in Company B, which sells some land within 10 years of acquisition.

The 2 companies are associated under the 2 companies test through the use of the aggregation rule contained in that test. Applying the aggregation rule to this example, Trust A is treated as holding anything held by persons associated with it. In this case, Trust A and Trust B are associated under the 2 trustees with common settlor test in section YB 7. Accordingly, taking into account Trust A's direct shareholding in Company A, Trust A is treated as holding all the voting interests in Company A and Company B, meaning these 2 companies are associated.

The aggregation rule can also be applied to treat the common settlor as holding all the voting interests in Company A and Company B because the settlor is associated with Trust A and Trust B under the trustee-settlor test in section YB 8. This also means the 2 companies are associated.

A result of Company A and Company B being associated is that Company B is liable to tax on the sale of land. Without the aggregation rule, Company A and Company B would not be associated despite their close community of interests.

Other features

The 2 companies test provides that the control by any other means limb in the test does not apply to a company that is a state enterprise, Crown Research Institute, Crown Health Enterprise or a company that is part of the same group of companies as one of these Crown-related entities (section YB 2(6)). It also provides that in the international tax rules (defined in section YA 1) 2 companies are not associated if one, but not both, is a non-resident (section YB 2(7)).

Additionally, for the purposes of the land provisions, 2 companies are not associated persons if one is a portfolio investment entity (PIE) or an entity that qualifies for PIE status (section YB 2(8)). This exception ensures that a widely held managed fund is not adversely affected because of the personal land dealings of the directors of the fund.

Company and person other than a company test (section YB 3)

Section YB 3 contains the test for associating a company and a person other than a company.

A company and a person other than a company are associated if:

- the person has a voting interest in the company of 25% or more. The concept of voting interests is defined in subpart YC.
- a market value circumstance exists for the company and the person has a market value interest in the company of 25% or more. A 'market value circumstance' is defined in section YA 1, and a 'market value interest' is defined in subpart YC. Under the measurement of company ownership rules in subpart YC, a person's interest in a company is generally measured by reference to the person's voting interests in the company. If these voting interests in certain circumstances—coming within the definition of 'market value circumstance' in section YA 1—do not reflect accurately the person's economic interest in a company then the person's interests are also measured by reference to the person's market value interests in the company.

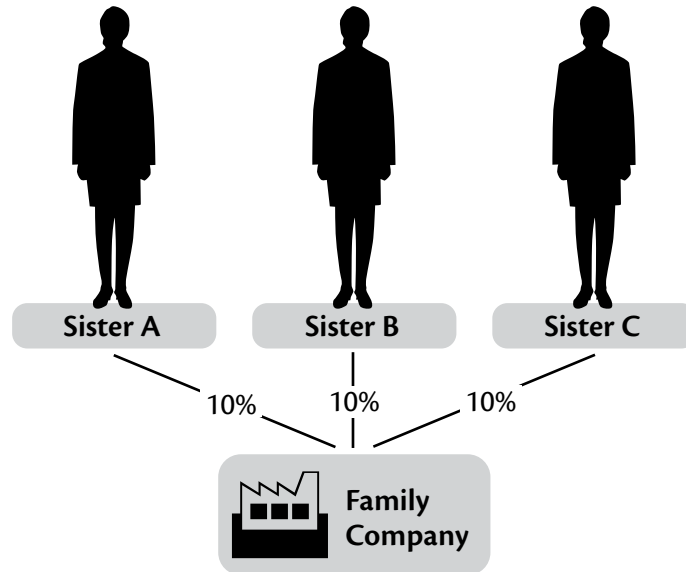
Aggregation rule company and individual

The test associating a company and person other than a company test contains a general aggregation rule, which applies for the purposes of the whole Act except the land provisions (section YB 3(3)). Accordingly, for the purposes of determining whether a company and a person other than a company are associated, a person is treated as holding anything held by persons associated with the person under sections YB 4 to YB 14. This aggregation rule is designed to prevent the test associating a company and a person other than a company being circumvented by the fragmentation of interests among associated persons, resulting in the interest threshold of 25% not being reached.

The test associating a company and a person other than a company contains a separate rule which aggregates the interests of associates for the purposes of the land provisions (section YB 3(4)). Under this rule, a person is treated as holding anything held by persons associated with the person under the limited relatives definition in sections YB 4 (namely, spouses, civil union partners, de facto partners and infant children) and under the tests in sections YB 7, YB 8, and YB 10 to YB 14. This modification ensures that for the purposes of the land provisions, the general relatives test and the beneficiary-related trust tests do not apply in the aggregation rule for the test associating a company and person other than a company.

When applying the rule aggregating the interests of associates, the rule is applied afresh to each person being tested for association with a company and it is irrelevant that a person does not directly hold shares in a company before the application of the aggregation rule.

The aggregation rules are an element of both of the company-based tests in sections YB 2 and YB 3. As noted above, the aggregation rules are designed to prevent these tests being circumvented by the fragmentation of interests among associated persons, resulting in the interest thresholds in these tests not being met. As such, the aggregation rules do not act as separate associated persons tests.

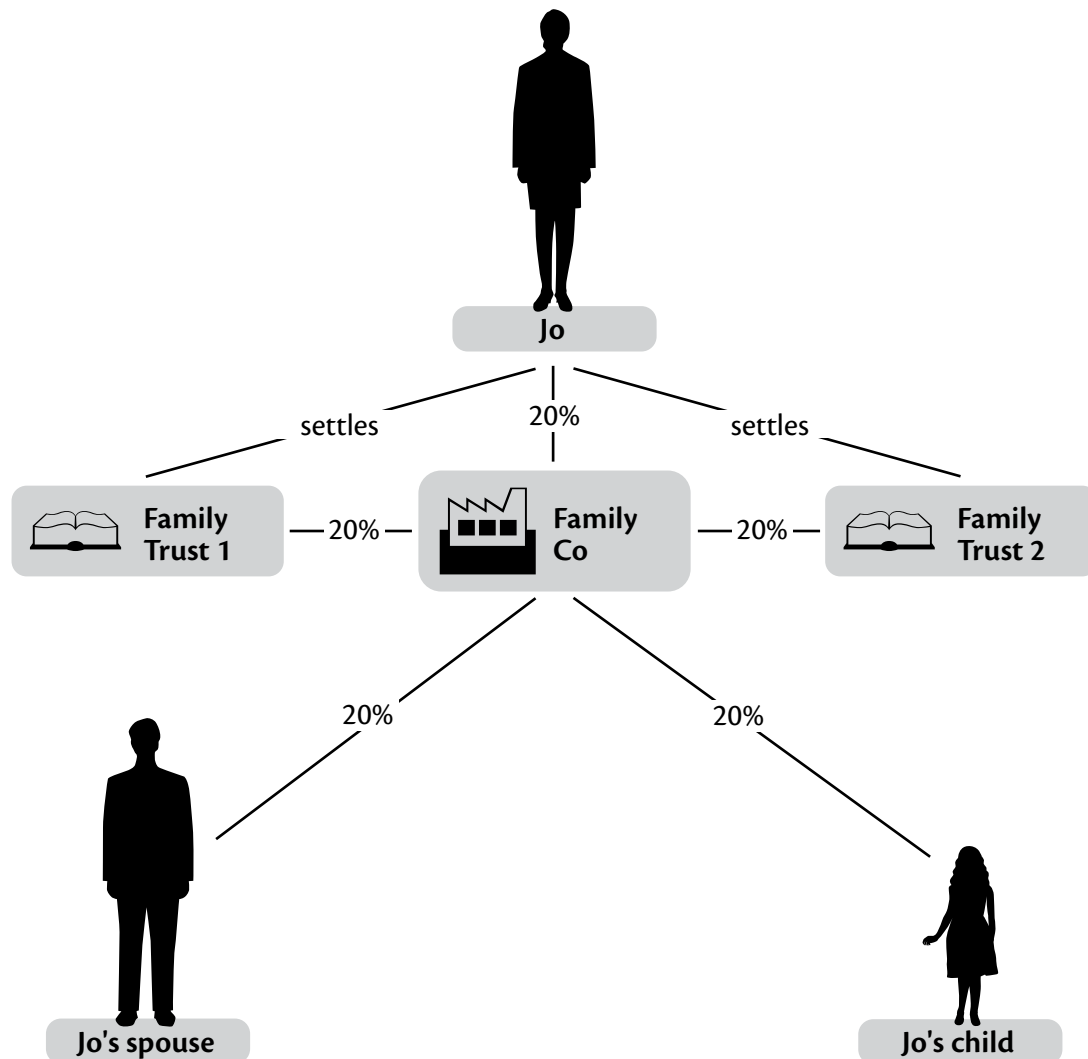
Example**Application of the general aggregation rule in the company and person other than a company test**

Without an aggregation rule, neither Sister A, B nor C would be associated with Family Company under the company and person other than a company test because their respective interests do not meet the required 25% threshold. However, under the aggregation rule in section YB 3(3), each sister would be associated with the company. This is because for the purposes of determining whether Sister A is associated with Family Company under section YB 3(1), she is treated as holding her sisters' 20% voting interests in the company (10% each from Sister B and Sister C). This 20%, when aggregated with her own 10% voting interest, means that Sister A is treated as holding a 30% interest and, therefore, is associated with the company.

The aggregation rule applies afresh to each person—so similarly, Sister B and Sister C are each treated as holding the other 2 sisters' aggregate 20% voting interests in the company. Therefore, when aggregated with the 10% interest they each own in the company, Sister B and Sister C are each associated with Family Company.

Example

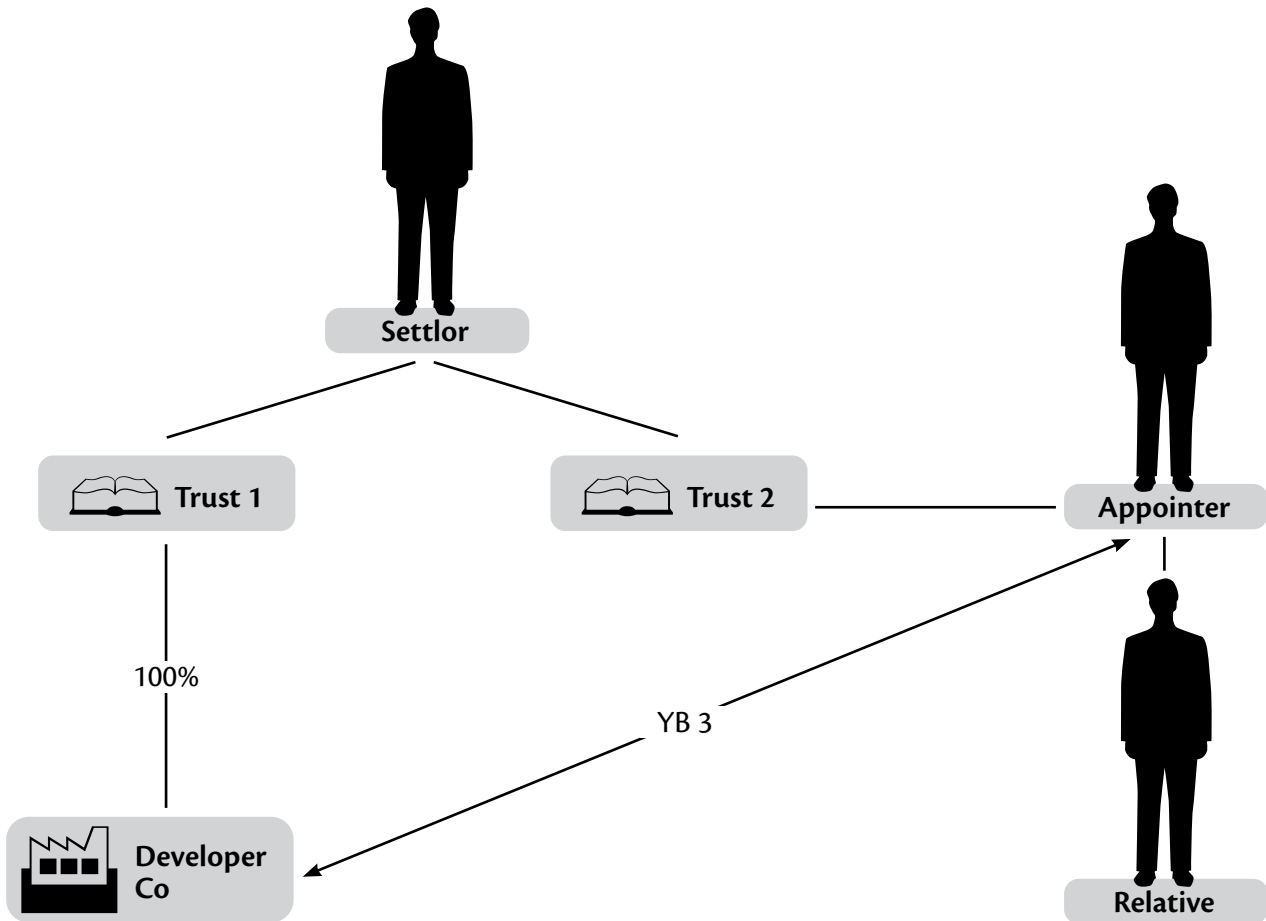
Application of the general aggregation rule in the company and person other than a company test



Jo settles Family Trusts 1 and 2 and arranges for each of them to hold 20% of the shares in Family Co. Jo also arranges for her spouse and child to hold 20% each in Family Co. Jo directly holds only 20%. Under the aggregation rule in section YB 3(3), Jo is treated as holding the shares in Family Co held by the family trusts and relatives because they are her associates. Accordingly, Jo is associated with Family Co. Without the rule aggregating the interests held by associated persons Jo would not be associated with Family Co despite the close community of interests.

Example

Application of aggregation rule in the company and person other than a company test in the context of the land provisions



The question in this case is whether the appointer of the trustee in Trust 2 is associated with Developer Co under the test in section YB 3 associating a company and a person other than a company. The appointer is associated with Developer Co under this test because of the application of the aggregation rule for land provisions in section YB 3(4) which treats a person as holding anything held by their associates. The appointer is associated with Trust 1 under the tripartite test in section YB 14. Specifically, the appointer is associated with Trust 2 under the test in section YB 11 associating a trustee and their appointer, and Trust 2 is associated with Trust 1 under the test in section YB 7 associating 2 trustees with a common settlor. Therefore, under the aggregation rule for land provisions in section YB 3(4) the appointer is treated as holding Trust 1's shares in Developer Co. Accordingly, the appointer and Developer Co are associated under section YB 3.

Note, however, that the relative of the appointer would not be associated with Developer Co. In particular, the tripartite test does not associate Trust 1 and the relative and therefore the relative is not treated as holding Trust 1's shares in Developer Co. The aggregation rule is applied afresh to the relative, and not to the appointer, for the purposes of determining whether the relative is associated with Developer Co. Therefore, the fact that the appointer is treated under the aggregation rule as holding Trust 1's shares when testing for association between the appointer and Developer Co is disregarded when testing for association between the relative and Developer Co.

Corporate trustees

In section YB 3, 'a person other than a company' includes a company acting in its capacity as a trustee of a trust (section YB 3(5)). This amendment is of a clarifying nature only and is consistent with long-standing policy (**Tax Information Bulletin (TIB), Vol 3, No 7, April 1992** at page 23).

The company look-through rules in subpart YC applying to voting and market value interests do not apply to a corporate trustee; therefore, the voting interests or market value interests held by a corporate trustee are not traced through to the shareholders of that corporate trustee. This treatment is a result of the separate capacity that a trustee (whether a company or natural person) has under the Income Tax Act 2007, and is recognised in the definition of 'trustee' in section YA 1 which refers to a trustee 'only in the capacity of trustee of the trust'. This separate trustee capacity feature of the income tax law has been maintained in the new associated persons definitions.

Therefore the shareholders of a corporate trustee are not relevant when testing for association between that trustee and other persons. This is consistent with the general position under the Income Tax Act, which is that a company acting in its capacity as trustee is treated as a trustee rather than a company. This means that the relevant test for determining association between a corporate trustee and a company in which the corporate trustee is a shareholder is section YB 3.

Relatives test (section YB 4)

There are 3 limbs to the general relatives test in the new associated persons definitions:

- The first limb associates 2 persons who are within 2 degrees of blood relationship (section YB 4(1)(a)). Previously the general relatives test extended to the fourth degree of blood relationship. This means that the blood relationships limb of the general relatives test extends to grandparents and siblings but not to nephews and nieces (third degree) and cousins (fourth degree) as the previous test did.
- The second limb associates 2 persons who are married, in a civil union, or in a de facto relationship (section YB 4(1)(b)).
- The third limb associates 2 persons if one person is within 2 degrees of blood relationship to the other person's spouse, civil union partner, or de facto partner (section YB 4(1)(c)). This limb associates persons with their in-laws and step-children.

For the purposes of the relatives associated persons test, a child by adoption is treated as a natural child of the adoptive parents and not as a natural child of the birth parents (section YB 4(3)).

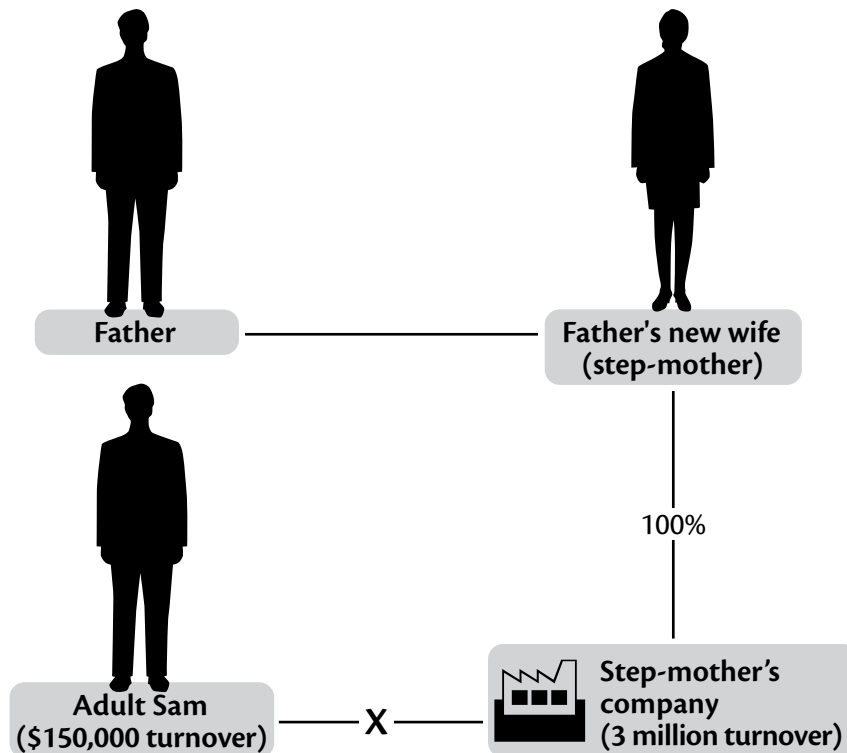
A new provision (section YB 4(4)) has been added to the test associating 2 relatives to ensure that a person is not associated with another person if the person cannot reasonably be expected to know that the other person exists or that they are within 2 degrees of blood relationship to the other person. This exclusion is designed to deal with a small minority of situations such as when siblings are separated at a very young age and do not know of each other's existence.

Narrower application of relatives test in certain cases (section YB 4(2))

The first and third limbs (section YB 4(1)(a) and (c)) of the general relatives test of association do not apply for the purposes of the land provisions (defined in section YA 1) or 2 compliance-cost saving provisions in the Income Tax Act—namely, the low turnover trader provision in section EB 13, and the provision relating to the adverse event livestock transfers in section EC 5. In these circumstances, persons are associated because of a blood relationship only if one is the infant child of the other. An 'infant child' is defined in the Age of Majority Act 1970 as a person under 20 years of age.

Example

Application of narrow relatives test in section YB 4(2)



Under the trading stock provisions in the Income Tax Act 2007, there are special low-compliance cost rules which apply to a 'low-turnover trader'. For a person to be a low-turnover trader, the turnover of that person's business, when aggregated with the turnover of associated persons, must be no more than \$3 million.

In this example, because a narrow relatives test applies for the purposes of the low-turnover trader rules, Adult Sam and his step-mothers' company are not associated and therefore Sam is entitled to use the low-turnover trader rules for his business. In particular, because Adult Sam is not treated under the relatives test in section YB 4 as being associated with his step-mother, the aggregation rule in the test in section YB 3 associating a company and a person other than a company does not apply to treat Adult Sam as holding his step-mother's shares in her company. If the ordinary relatives associated persons test had applied to the low-turnover trader rules Sam would be treated as being associated with his step-mothers' company under section YB 3 and therefore would not have been entitled to use the low-turnover trader rules.

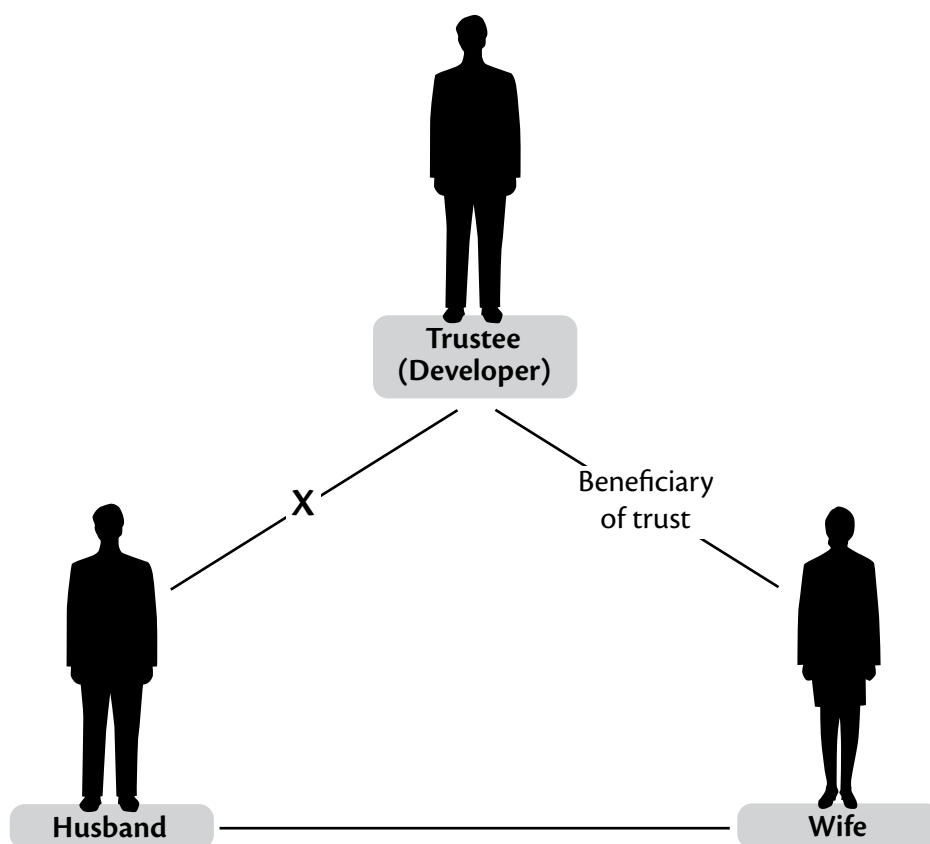
Trustee for relative test (section YB 5)

A person (first person) and a trustee of a trust under which a relative (as defined in section YB 4) of the first person has benefited or is eligible to benefit are associated persons under new section YB 5. For example, a husband and a trustee of a trust under which the husband's wife is a beneficiary would be associated under this test.

The trustee for relative test does not apply for the purposes of the land provisions. This is consistent with the land provision exclusions in the other beneficiary-related tests in section YB 6 (trustee and beneficiary) and YB 9 (settlor and beneficiary).

Example

Person and trustee for relative: exception for the purposes of the land provisions



Because the trustee for relative test does not apply for the purposes of the land provisions, the husband would not be associated with the trustee of the trust under which his wife is a beneficiary. Under the previous trustee for relative test in former section YB 12, the husband would have been associated with the trustee for the purposes of the land provisions.

Additionally, as further discussed below, this test does not apply to energy consumer trusts established under the Energy Companies Act 1992 or the unit trust administering bonus bonds (section YB 16).

Trustee and beneficiary test (section YB 6)

A trustee of a trust and a person who has benefited or is eligible to benefit under the trust are associated persons under new section YB 6. This provision does not apply for the purposes of the land provisions.

Persons have benefited under a trust if they have received a distribution under the trust.

Inland Revenue's long-standing policy on when a person is eligible to benefit under a trust will continue, see **Tax Information Bulletin (TIB), Vol 7, No 9, February 1996** page 25. In particular, a person is 'eligible to benefit' when the person is either:

- named by the trustee as a potential beneficiary, or
- designated as a member of a class of potential beneficiaries, for example, 'the children of ...'

When trustees have a general power of appointment, persons not already appointed as beneficiaries under the power are not treated as being eligible to benefit.

Therefore, a person who is eligible to benefit under a trust (as described above) does not need to have actually received a distribution (as defined in section HC 14 of the Income Tax Act 2007) under the trust to qualify as a beneficiary.

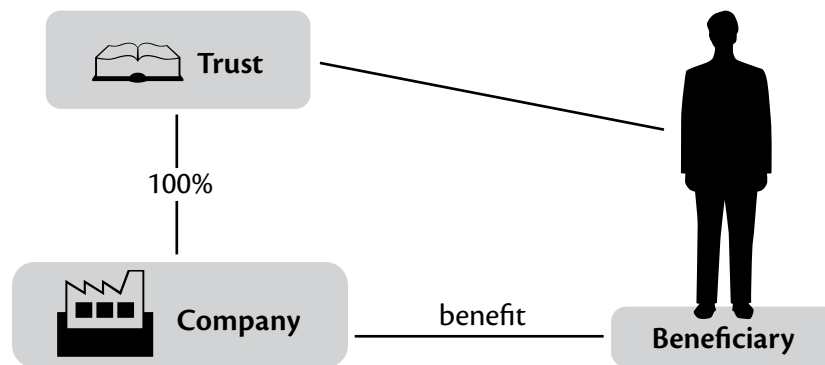
An exception to the trustee and beneficiary test for certain employee trusts is contained in section YB 15. Additionally, as with section YB 5, this test does not apply to energy consumer trusts or the unit trust administering bonus bonds (section YB 16).

The trustee and beneficiary test (and other trustee-related tests) are not relevant to unit trust investment vehicles. This is because such unit trusts are treated as companies for all income tax purposes. This means that it is the company related tests—in particular, section YB 3—that are the relevant associated persons tests. The 25% threshold in section YB 3 would ensure that retail investors would not be associated with widely held public unit trusts.

The trustee and beneficiary test (and other beneficiary-related tests) are not relevant to purpose trusts such as charitable trusts and community trusts referred to in the Community Trusts Act 1999 (these trusts were established to hold the shares in the successor companies to the former trustee banks). This is because purpose trusts do not at law have beneficiaries.

The previous general definition of associated persons did not contain a trustee and beneficiary test. This constituted a significant omission in test coverage and transactions were often structured to take advantage of the loophole. Without a trustee and beneficiary test in the associated persons definitions, many of the operative rules in the Income Tax Act using the general associated persons definition could be readily circumvented by simply interposing a discretionary trust.

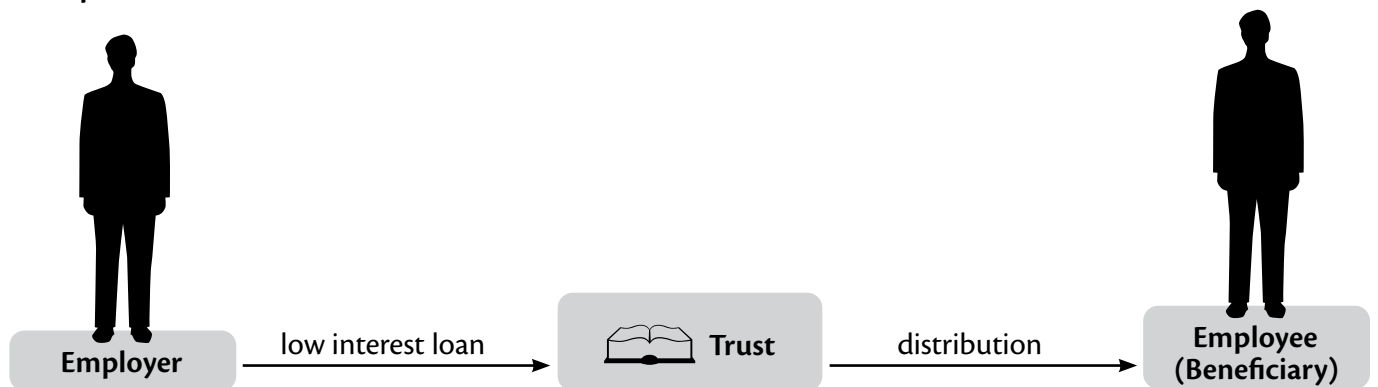
Example



In this example, the company provides a benefit to a beneficiary of its trustee shareholder. The company provides the benefit because the trustee is its sole shareholder. Section CD 6(1)(a)(ii) in the dividend rules treats payments to associated persons of shareholders as dividends. However, without a trustee and beneficiary test, this simple arrangement would avoid the dividend rules.

Under the new trustee and beneficiary test, because the company is providing a benefit to an associated person (Beneficiary) of a shareholder in the company (Trust), the company has made a dividend to the beneficiary under section CD 6(1)(a)(ii).

Example



In this example, an employer provides a low interest loan to a trust under which an employee is a beneficiary. Under section CX 18, FBT applies to fringe benefits provided to associated persons of employees. Without the trustee and beneficiary test in section YB 6, this simple arrangement avoids this rule. However, because of the new trustee and beneficiary test, the employer would be providing a fringe benefit (the low interest loan) to an associated person of the employee (the Trust) and would therefore be subject to FBT.

Two trustees with common settlor test (section YB 7)

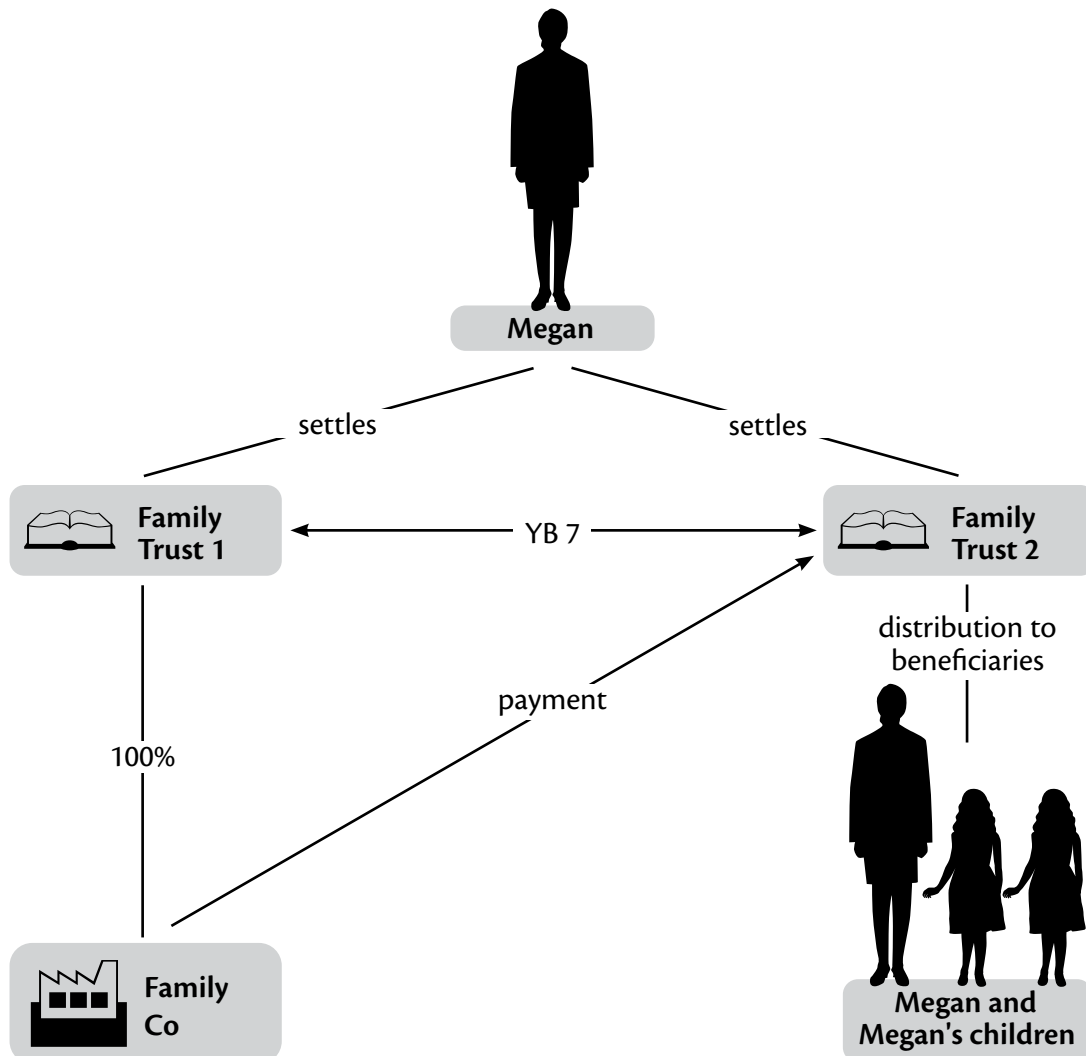
Under new section YB 7, a trustee of a trust and a trustee of another trust are associated persons if the same person is a settlor of both trusts.

New section YB 10 provides that for the purposes of the new section YB 7, 'settlor' has the meaning set out in section HC 27 of the Income Tax Act 2007, but does not include a person who provides services to a trust for less than market value.

An exception to the 2 trustees with common settlor test for certain employee trusts is contained in section YB 15.

Without a test associating 2 trustees with a common settlor many of the operative rules in the Income Tax Act which use the associated persons definition, such as the dividend rules, could be circumvented by structures such as the following example.

Example



In this example, Megan settles Family Trust 1, a trust that owns all of the shares in Family Co. Megan also settles Family Trust 2 whose discretionary beneficiaries include Megan's children and Megan herself. Family Co. makes a payment to Family Trust 2.

Under the dividend rules in sections CD 3 to CD 6 of the Income Tax Act, any payment made by a company to an associated person of a shareholder of the company is treated as a dividend if that payment would have been a dividend if it had been made to the shareholder.

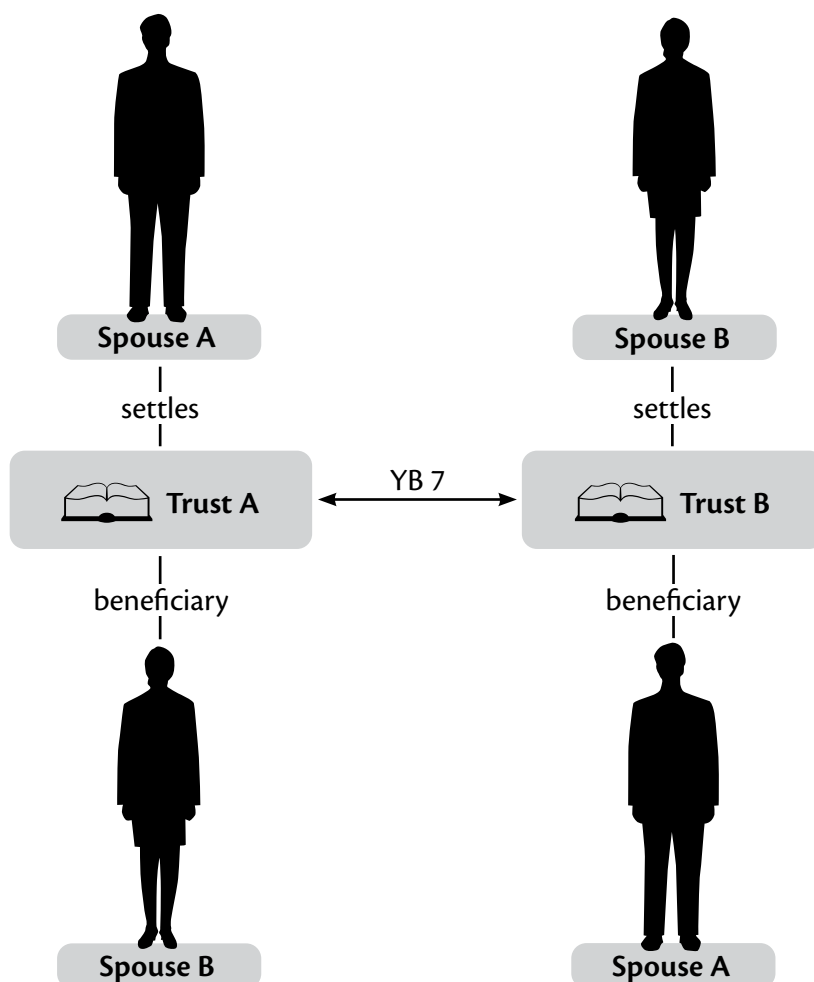
In the absence of a 2 trustees with common settlor test, Family Co has not made a payment to an associated person of its shareholder (Family Trust 1), in terms of section CD 6(1)(a)(ii). Therefore, the payment from Family Co to Family Trust 2 would not be treated as a dividend.

Under the new 2 trustees with common settlor test in section YB 7, Family Trust 1 and Family Trust 2 are associated persons as they have a common settlor (Megan). Therefore, the payment from Family Co to Family Trust 2 (an associated person of Family Co's shareholder, Family Trust 1) is treated as a dividend.

Two trustees with common settlor: mirror trusts

For the purposes of the 2 trustees with a common settlor test in section YB 7, 2 persons who are married, in a civil union, or in a de facto relationship are treated as the same single person. This is relevant to identifying a common settlor of 2 trusts, and prevents the new associated persons definition being circumvented by the use of 'mirror trusts'. This is illustrated in the following example.

Example



In this example spouse A settles a family trust (Trust A) for the benefit of spouse B and spouse B settles another family trust (Trust B) for the benefit of spouse A. Without the provision in the 2 trustees with common settlor test treating 2 persons who are married, in a civil union, or in a de facto relationship as the same single person, the trustees of Trust A and Trust B would not be associated despite the close community of interests.

The trustees of Trust A and Trust B are associated under new section YB 7 because Spouse A and Spouse B are treated as the same single person and therefore the trustees of Trust A and Trust B have a common settlor.

Trustee and settlor test (section YB 8)

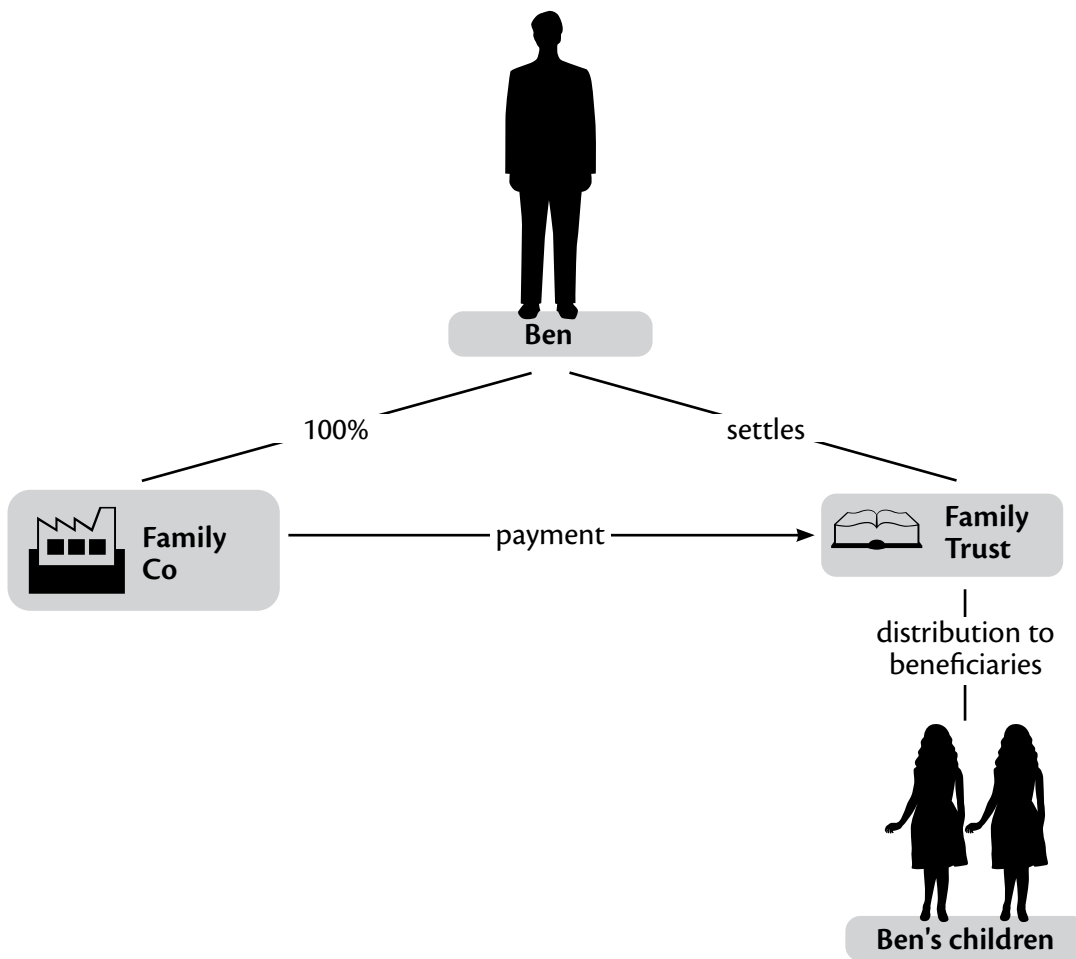
A trustee of a trust and a settlor of the trust are associated persons under new section YB 8.

New section YB 10 provides that for the purposes of new section YB 8, 'settlor' has the meaning set out in section HC 27, with the modification that a settlor does not include a person who provides services to a trust for less than market value.

An exception to the trustee and settlor test for certain employee trusts is contained in section YB 15.

As with the other trustee-related tests, the trustee and settlor test is an important element of the new associated persons definitions. Without this test in the associated persons definitions, schemes could be developed to exploit such a loophole. This is illustrated by the following examples.

Example

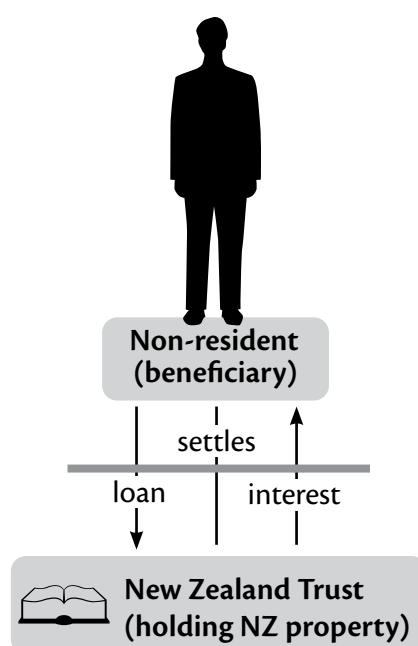


In this example, Family Co makes a payment to Family Trust. Ben is the sole shareholder of Family Co and the settlor of Family Trust.

Without a trustee and settlor test in the associated persons definition the payment from Family Co to Family Trust is not caught as a dividend despite the close community of interests. This is because Family Trust would not be associated with Ben who is the sole shareholder of Family Co.

Under the new trustee and settlor test in section YB 8, Ben and Family Trust are associated persons as Ben is the settlor of Family Trust. The payment from Family Co to the Family Trust is accordingly treated as a dividend because Family Co has made a payment to an associated person (Family Trust) of its shareholder (Ben) in terms of section CD 6(1)(a)(ii).

Example Non-resident settlor



In this example, a non-resident settles a New Zealand trust (with a New Zealand-incorporated company as trustee) which owns New Zealand land and buildings. This investment by the trustee is funded by a loan from the non-resident settlor. If the non-resident is not associated with the New Zealand trustee, then the interest paid on this loan qualifies for the approved issuer levy (AIL) of 2% instead of being subject to the higher NRWT (non-resident withholding tax) rate.

The previous associated persons definition used in the AIL rules was generally deficient in relation to arrangements involving trusts. In this example in particular, without a trustee and settlor test of association, the interest would qualify for AIL treatment despite the in-substance association between the 2 parties.

The new trustee and settlor test in section YB 8 would associate the non-resident with the New Zealand trustee. Accordingly, the interest derived by the non-resident from New Zealand would be subject to a higher rate of NRWT instead of AIL at 2%, which is the appropriate treatment.

Settlor and beneficiary test (section YB 9)

A settlor of a trust and a person who has benefited or is eligible to benefit under the trust are associated persons under section YB 9. This test does not apply for the purposes of the land provisions (as defined in section YA 1).

The settlor and beneficiary test is the third test of association (the others being the trustees with a common settlor and trustee and settlor tests) that is based on the settlor of a trust. This focus on the settlor is consistent with the settlor-based focus of the trust taxation rules.

Given that there is a sufficient connection between a trustee and a beneficiary, as well as between a trustee and a settlor to justify treating them as associated persons, there is equally a sufficient connection between a settlor and a beneficiary to justify treating them as associated persons as well.

An exception to the settlor and beneficiary test for certain employee trusts is also contained in section YB 15.

Definition of settlor (section YB 10)

As mentioned, for the purposes of the settlor-based tests in sections YB 7 to YB 9, settlor has the meaning set out in section HC 27, with the modification that a settlor does not include a person who provides services to a trust for less than market value. This modification prevents a professional advisor who provides services to a trust at no charge being treated as a settlor of the trust.

The term “settlor” has a wide meaning under the section HC 27 definition. A settlor of a trust is defined to include a person who transfers value to a trust, for the benefit of the trust, or on terms of the trust. Section HC 27 also includes rules for determining when a beneficiary is a settlor if they are owed money by the trustee and whether a transfer of value or provision of financial assistance has been made.

These transfers of value are referred to as settlements. A settlement is any action that makes a person a settlor of a trust and includes any of the following:

- disposal of any property to the trust for less than market value
- property or funds made available to the trust for less than market value
- any property acquired from the trust or any service from the trustee for greater than market value.

A settlement can also occur as a result of a transaction or series of transactions entered by a person that has the effect of making that person a settlor.

The definition of settlor is further extended by the provisions of section HC 28, the most significant of which are:

- When a company makes a settlement, any shareholder with an interest of 10% or more in that company is treated as a settlor in relation to that settlement as well as the company itself.
- When a trustee of a trust (the first trust) settles another trust (the second trust), the settlor of the second trust is treated as including any person who is a settlor of the first trust.
- When a person has any rights or powers in relation to a trustee or settlor of a trust which enables the person to require the trustee to treat the person (or any nominee) as a beneficiary of the trust, the person is treated as a settlor of that trust.

The definition of “settlor” is used extensively in the Income Tax Act and its wide meaning is consistent with the settlor-based focus of the trust taxation rules in the Income Tax Act.

The definition of “settlor”, in conjunction with the nominee look-through rule in section YB 21, does not include professional advisors acting on behalf of clients and other persons such as friends and family members who simply allow their name to be listed as the settlor on a trust deed. The definition of “settlor” that is being used is essentially the same as that originally enacted in 1988 as part of a reform of the trust rules (with the exception that the provision of services at less than market value are excluded). The main focus of this definition is on persons who provide the trust property, and therefore does not include persons who merely allow their name to go on the trust deed as the named settlor.

It is therefore the client of the professional advisor, or the person that the friend or family member is acting for, who is treated as the settlor under the settlor-based tests in sections YB 7 to YB 9.

This position is consistent with Inland Revenue’s long-standing policy. Tax Information Bulletin (TIB) of November 1989 on the trust rules at paragraph 6.93 states:

“Often professional advisers or relatives will assist in establishing a trust by settling a nominal sum on trust on behalf of another person. In these circumstances it is not appropriate to expose the professional adviser or relative to a potential tax liability. The professional adviser or relative is not the real settlor of the trust but is in effect only an intermediary or facilitator. The real settlor is the person on whose behalf the professional adviser or relative acted in making the settlement. Thus, s.226(3) [now section YB 21 of the Income Tax Act 2007] treats the person for whom the nominee or the nominal settlor acted as the settlor rather than the nominee or nominal settlor.”

Trustee and person with power of appointment or removal test (section YB 11)

A trustee of a trust and person who has a power of appointment or removal of the trustee are associated persons under section YB 11. This test is intended to complement the test associating a trustee and settlor in section YB 8. In many cases, a settlor of a trust, as the author of the instrument creating and governing the administration of the trust, retains the power to appoint or remove trustees. However, this power could be reposed in a separate person.

There is sufficient connection between a trustee of a trust and the person who has the power to appoint or remove the trustee to justify treating them as associated persons.

The situations considered to be caught by the test in section YB 11 associating a trustee and a person with the power of appointment or removal of the trustee include:

- a person who holds a power to appoint or remove trustees jointly with another person
- a person who holds a power to appoint or remove trustees only with the consent of another person (often referred to as the 'protector').

However, the following situations are not considered to be caught by the test in section YB 11:

- a person who holds a power to appoint or remove trustees only on the happening of certain events in the future (for example, the incapacity of another person) are not treated as currently holding a power of appointment or removal
- a person (often referred to as the protector) who holds the power to veto the appointments or removal of a trustee (because they do not hold any positive power).

The requirement in the tripartite test in section YB 14 that 2 persons must be associated with the same third person under different associated persons tests should obviate any concerns about whether otherwise unrelated trustees are associated under that test merely because a professional advisor acting in their capacity as such has been granted the power to appoint or remove trustees by their clients.

An exception to the test associating a trustee and a person with a power of appointment or removal of the trustee for certain employee trusts is contained in section YB 15.

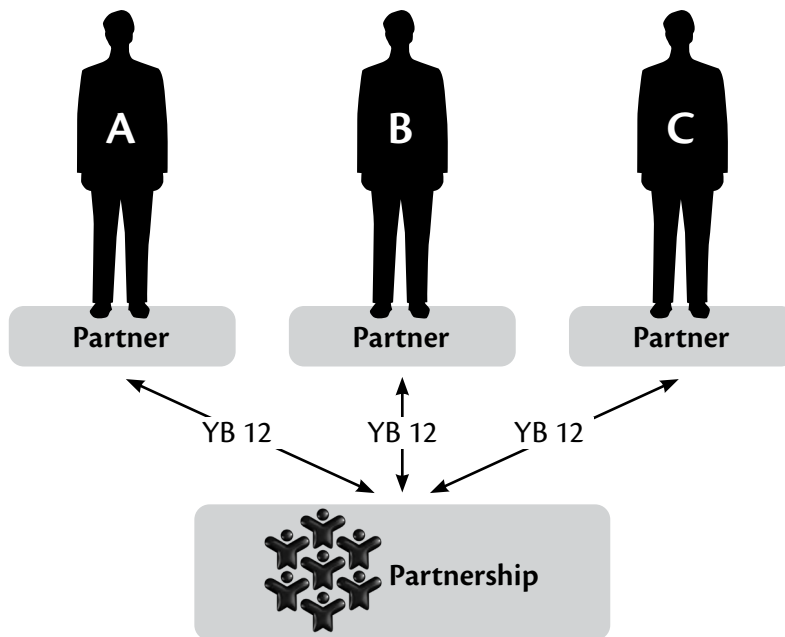
Partnership and partner test (section YB 12)

A partnership and a partner in the partnership are associated persons under section YB 12(1).

The tripartite test in section YB 14—which associates 2 persons if they are each associated with the same third person under different associated persons tests—will not apply to associate the partners themselves with each other. This is because partners in a partnership would be associated with the same third person (the partnership) under the same associated persons test, namely section YB 12.

Example

Partnership and partner

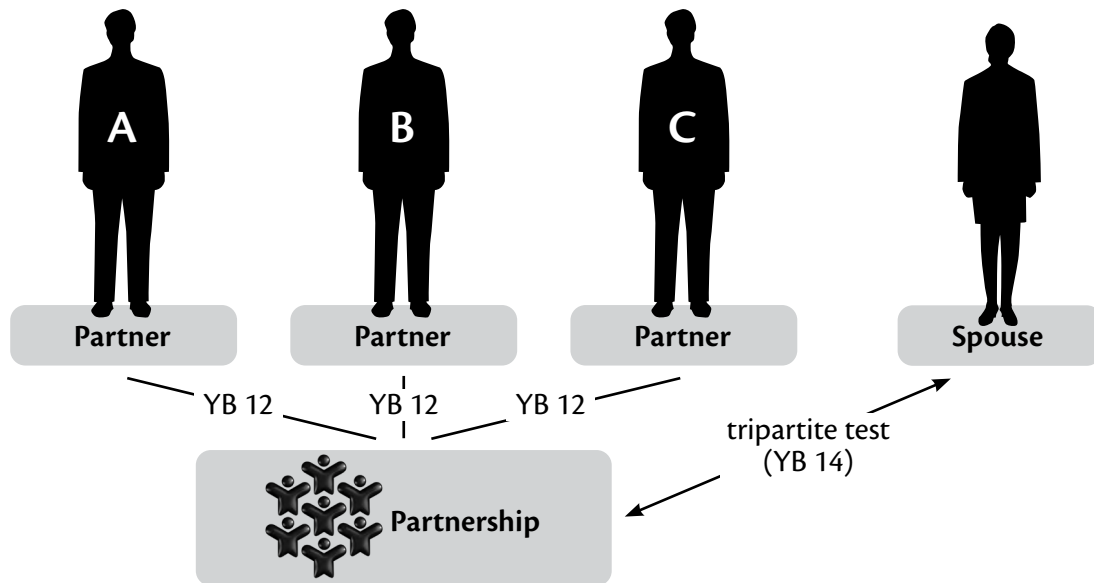


A, B and C are individuals who are partners in a partnership. Under the partnership and partner test in section YB 12, Partners A, B and C are each associated with the partnership. However, they are not associated with each other under the tripartite test in section YB 14 through their association with the partnership. The partners may still be associated with each other under a different associated persons test. For example, if partners B and C were married they would be associated with each other under the relatives test in section YB 4.

The test associating a partnership and an associate of a partner in former section YB 17 has been subsumed by the new tripartite test in section YB 14, which associates 2 persons if they are each associated with the same third person under different associated persons tests. This means that an associate of a partner, such as a spouse of a partner, would still be associated with the partnership itself, as illustrated in the following example.

Example

Partnership and associate of a partner: association through tripartite test



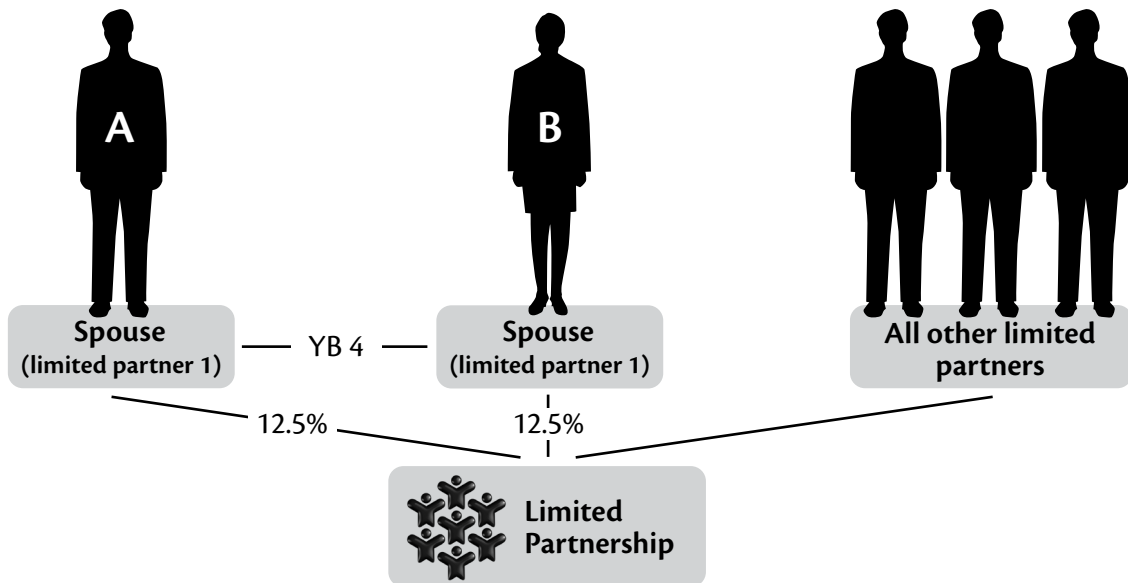
In this example, the spouse of Partner C is associated with Partner C under the relatives test in section YB 4, and Partner C and Partnership are associated under the partnership and partner test in section YB 12. Therefore, applying the tripartite test, Spouse and Partnership are associated persons as they are each associated with the same third person (Partner C) under different associated persons tests.

Limited partnerships

There is a separate test for determining if a limited partnership and a person are associated. A limited partnership (as defined in section YA 1 of the Income Tax Act 2007) and a person are associated only if the person has a partnership share of 25% or more in the limited partnership (section YB 12(2)).

This treatment is appropriate because a limited partner cannot be involved in the management of the partnership (unlike in a general partnership). It should be noted that section YB 12(2) does not include a general partner in a limited partnership. A general partner in a limited partnership will be associated with the limited partnership under section YB 12(1B). The tests in sections YB 12(2) to (4) do not apply if the limited partnership association rules in section YB 16B apply.

Section YB 12(3) and (4) contain aggregation rules for limited partnerships, similar to the aggregation rules in the company and person other than a company test in section YB 3 (the aggregation rule in section YB 12(3) applies for the purposes of the whole Act except the land provisions, and the more limited aggregation rule in section YB 12(4) applies for the purposes of the land provisions). This is appropriate given that a limited partner is more akin to a shareholder in a company and the interest threshold for associating a limited partner in a limited partnership – 25% – is the same as the threshold in section YB 3.

Example**Aggregation rule for limited partnership**

In this example, in the absence of an aggregation rule, Spouse A and Spouse B would not be associated with Limited Partnership, as their respective shares in the partnership do not meet the required 25% threshold. However, applying the aggregation rule for limited partnerships in section YB 12(3), both Spouse A and Spouse B would be associated with Limited Partnership. This is because for the purposes of determining whether Spouse A is associated with Limited Partnership under section YB 12(2), Spouse A is treated as holding anything held by associates—in this case, Spouse A is associated with Spouse B under the relatives test in section YB 4. When Spouse A's 12.5% share in Limited Partnership is aggregated with his associate's (Spouse B) 12.5% share, the required 25% threshold is met and Spouse A is therefore associated with Limited Partnership under section YB 12(2).

Once again, the aggregation rule is applied afresh to each person. As a result, the aggregation rule is also applied in this case to associate Spouse B with Limited Partnership. This is consistent with the application of the aggregation rule in the company-related tests.

Tripartite test (section YB 14)

The tripartite test in section YB 14 associates 2 persons if they are each associated with the same third person under different associated persons tests.

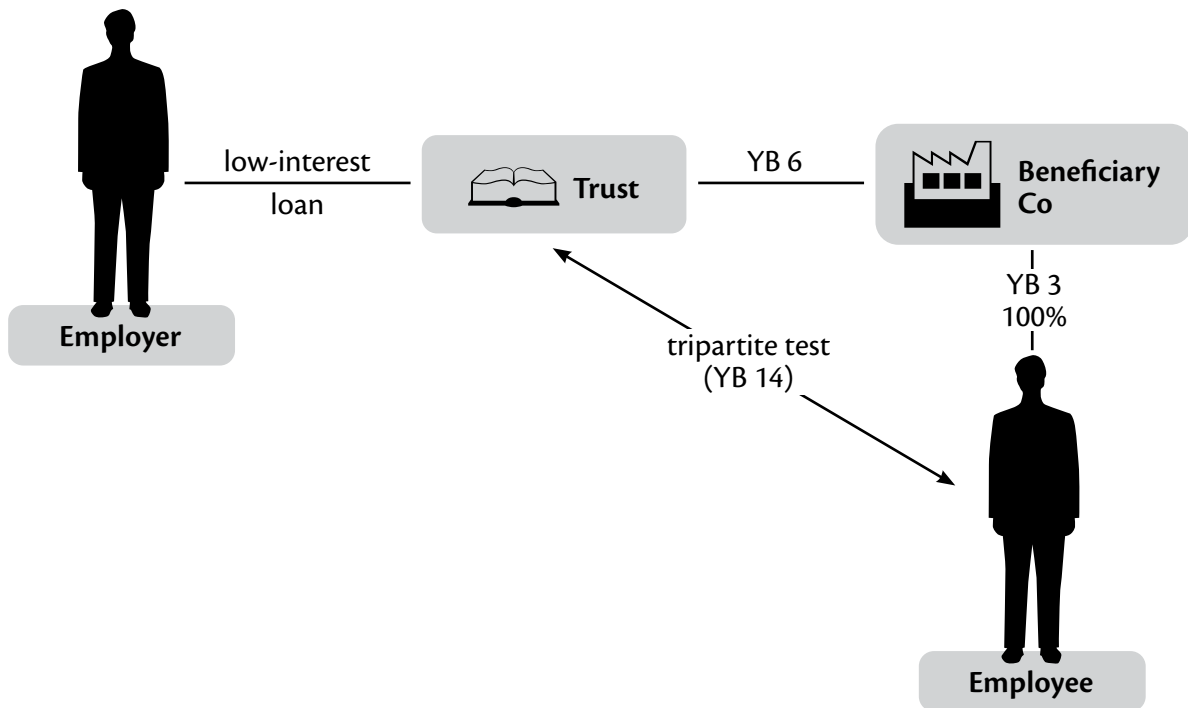
The tripartite test acts as an important buttress to the other associated persons tests and makes the associated persons definition as a whole more difficult to circumvent.

For the tripartite test to associate 2 persons, each of these persons must be associated with the same third person under different associated persons tests, not including the tripartite test itself. The requirement that the 2 persons cannot be associated with the same third person under the tripartite test itself is necessary to prevent the tripartite test operating in a reiterative manner. The requirement that the 2 persons have to be associated with the same third person under different associated persons tests ensures that the tripartite test does not apply more widely than is necessary to protect the tax base.

The following examples illustrate the important role of the tripartite test in preventing the other associated persons tests being circumvented by arrangements involving the interposition of relatives, companies and trusts which are under the influence or control of the main protagonists.

Example

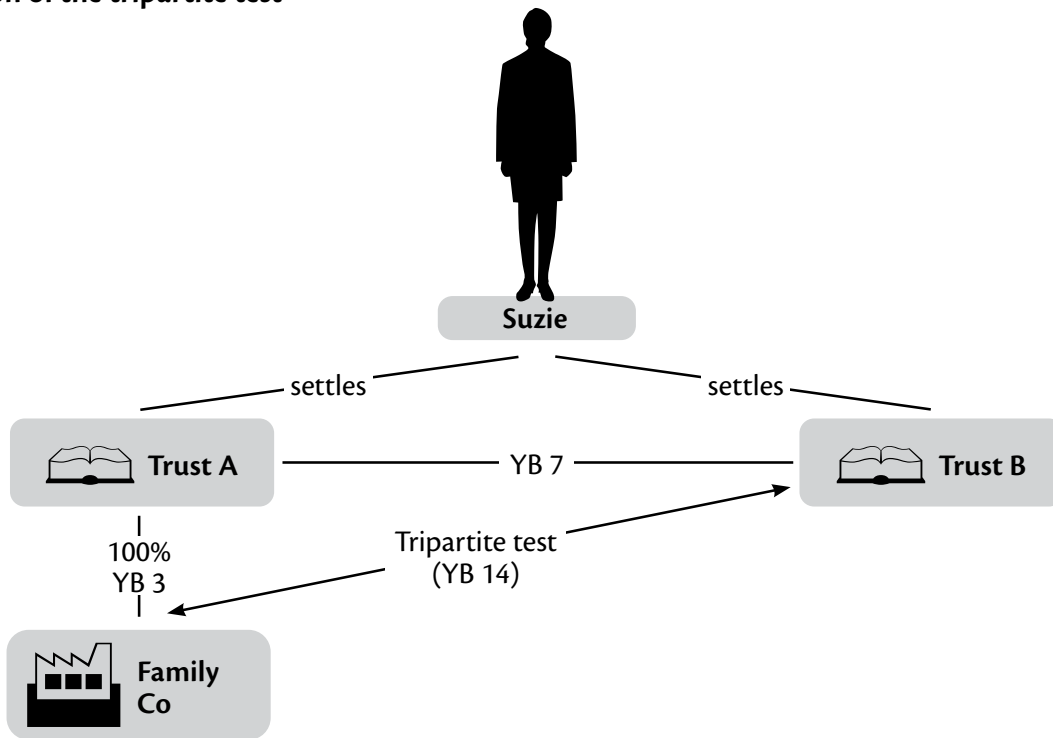
Application of the tripartite test



In this example, the employer makes a low-interest loan to Trust which in turn makes a distribution to Beneficiary Co which is wholly owned by an employee of the employer. The tripartite test in section YB 14 associates Trust with the employee because they are both associated with Beneficiary Co. In particular, Trust is associated with Beneficiary Co under the trustee-beneficiary test in section YB 6, and the employee is associated with Beneficiary Co under the test in section YB 3 associating a company and a person other than a company. As a result, because the employer has provided a fringe benefit (the low-interest loan) to an associate of an employee, the employer would have to account for FBT on the low-interest loan.

Example

Application of the tripartite test

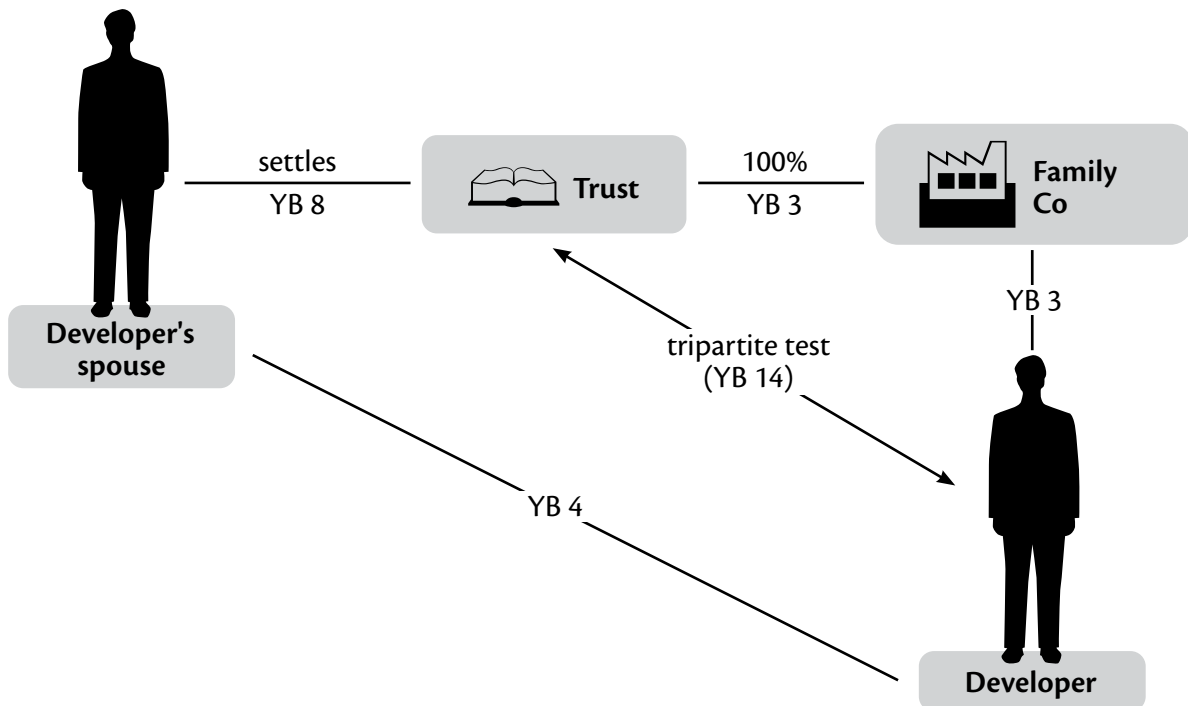


In the above example, Suzie settles 2 family trusts: Trust A and Trust B. Trust A in turn owns all the shares in Family Co. The issue is whether Family Co is associated with Trust B.

Without a tripartite test, Family Co and Trust B would not be associated, despite the close community of interests between them. However, under the tripartite test in section YB 14, Family Co and Trust B are associated. In particular, Family Co is associated with Trust A under the company and person other than a company test in section YB 3, and Trust A is associated with Trust B under the 2 trustees with a common settlor test in section YB 7. Therefore, under the tripartite test, Family Co and Trust B are associated persons.

Example

Application of the tripartite test and the aggregation rule



In this example, Developer's spouse settles Trust, which in turn owns all the shares in Family Co. The issue is whether Developer is associated with Family Co under the test associating a company and a person other than a company in section YB 3.

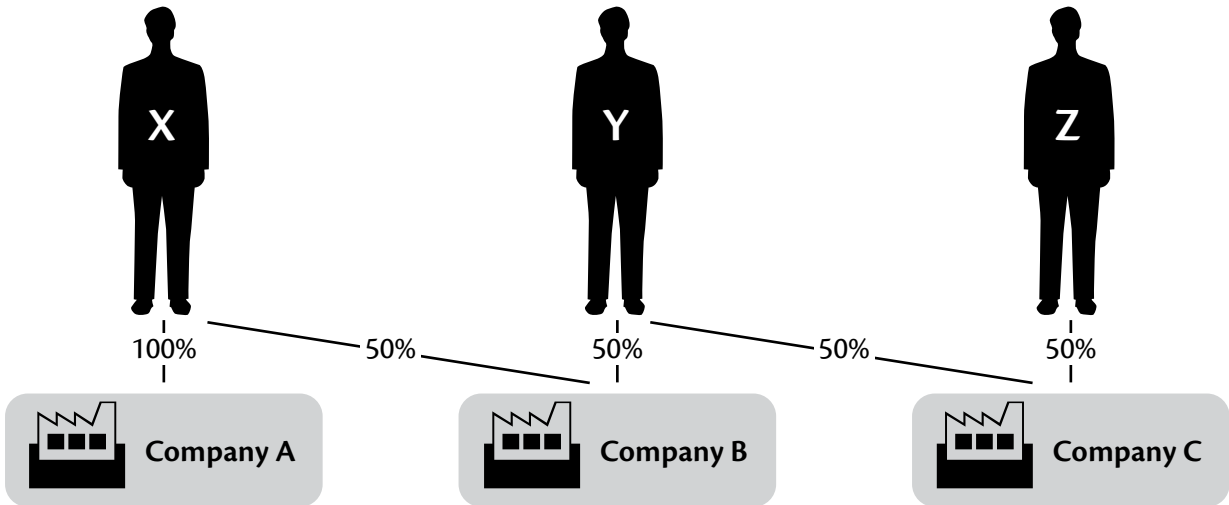
Developer would be associated with Family Co under the company and person other than a company test because of the application of the aggregation rule in that test, in conjunction with the tripartite test. In particular, Developer would be treated for the purposes of the company and person other than a company test as holding all the shares held by Trust in Family Co. This is because Trust is associated with Developer under the tripartite test: Developer is associated with his spouse under the relatives test (section YB 4) and Developer's spouse is associated with Trust under the trustee and settlor test (section YB 8), which means that Developer is associated with Trust under the tripartite test.

Without the tripartite test in section YB 14 and the rule in the company and person other than a company test aggregating interests held by associated persons, Developer would not be associated with Family Co even though there is a large community of interest between them.

Different associated persons requirement

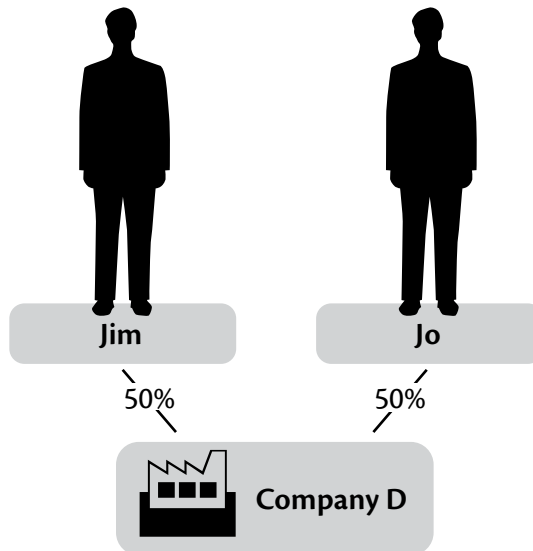
The requirement in the tripartite test in section YB 14 that the 2 persons have to be associated with the same third person under different associated person tests is designed to prevent the tripartite test applying more widely than is necessary to protect the tax base. This requirement is illustrated by the following examples.

Example



In this example, individuals X, Y and Z, who are not associated with each other, own all the shares in Company A, Company B and Company C. Without the different associated persons tests requirement, Company A and Company C would be associated under the tripartite test in section YB 14, despite not having any common shareholders. However, because Company A and Company C are each associated with Company B under the same 2 companies test in section YB 2, they are not associated under the tripartite test.

Example



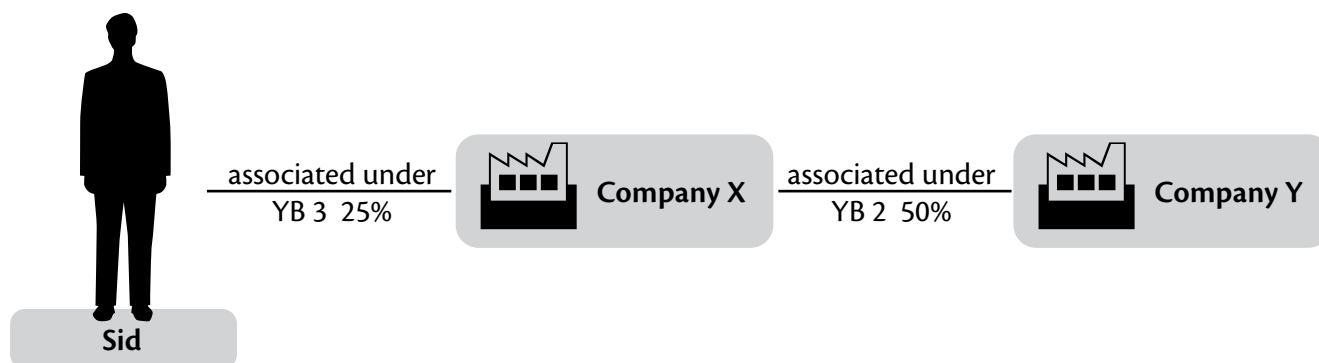
In this example, Jim and Jo, who are not separately associated with each other, each hold 50% of the voting interests in Company D and are therefore each associated with Company D under the test in section YB 3 associating a company and a person other than a company. Without the different associated persons tests requirement, Jim and Jo would be associated under the tripartite test. However, because Jim and Jo are each associated with Company D (the common third person) under the same test (section YB 3), they are not associated under the tripartite test in section YB 14.

Exception for companies tests (section YB 14(2))

As well as not applying to associate 2 persons if they are each associated with the same third person under the same associated persons test, the tripartite test will not associate 2 persons if they are each associated with the same third person under the company-related tests in sections YB 2 and YB 3.

Example

Tripartite test: Companies tests exception



In this example, Sid is associated with Company X under the company and person other than a company test in section YB 3, and Company X and Company Y are associated under the 2 companies test in section YB 2.

Without the companies tests exception in section YB 14(2), the tripartite test would apply to associate Sid and Company Y (Company X being the common third person). This would be the case even though Sid only has a 12.5% interest in Company Y—the product of multiplying Sid's 25% interest in Company X by Company X's 50% interest in Company Y—which is below the 25% threshold in the company and person other than a company test in section YB 3. The companies test exception in section YB 14(2) ensures that Sid is not associated with Company Y under the tripartite test.

Exceptions for certain trusts and charitable organisations

(sections YB 16 and YB 8(2))

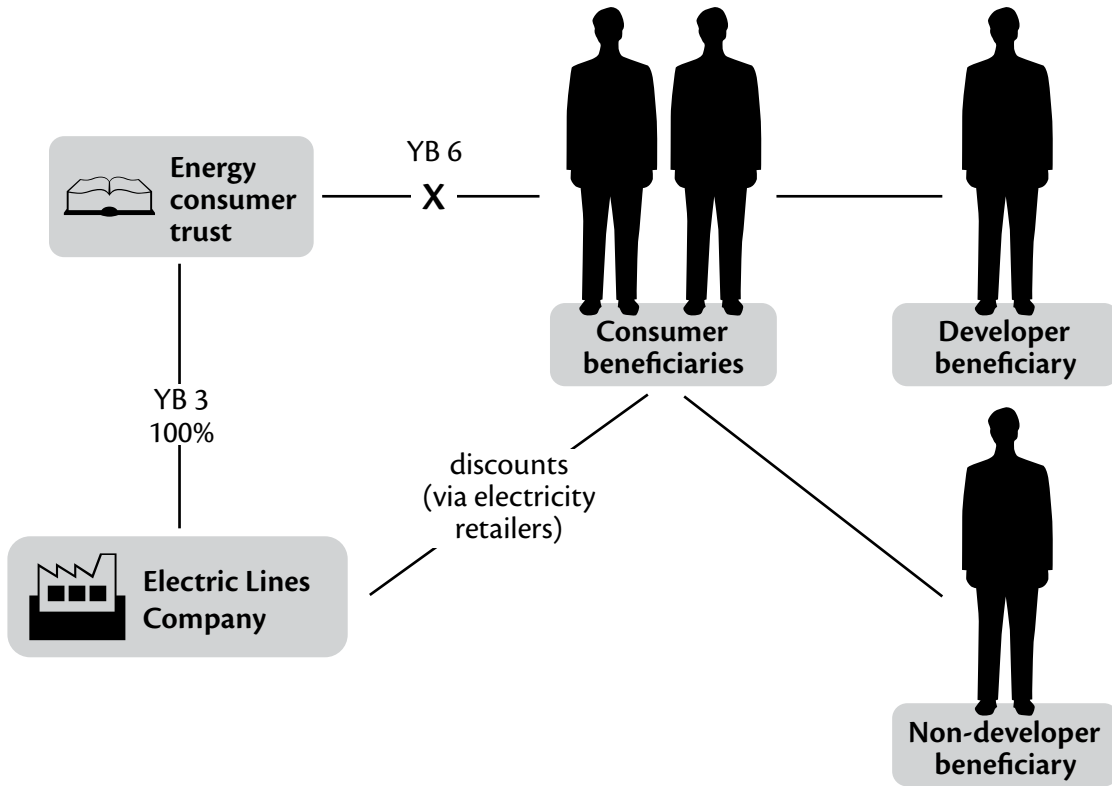
Energy consumer trusts and bonus bonds unit trust

Under section YB 16(1), a lines trust established under the Energy Companies Act 1992, commonly referred to as an energy consumer trust, is excluded from the trustee for relative test (section YB 5) and the test associating trustees and beneficiaries (section YB 6). This is because such trusts are public in nature and are not intended to be subject to the associated persons tests.

Excluding energy consumer trusts from the tests in sections YB 5 and YB 6, ensures that discounts to consumers from electricity lines companies owned by consumer trusts are not treated as dividends, as illustrated in the following example.

Example

Exception for energy consumer trusts



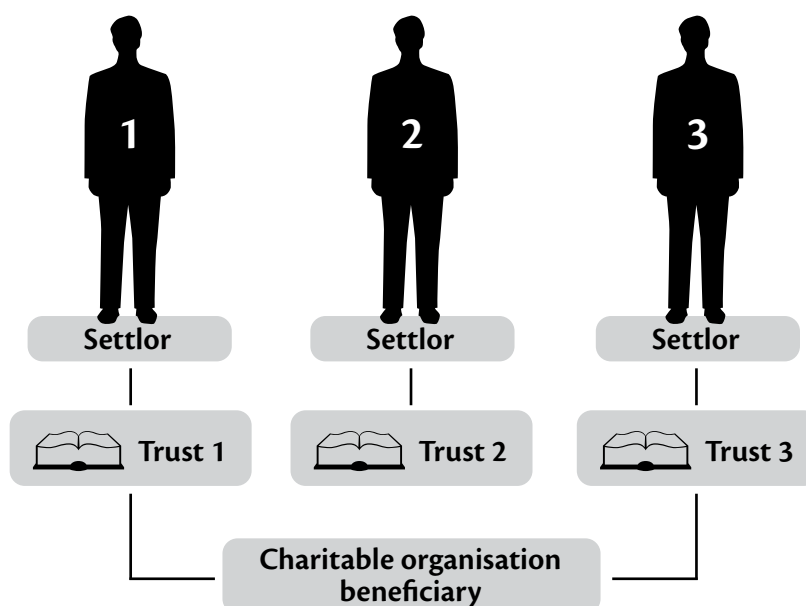
The exception for energy consumer trusts also prevents consumer beneficiaries from being associated with one another. Even without this exception, the scope of the tripartite test is such that it would not apply to treat consumer beneficiaries as associated persons. Using the above example, this means that the developer beneficiary and the non-developer beneficiary will not be associated persons. This is because they are both associated with the same third person (Energy consumer trust) under the same associated persons test, namely the trustee and beneficiary test in section YB 6, which means that the tripartite test does not apply.

Additionally, section YB 16(1) also excludes the unit trust that administers bonus bonds from the associated persons tests in sections YB 5 and YB 6 because of its public nature. This unit trust is excluded from the unit trust definition in section YA 1 of the Income Tax Act 2007, and therefore is not treated as a company, which means that the trust-related associated persons tests could potentially apply to it.

Charitable organisations

Under section YB 16(2), 'charitable organisations' (as defined in section YA 1 of the Income Tax Act 2007) are not treated as beneficiaries for the purposes of tests associating trustees and beneficiaries (section YB 6) and settlors and beneficiaries (section YB 9).

Example



Without the exception for charitable organisations in section YB 16(2), the beneficiary-related tests could have unintended consequences. For example, if the beneficiary of several unrelated trusts is the same charity, the trustee and settlor of each such trust could end up being associated with the trustee and settlor of all such trusts without being aware of the fact. This exception therefore ensures that trustees and settlors of trusts in this situation are not treated as associated persons simply because the same charity is a beneficiary under their trust.

Charitable trusts

The trustee and settlor test in section YB 8 does not apply if the trust is a charitable trust. This exception—section YB 8(2)—prevents donors to a charitable trust being associated with each other. A charitable trust under the Income Tax Act 2007 is required to be registered as a charitable entity under the Charities Act 2005 and is therefore subject to any regulatory requirements of that Act. Such charities do not pose a risk to the tax base and therefore it is not necessary to include them in the trustee and settlor associated persons test.

Rationalising associated persons references in operative provisions

A number of operative provisions in the Income Tax Act 2007 previously contained modifications or additional wording in their associated persons references. These modifications were a result of different combinations of the associated persons tests in former subpart YB applying, in particular, the tests that applied for the purposes of the whole Act (excluding the 1973, 1988 and 1990 version provisions) or the 1988 version provisions (corresponding to the associated persons definitions in sections OD 7 and OD 8(3) of the Income Tax Act 2004). An example of such a provision was section EX 21(15).

These modifications to the associated person references in the operative provisions of the Income Tax Act 2007 have been generally omitted because they have been effectively subsumed by the various reforms to the associated persons tests in new subpart YB. The wording of these operative provisions therefore has been significantly simplified because they will simply refer to persons being associated without more (for example, without various references to the 1973, 1988 or 1990 version provisions). As a result, the wording of the associated person references in the operative provisions of the Income Tax Act 2007 are now streamlined and easier to understand.

For example, the wording of section GB 28(2) was:

‘A person is treated as being associated with another person if a person would be treated as being associated under the parts of subpart YB (associated persons and nominees) that apply for the purposes of the whole Act (excluding the 1973, 1988, and 1990 version provisions), or the 1988 version provisions, at the time the services are personally performed by the working person.’

This wording has been replaced by:

‘A person is treated as being associated with another person if they are associated at the time the services are personally performed by the working person.’

The definitions of the 1973, 1988 and 1990 version provisions and previous section YB 20 have been repealed because they are largely subsumed by the various reforms to the associated persons tests in subpart YB. These definitions equate to the lists of operative provisions to which the former specific associated persons definitions in sections OD 8(4), OD 8(3) and OD 8(1) of the Income Tax Act 2004 applied. However, because of the various modifications that apply in the associated persons tests in relation to the land transaction provisions, previously defined as the ‘1973 version provisions’, this definition has been re-enacted in section YA 1 and called ‘land provisions’.

The new associated persons definition in the Income Tax Act 2007 also applies in the Tax Administration Act 1994 because of section 3(2) of the Tax Administration Act 1994.

A number of the specific modifications or additional wording in the associated persons references in the operative provisions in the Income Tax Act 2007 were incorrect. These references have been corrected applicable from the commencement of the Income Tax Act 2007 on 1 April 2008, even though these references themselves have been omitted as part of these reforms of the associated persons definitions. It is necessary to correct these references from the commencement of the Income Tax Act 2007 on 1 April 2008 because the current associated person reforms do not apply generally until the 2010–11 income year.

Section CD 6(1)(a)(iii) repealed

A transfer of value from a company to a person is a dividend if the cause of the transfer is a shareholding in the company as described in section CD 6 of the Income Tax Act 2007. Section CD 6(1)(a)(iii) contained an extension which treated as a dividend any distribution made by a company to a trust under which a shareholder of the company, or spouse, civil union, or de facto partner of the shareholder, was a beneficiary. This trust extension rule has been repealed because its function is performed by the new associated persons definition—in particular, the trustee-beneficiary test in new section YB 6.

Section CD 22(9) amendment

The definition of ‘fifteen percent interest reduction’ in section CD 22(9), which relates to the share buy-back exclusion from the dividend definition, refers to ‘counted associate’, which is defined inter alia as ‘a trustee of a trust under which a spouse, civil union partner or de facto partner, or minor child of the shareholder is a beneficiary’. This wording has been amended so that it is consistent with other references in the associated persons definitions which describe discretionary beneficiaries. The provision now refers to a person who has benefited or is eligible to benefit under a trust (instead of referring to a beneficiary).

Section DB 42(2) amendment

Section DB 42(1) allows a taxpayer a deduction for any loss arising through misappropriation by an employee. Former section DB 42(2) stated that this deduction was not available if the taxpayer and the employee were associated in certain ways.

The new associated persons definition is comprehensive enough to cover all the relationships described in former section DB 42(2). Therefore the specific associated persons tests in this provision have been replaced by a standard associated persons reference. New section DB 42(2) simply provides that the section does not apply when a person who misappropriates property is associated with the person who carries on the business.

Omitted tests

Several associated persons tests contained in the previous subpart YB of the Income Tax Act 2007 have been omitted for simplification and rationalisation purposes. These omitted tests were:

- The test associating 2 persons if they habitually act together (former section YB 18).
- The test associating a person and a charity, friendly society, or non-profit body controlled by that person or a relative of that person (former section YB 19).
- The tests associating 2 companies and a company and a person other than a company, which were based on income interests (former sections YB 3 and YB 7). These tests were redundant given the equivalent comprehensive tests based on voting interests. The existence of these tests can be explained historically by the fact that they were originally enacted in 1988 before the voting interest concept was enacted in 1992.
- The test associating a partnership and an associate of a partner (former section YB 17). This test has been subsumed by the new tripartite test in section YB 14. Under the tripartite test 2 persons are associated if they are each associated with the same third person under different associated persons tests. This means that an associate of a partner, such as a spouse of a partner, would still be associated with the partnership under the tripartite test.

Rationalisation of other income tax provisions

A number of provisions in the Income Tax Act 2007 embodying a related person concept, similar to that in the associated persons definitions, have been rationalised. It is desirable, from a simplification perspective, that similar concepts in the Act be addressed similarly.

Replacing company control definition with associated persons definition

Section YC 1 of the Income Tax Act, which defined when a company was treated as being under the control of any persons, has been repealed. Its function is now performed by the new associated persons definition.

The definition of company control in section YC 1 and the definitions of associated persons in subpart YB are conceptually similar in that they define related parties for the purposes of operative provisions in the Income Tax Act 2007. The separate use of the section YC 1 company control definition rather than the associated persons definitions was probably a legacy of the company control definition being developed in the Income Tax Act before the associated persons definitions. The company control definition in the Act was first implemented in 1939, whereas the first associated persons definition in the Act was not enacted until 1968.

Allowing section YC 1 to be subsumed by the new associated persons definition is a desirable simplification measure.

The provisions in the Income Tax Act 2007 which previously employed the section YC 1 definition of company control, have been amended to use the new associated persons definition. They are:

- section GC 5 (leases for inadequate rent)
- section RF 11 (dividends paid to companies under control of non-residents)
- paragraph (a) of the definition of 'holding company' in section YA 1.

Replacing related person definition with associated person definition

Former section CD 44(15) to (17) of the Income Tax Act 2007 contained a definition of 'related person' which was used in section CD 44(11) and (12) to determine the amount of the capital gain exclusion from a dividend arising from the realisation of a capital asset in the course of a company's liquidation. As part of the amendments to rationalise the Income Tax Act provisions which embody an associated persons concept, the function of the former related person definition in section CD 44 will be performed by the new associated person definition.

Section CD 44(11) and (12) have been replaced by section CD 44(10A) and (10B) with associated persons references replacing related persons references. The new provisions apply for capital gain amounts derived or losses incurred after 31 March 2010, therefore ensuring that the changes have prospective application only.

For capital gain amounts derived or capital loss amounts incurred between 1 April 1988 and 31 March 2010, the previous law which used the related person definition continues to apply. This law contained in former section CD 44(11), (12) and (15) to (17), is now contained in section CZ 9B of the Income Tax Act 2007.

The references to related persons in the dividend definition in section YA 1 have also been replaced with references to associated persons.

Definition of 'relative'

The definition of 'relative' in section YA 1 of the Income Tax Act 2007 has been simplified so that it extends only to the second degree of blood relationship. Previously the definition also extended for the purposes of some provisions to the fourth degree of blood relationship. The new definition of relative includes a trustee of a trust under which a relative has benefited or is eligible to benefit—this continues the effect of paragraph (c)(v) of the old relative definition.

Non Resident Withholding Tax and Approved Issuer Levy

NRWT and AIL use the 'associated person' rules outlined earlier in this publication but also have specific 'associated person' rules and tests.

Indirect associated funding - exists when a non-resident indirect lender provides funds to a direct lender who then provides the funds to a person associated with the non-resident indirect lender.

Non Resident owning bodies - A group of non-residents that have characteristics that indicate they are acting together to debt fund a NZ company for which they own 50% or more.

Related party debt - A financial arrangement where the lender is an associated person or funding is provided through an indirect funding arrangement or lender is a member of a non-resident owning body that is associated with the borrower and expenditure arises to the borrower for which they are allowed a deduction (this excludes a member of a NZ banking group).

Application of changes to other Acts

A number of provisions in other Acts, which utilise the associated persons definitions in the Income Tax Act 2007, have been consequently amended as a result of these reforms. The provisions in these other Acts are:

- Fisheries Act 1996, section 59(10)(c) and (d)
- Misuse of Drugs Amendment Act 2005, section 31
- Privacy Act 1993, section 6
- Radiocommunications Act 1989, sections 153(2) and 161(2)
- Smoke-free Environments Act 1990, section 2(1).

A number of provisions in other Acts also utilised former section YC 1 of the Income Tax Act 2007, which defined when a company was treated as being under the control of any persons. These references to section YC 1 have been replaced with references to the new associated persons definition in the Income Tax Act 2007. The provisions in these other Acts are:

- Insolvency Act 2006, section 182(1)
- Public Service Investment Society Management Act (No.2) 1979, section 2(2)
- Trustee Companies Management Act 1975, section 2(2)
- Unit Trusts Act 1960, section 3(4).

Legislative references

Sections CB 8(c), CD 5, CD 5(2B), CD 6(1)(a)(ii), CD 22(9), CD 25(4), CD 27(1)(b), CD 27(3)(a)(ii), CD 44(10B), CD 44(10C), CD 44(14B), CX 2(5), CZ 9B, DB 42(2), EB 13(2), EX 20B(5)(a)(i), EX 20B(9)(c), FE 21(3)(d)(ii), FE 21(7)(a)(i), FE 21(7)(a)(ii), FE 21(8), GB 28(2), GB 48(1)(b), GB 48(3)(d), GB 48(3)(e), GC 5(5), HC 15(5)(a)(ii), HC 21(3), HC 27(1)(e), HC 27(3), HC 32(2), HC 35(4)(a), HC 36(5), RF 11, YA 1, YB 1–YB 16, of the Income Tax Act 2007.

Sections 17(1C)(a), 89N(1)(c)(iii), 89N(1)(c)(v), 141(7)(c) and 141D(3B)(b) of the Tax Administration Act 1994.



Te Kāwanatanga o Aotearoa
New Zealand Government