# NEW ZEALAND TAX RESIDENCY: *DIAMOND* REFLECTED IN *VAN UDEN*

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It was Robert Frost who wrote, "home is the place where, when you have to go there, they have to take you in". He would perhaps disdain to be quoted in an article about tax residency. Nonetheless, his words appear a fairly neat reduction of the position New Zealand's tax law has adopted. Currently the residency of a taxpayer is governed by s YD1 of the Income Tax Act 2007. This article primarily focuses on a discussion around s YD1 (2), and the requisite determination of a person's permanent place of abode.

The law regarding this issue was discussed at length by the Court of Appeal in the case of *Commissioner of Inland Revenue v Diamond*.[1] The method established was recently applied in the case of *van Uden v Commissioner of Inland Revenue*.[2] Together these two cases provide insight into the way the New Zealand courts will determine tax residency when a determination of a permanent place of abode is required.

The current law poses difficulties for practitioners. Where there is uncertainty in residency, the courts must undertake a subjective analysis that can lead to unexpected results. This is undesirable in an aspect of taxation law where certainty is essential, particularly in light of the fact that in cases of disputed residency the Commissioner has still sought shortfall penalties.

The subjective manner in which the courts have treated the determination allows the Commissioner a wide latitude to make assessments, often in cases where the taxpayer's residency is arguable. To dispute these assessments the taxpayer is required to go through the court process, which is often expensive and lengthy.

## GOVERNING LEGISLATION

The starting point for this discussion must be the relevant provisions in the legislation.

The current governing section for the tax residency of natural persons in New Zealand is s YD1 of the Income Tax Act 2007. This provision has been inherited from previous iterations of New Zealand income tax enactments. Section YD1(2) states that one is a resident of New Zealand for tax purposes if they have a permanent place of abode in the country, irrespective of how much time they spend in New Zealand.

This section has been inherited in substance from s OE1 (1) of the Income Tax Act 2004, which was a development of s 241(1) of the Income Tax Act 1976. Section 241(1) required that a person have their home in New Zealand.

The nature of a home was discussed by the Federal Court of Australia in the decision of *Applegate* by Judge Fisher.[3] It was determined that for a person to have their home in New Zealand, they did not necessarily have to live in New Zealand. Instead, it meant they must have a permanent place of abode; a place they would return to, should they return to the country. He cited certain factors relevant to the determination, which Judge Clifford also cited in his *Diamond* High Court judgement for determining what would constitute such an abode.[4] These are:

- the taxpayer's reasons for going overseas;
- whether a permanent place of abode was established out of New Zealand;
- arrangements made concerning the home in New Zealand;
- employment;
- financial ties with New Zealand;
- other ties with New Zealand; and
- length of time out of New Zealand.

1 *Commissioner of the Inland Revenue v Diamond* [2015] NZCA 613.

2 *van Uden v Commissioner of Inland Revenue* [2018] NZCA 487.

3 *Federal Commissioner of Taxation v Applegate* [1979] 27 ALR 114 (FCA).

4 *Diamond v Commissioner of Inland Revenue* [2014] NZHC 1935 at [40].

Judge Fisher's interpretation of s 241(1) of the Income Tax Act 1976 has resulted in the present language of s YD1(2) of the Income Tax Act 2007, which requires that for the taxpayer to be a resident (assuming they do not qualify under s YD1(3)), they must have a permanent abode in New Zealand.

## THE *DIAMOND* CASE

In the first instance the Taxation Review Authority (TRA) deemed Mr Diamond to have a permanent place of abode in New Zealand. He successfully appealed this decision in the High Court. The High Court's judgement was upheld by the Court of Appeal following an appeal by the Commissioner.

## BACKGROUND

Mr Diamond was born in New Zealand and served in the New Zealand army for a period of 25 years. Following this, he left New Zealand with the intention of never returning (apart from brief visits to see his children). He was married in 1981 to Mrs Wendy Diamond. The couple separated in 1994 but remained close both personally and financially.

Mr Diamond returned to New Zealand for brief periods to visit his children. He provided for them by giving his former wife full access to the United States bank account into which his salary was paid. She withdrew considerable sums which were used for child support and other expenses. When the issue was raised in the TRA, these ties to New Zealand were considered relevant by Judge Sinclair in her finding that Mr Diamond was a tax resident of New Zealand.

Mr. Diamond had been involved in several property transactions with his former wife. Of these, the most significant to the Commissioner's assessment was his beneficial ownership of a property at 24 J Esplanade (the Esplanade property), a property he had never lived at. The Commissioner deemed Mr Diamond to be a New Zealand tax resident on the basis that the Esplanade property was a permanent place of abode.

At the time of the Commissioner's assessment, the property was tenanted and owned by a loss attributing qualifying company (LAQC) in which Mr Diamond owned only one per cent of the shareholdings. What was problematic for the Diamonds was that both Mr and Mrs Diamond gave evidence that the Esplanade property was owned beneficially by Mr. Diamond.

Mr Diamond took the issue to the TRA, where Judge Sinclair upheld the Commissioner's treatment of his residency status. This decision was overturned by the High Court. The High Court's decision was then upheld by the Court of Appeal following the Commissioner's appeal.

## DECISION

The Commissioner had assessed Mr Diamond as a resident based on him having a permanent place of abode in New Zealand. The Commissioner's assessment was based on Mr Diamond's beneficial ownership of the Esplanade property.

When this assessment was challenged in the TRA, Judge Sinclair applied the test proposed by Judge Barber in *Case Q55*.[5] In that case, Judge Barber stated that the paramount factor in assessing a person's tax residency was the strength of their ties to New Zealand – but those ties must include an available place of dwelling.[6]

This approach requires a test of two steps. Firstly, it must be determined whether there was an available dwelling for the person in New Zealand. Secondly, the strength of the person's connections to New Zealand must be assessed.

Judge Sinclair found that as Mr Diamond was at liberty to issue notice under the Residential Tenancies Act 1986 and the Esplanade property was close in location to his other connections in New Zealand, it could serve as a place to base himself if he were to return to the country. On this basis, Judge Sinclair held the property to be a permanent place of abode.

The High Court and the Court of Appeal disagreed with this position. Judge Clifford held that *Case Q55* was an unsuitable authority to be applied to Mr Diamond's case. In *Case Q55* the taxpayer rented out his home for a specified period and always intended to return to New Zealand. Thus, the facts of that case were significantly distinct from those of Mr Diamond's case.

Judge Clifford found that *Q55* should properly be seen as an authority that a person's permanent place of abode in New Zealand will not cease to have that character merely because, while the person is outside New Zealand for a period greater than the statutory deeming period, that dwelling is rented out.[7]

The considerations here are distinct from the two-step approach. The approach taken by Judge Sinclair is primarily focused on one's connections to New Zealand. Under this approach, if a person is deemed to have sufficient connections to New Zealand and owns any residential property in the country, they could be deemed tax resident regardless of how long they have been out of New Zealand or any intention they may have evinced to leave New Zealand permanently. This approach seems contrary to common sense.

## PERMANENT PLACE OF ABODE

Section OE1 was the predecessor to s YD1 in the Income Tax Act 2004. In the High Court, Judge Clifford undertook a comprehensive analysis of the ordinary meaning of s OE1 in combination with the legislative history of the provision, and

5 *Case Q55* [1993] 15 NZTC 5, 313.

6 At 7.

7 *Diamond v Commissioner of Inland Revenue*, above n 4, at [44].

concluded that to have a permanent place of abode in New Zealand is to have a home in New Zealand. The word "abode" signifies a degree of permanence, thus it must be a habitual residence.[8] This is distinct from owning or maintaining a property that could be used as a home.

In *Diamond,* the Court of Appeal applied s OE1(1) after an analysis of the legislative purpose and statutory wording. This analysis, coupled with the Court's rejection of *Case Q55* as an authority, led to the determination that whether an individual has a permanent place of abode is a question of fact that requires a holistic assessment. In this assessment, the context and circumstances of the taxpayer should be considered.

## THE *VAN UDEN* DECISION

The Court of Appeal released its decision in November 2018. This case is a good example of the method adopted in *Diamond* being applied.

### BACKGROUND

This case concerned a Mr van Uden, a sailor who maintained a New Zealand home at 27 Evelyn Road. It was accepted by the Court that he and his wife, who accompanied him while he was at sea, were typically at sea eight months out of a year. Mr van Uden contended that he maintained the home out of convenience and that he should properly be considered as a rootless person due to his vocation. The Commissioner assessed Mr van Uden on the basis that he was a New Zealand tax resident under s YD1 (2).

Considerations that were relevant in this dispute included that the property the van Udens stayed at while they were in New Zealand, as well as the couple's rental properties, was owned by a trust in which both were trustees. The couple stayed at the Evelyn Road property consistently while they were on shore, and incurred significant household expenses with respect to the property. Finally, Mr van Uden and his wife purchased the neighbouring property, 29 Evelyn Road, which they invested in significantly.

The TRA accepted the Commissioner's view that the 27 Evelyn Road property was a permanent place of abode. The High Court and the Court of Appeal upheld this decision.

### *DIAMOND* APPLIED

The *Diamond* test calls for a contextual factual assessment of the circumstances surrounding the taxpayer. The TRA, the High Court and the Court of Appeal all determined that the 27 Evelyn Road property did constitute a permanent place of abode following their application of this test. The following are the most important elements of their evaluation.

The word "abode" was given the meaning of "habitual residence, house or home or place in which the person stays, remains or dwells".[9] Mr van Uden had characterised his habitation of the property as one of convenience rather than one of habitual residence, but the courts did not support this characterisation. Inland Revenue had established that Mr van Uden stayed at the property at almost all times he was in New Zealand. Further, as already noted, the couple exhibited a pattern of expenditure consistent with domestic use of the property.[10]

The argument was raised that the property was owned by the trust rather than by Mr van Uden. However, the courts saw no merit in this argument, as owning one's place of abode is not required.

Most determinative to the courts' finding was the regularity with which Mr van Uden returned to the property.[11]

## CONCLUSIONS

The results of the *Diamond* decision are that whether one has a permanent abode to establish New Zealand tax residency is an ambiguous question that requires a hearing to determine. This is problematic at a practical level for professionals attempting to establish the residency status of their clients. There is no clear "bright line" to determine residency, as the question of "habitual residence" is a subjective one that could be difficult to prove or disprove evidentially.

This will also pose difficulties for those seeking to establish themselves as tax residents of New Zealand, particularly if they are new migrants or they spend significant time outside New Zealand. It is arguable that the subjective nature of the test leaves too much discretion in the hands of Inland Revenue officers.

We acknowledge that the provisions regarding an individual maintaining a permanent abode have existed as a part of New Zealand law for a significant period. However, the fact is that there is too much subjectivity around a matter that should be routine. The law around this issue requires clarification.

The question of Mr van Uden is a good demonstration of the problems discussed here. There are likely many professionals who would have advised Mr van Uden that he was a non- resident for tax purposes due to the ownership status of the property he lived in and the short amount of time each year he spent in New Zealand.

The courts require a holistic analysis of the factual matrix surrounding an individual's circumstances. The factors raised in *Diamond*, while useful, do not describe the weight each factor should be assigned or go far enough to provide adequate certainty. ■

8 At [56].

9 *van Uden v Commissioner of Inland Revenue* [2017] NZHC 2554 at [43].

10 At [53].

11 At [61].