

Report to

Crown Forestry Rental Trust



Tax Advice for Claimant Groups on Post-Settlement Governance Entity Structures

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FOREWORD

The Crown Forestry Rental Trust (“**the Trust**”) was set up under the Crown Forest Assets Act 1989 to receive the rentals from forestry companies occupying Crown forest land. The Trust applies interest earned on accumulated annual Crown forest rental fees to assist claimants to prepare, present and negotiate claims before the Waitangi Tribunal that could involve Crown Forest Licensed land (including mandated claimant bodies engaged in direct negotiations with the Crown).

The Trust may provide funding contributions to eligible claimant groups through all phases of settlement negotiations up to ratification of the Deed of Settlement and the post-settlement governance entity which is to receive the settlement assets.

Post-settlement governance entities hold and manage the assets transferred to a claimant group under their Deed of Settlement. The Crown will not complete settlement until a, overall governance entity has been legally established, and ratified by the claimant group.

The common law trust is the most regularly used entity under current Crown policy. However, the Crown will consider other entity governance models that provide for representation, accountability and transparency.

The Crown generally requires that all settlement redress must be transferred directly to the post-settlement governance entity. What the governance entity then does with the settlement redress is up to it.

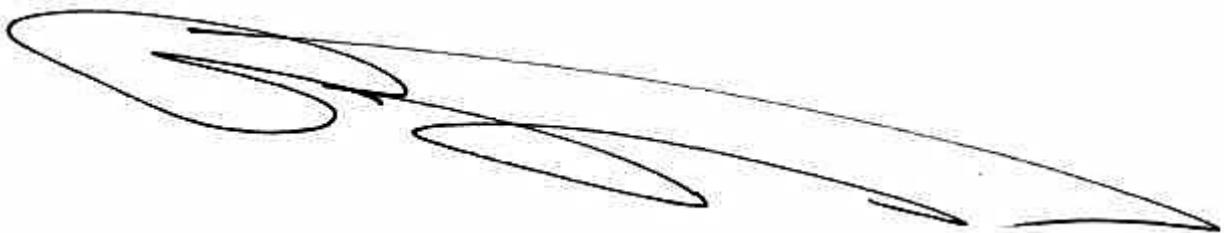
Fundamental to the design of an effective and durable governance structure is the identification of the current and future requirements of the claimant group and how it wishes to manage and distribute income derived from its assets. This means that claimant groups will need to consider, the shape and functions of any structure that might be established in conjunction with the post-settlement government entity to manage those assets that are transferred as part of the settlement early on in the settlement process.

Invariably, a claimant group will need specialist advice (covering legal and tax issues) to assist in identifying the most tax-efficient structuring options to receive hold and manage the assets following their transfer at settlement.

This report prepared by Ernst Young Limited provides claimant groups with a comprehensive introduction to, and appreciation of, the tax implications and liabilities that may come with receiving assets as a result of settlement and the structural options for post settlement governance entities that minimise tax liabilities.

The Trust recognises that claimant groups will usually need specialist advice on their specific commercial and financial business entities and how their redress package will align and be managed within these entities. This report provides a platform for claimant groups to make informed decisions about the options for their post-settlement governance entity structures.

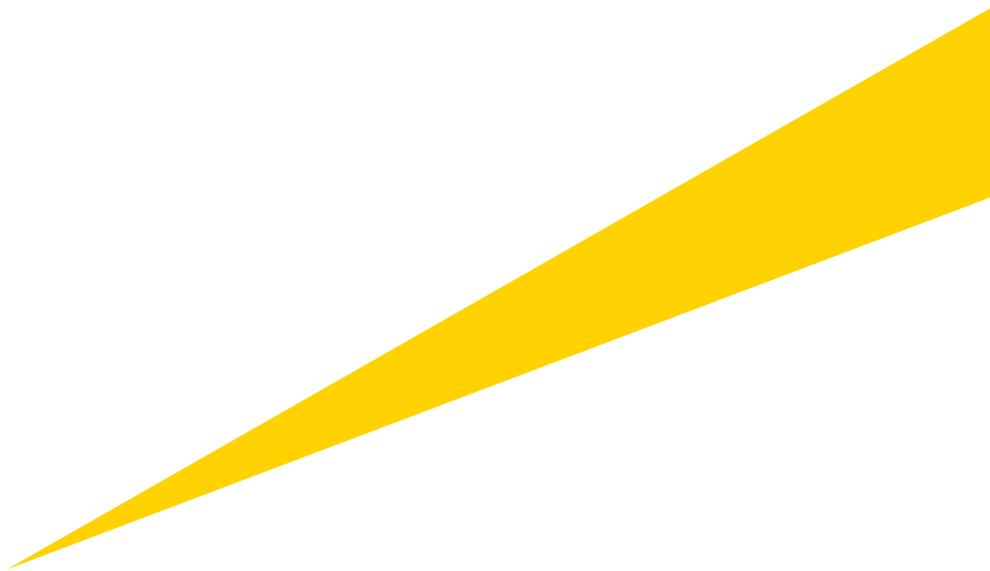
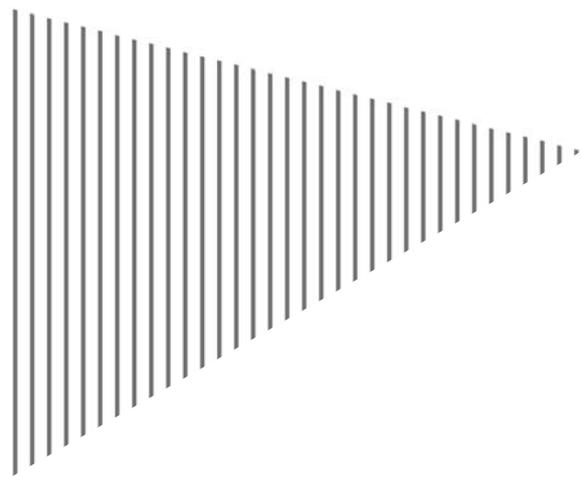
Darrin Sykes

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**Chief Executive
CROWN FORESTRY RENTAL TRUST**

Disclaimer:

This report has been prepared for information purposes only and does not constitute taxation advice. Any person who wishes to understand how any matter covered in this report applies to a particular set of circumstances should seek specific accounting, tax and legal advice in relation to those circumstances. While every endeavour has been made to ensure that the content of this report is accurate, no liability can be accepted for any incorrect statement or omission or for changes to policies or processes outlined in this report.



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governance entity structures**

May 2012

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1. Introduction

1.1. Roles of the PSGE

1.1.1. The PSGE is required to manage various roles including:

- ▶ **Political / governance** – acknowledging the mandatory requirement for a PSGE and the inherent need for political representation, advocacy and strategic oversight over the iwi’s assets and interests.
- ▶ **Commercial** – acknowledging the iwi’s wish, in accordance with prudent commercial practice, to separately manage and grow the iwi’s commercial assets to generate wealth to meet the needs of the iwi.
- ▶ **Charitable** – acknowledging the iwi’s wider social, cultural and environmental objectives that are inherently charitable.
- ▶ **Distributive** – acknowledging the iwi’s desire to provide a wide range of benefits to the iwi’s beneficiaries that may lie outside the legal bounds of charitable entities, and the implicit distributive role required in providing such benefits.

1.1.2. Since the above roles have different needs and priorities, it is important that a claimant group carefully considers what type of legal and tax entity it uses for its PSGE and start developing a PSGE group structure to assist in future activities.

1.2. Purpose of report – important

1.2.1. The purpose of this report is to provide tax information on the various issues and risks that should be considered as part of the settlement process. The report does not attempt to address all of the taxation consequences that may be relevant to a claimant group. Accordingly, no person should rely on the contents of the report without first obtaining advice from a qualified professional person. Further, Ernst & Young is not responsible for the results of any actions taken on the basis of the information in this report.

1.2.2. This report is based on the New Zealand income tax laws and published Inland Revenue policy and practice as at 18 May 2012 and we are not obliged to update the report. Taxation laws are subject to change, and such changes may alter the analysis and conclusion contained in the report.

1.2.3. We recommend that claimant groups seek advice from accounting, tax and legal advisors early in the negotiation process.

2. Glossary

- ▶ **“AHC”** means a wholly owned subsidiary of a MIO that acts as an asset-holding company under the Māori Fisheries Act 2004;
- ▶ **“CCRA”** refers to the Climate Change Response Act 2002;
- ▶ **“CFRT”** means the Crown Forestry Rental Trust;
- ▶ **“Charities Act”** refers to the Charities Act 2005;
- ▶ **“Companies Act”** refers to the Companies Act 1993;
- ▶ **“CTA”** refers to the Charitable Trusts Act 1957;
- ▶ **“the GST Interpretation Statement”** refers to an Interpretation Statement, *Treaty of Waitangi Settlements – GST Treatment IS3427*, issued by Inland Revenue in September 2002.
- ▶ **“the Income Tax Interpretation Statement”** refers to an Interpretation Statement, *Income Tax Treatment of Treaty of Waitangi Settlements IS0043*, issued by Inland Revenue in October 2004;
- ▶ **“the ITA 2007”** refers to the Income Tax Act 2007;
- ▶ **“LP Act”** refers to the Limited Partnership Act 2008;
- ▶ **“LP”** means a limited partnership;
- ▶ **“LTC”** means a look-through company;
- ▶ **“MIO”** means an organisation established and recognised by Te Ohu Kai Moana Trustee Limited as a mandated iwi organisation under the Māori Fisheries Act 2004;
- ▶ **“NZUs”** means New Zealand Units issued pursuant to the emissions trading scheme;
- ▶ **“OTS”** means the Office of Treaty Settlements;
- ▶ **“PSGE”** means post-settlement governance entity;
- ▶ **“TMAD”** means a taxable Māori authority distribution;
- ▶ **“Trustee Act”** refers to the Trustee Act 1956;

3. The current state – typical asset and business structures of claimant groups

Key points

Carry out a stock-take of the iwi's existing entities, assets and income earning activities as part of the PSGE structure process.

Consider whether the existing structures should be incorporated into the PSGE group or remain as separate entities:

- ▶ Are there any limitations or restrictions on the ability to undertake commercial activities contained in the current trust deeds (i.e., do the trustees have the powers to borrow monies, invest capital, enter into joint ventures)?
- ▶ Do the existing structures allow easy and flexible distributions to individuals (i.e., is the class of beneficiaries sufficiently wide to satisfy the iwi's objectives)?
- ▶ Should any fisheries settlement assets be kept separate from the comprehensive settlement assets?
- ▶ Will the existing businesses receive or provide funding to new commercial activities following the comprehensive settlement?
- ▶ Are the existing structures tax efficient?

3.1. Introduction

3.1.1. Undertaking a stock-take of an iwi's existing entities, assets and income earning activities is an important step in a PSGE structure process.

3.1.2. A comprehensive understanding of an iwi's existing entities will help determine what role (if any) the existing entities will play in the PSGE structure. In particular it is useful to consider:

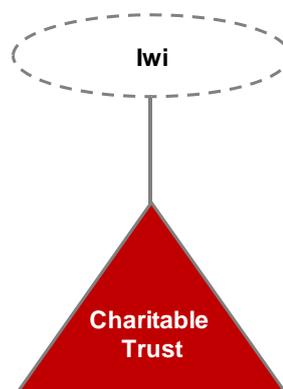
- ▶ the function of the existing entity (i.e., political, cultural, commercial);
- ▶ the effectiveness of the existing entity (i.e., are there any inefficiencies in the current structure); and
- ▶ the flexibility of the existing entity (i.e., are there any inherent restrictions that limit the existing entity's operations / distributions).

3.1.3. To the extent that an iwi has existing assets or income earning activities it is worthwhile considering whether these assets / income earning activities will remain separate from the PSGE structure (if a new structure is established) or if they should be incorporated into the PSGE structure. Transitional tax issues may arise if an iwi wishes to restructure its existing state. Issues commonly arise when restructuring pre-existing charities therefore it is recommended that a restructure is contemplated and addressed in the Deed of Settlement. These issues and solutions are considered further at section 7.

3.1.4. In our experience an iwi's current state may sit anywhere along a broad spectrum. We have outlined below descriptions of three typical current state scenarios that sit at different points on the spectrum:

- ▶ minimal structure;
- ▶ simple structure; and
- ▶ complex structure.

3.2. Minimal structure



3.2.1. A minimal iwi structure may typically involve one or two iwi entities, including a body that has been recognised as the mandated body for Treaty of Waitangi settlement negotiations with the Crown¹. Generally the mandated body is either:

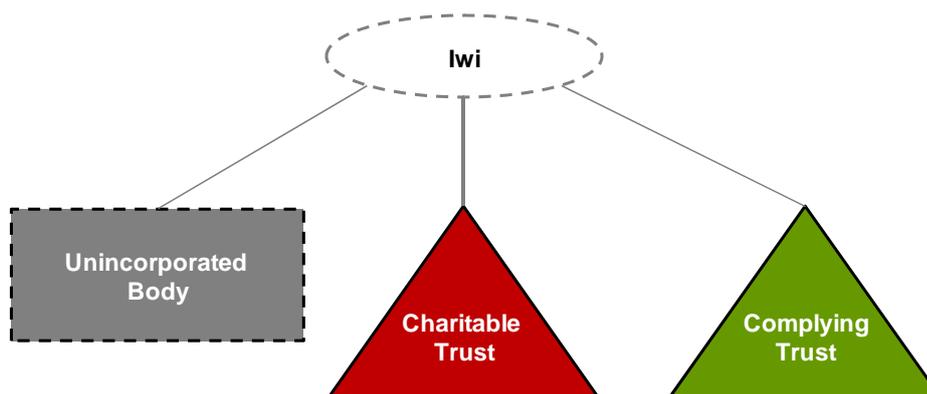
- ▶ a trust established by deed under the CTA; or
- ▶ a company incorporated under the Companies Act.

3.2.2. Usually the mandated body has only a small amount of net assets and derives minimal or nil profits as it is established for the sole purpose of negotiating Treaty of Waitangi claims on behalf of the iwi.

3.2.3. As the Charitable Trust will be registered as a charitable entity under the Charities Act it will be exempt for income tax purposes.

3.2.4. A minimal structure is basically a blank canvas when considering structuring options for the PSGE and the wider PSGE group. An effective and successful PSGE group structure can be achieved provided there is a clear understanding of the long-term strategic plan for the iwi (i.e., what are the iwi's future needs and aspirations).

3.3. Simple structure



3.3.1. A simple iwi structure may typically involve a few iwi entities with a mixture of legal and tax characteristics. A simple structure may include:

- ▶ an unincorporated body established and recognised as the mandated body for Treaty of Waitangi settlement negotiations with the Crown;
- ▶ a trust established by deed under the CTA to provide assistance for educational and development opportunities and other charitable objectives; and

¹ The minimal structure described commonly occurs if the iwi does not have any fisheries assets or the negotiating entity is a sub tribe and their fisheries assets are held by an iwi entity.

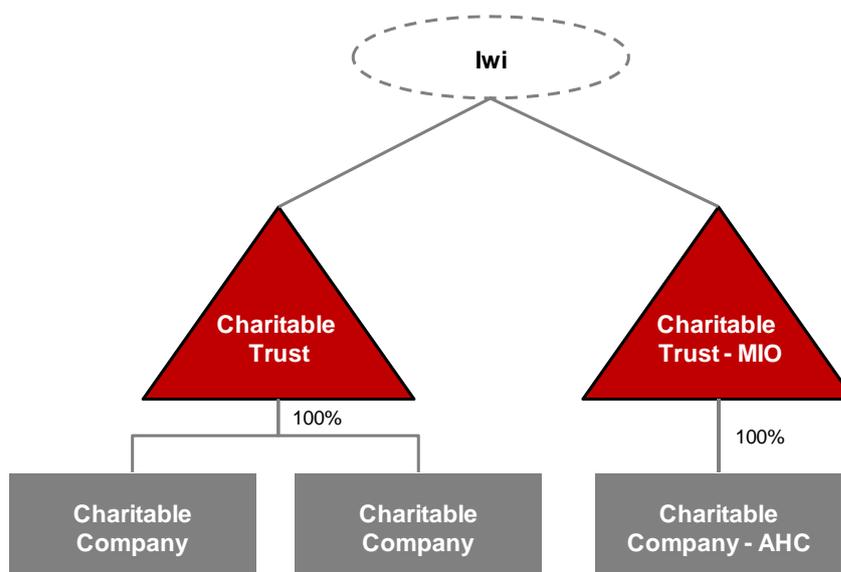
- ▶ a private discretionary trust established by deed to receive an “on account” settlement and treated as a complying trust for income tax purposes.

3.3.2. Usually the mandated body has only a small amount of net assets and derives minimal or nil profits as it is established for the sole purpose of negotiating Treaty of Waitangi claims on behalf of the iwi.

3.3.3. The Charitable Trust will have been established to distribute grants / donations received in furtherance of its charitable objectives as set out in its trust deed. As the Charitable Trust will be registered as a charitable entity under the Charities Act its income will be exempt for tax purposes.

3.3.4. The private discretionary trust (Complying Trust) will be treated as a complying trust for tax purposes and any trustee income will be taxed at the prevailing trustee rate (33%). At the time it was established it may have been intended that the complying trust would be the PSGE. However, a comprehensive review of the iwi’s future state and strategic objectives may not have been undertaken at that stage as the receipt was only “on account” of the final redress amount.

3.4. Complex structure



3.4.1. A complex iwi structure will typically involve a number of iwi entities including entities established for the receipt of fisheries assets.

3.4.2. The iwi structure may include:

- ▶ a trust (the Charitable Trust) established by deed under the CTA and recognised as the mandated body for Treaty of Waitangi settlement negotiations with the Crown;
- ▶ the Charitable Trust may have wholly owned subsidiaries that may hold iwi land or operate businesses;
- ▶ a trust established by deed and recognised as a MIO; and
- ▶ a wholly owned subsidiary of the MIO to act as an AHC to receive and manage certain fisheries assets.

3.4.3. All of the members of the existing structure may have registered as a charitable entity under the Charities Act and will be exempt for income tax purposes. The 0% tax rate and social nature of charities have made charitable groups an attractive structure in the past for iwi organisations. However, there are inherent limitations and inefficiencies in a charitable structure that cause difficulties as iwi organisations become involved in more complex commercial activities and require flexible distributive powers.

- 3.4.4. The above example of a complex iwi structure contains only charitable entities as a charitable group is a widely used structure. However, a complex iwi structure may also contain different types of entities including private discretionary trusts that are taxed either as complying trusts or Māori authorities.

4. Tax implications of settlement assets

Key points

Seek advice from your legal and tax advisors **prior** to agreeing the settlement and deciding to transfer any assets to other entities.

Commercial or cultural redress received upon settlement should generally be treated as a non-taxable capital receipt. However, the income tax treatment does depend upon the nature of the redress received.

There should not be a GST liability arising from a Treaty settlement.

Consider the income tax and GST implications of transferring assets to other entities within the PSGE group.

Consider what tax indemnities should be negotiated for inclusion in the settlement legislation.

4.1. Introduction

4.1.1. This section contains a discussion of the general income tax and GST principles and how they apply to the various types of commercial, financial and cultural redress at:

- ▶ initial receipt by the PSGE; and
- ▶ subsequent transfer by the PSGE to another entity.

4.1.2. Our comments are general in nature and should not be interpreted as tax advice for your iwi. Individual iwi have specific and unique tax issues that require a tailored solution. You should always discuss your particular circumstances with your tax advisor.

4.1.3. Our comments are based on tax legislation in force at the date of this report and are accurate at the time of writing. Unless otherwise stated, any section or legislative reference is to the ITA 2007.

4.2. Types of commercial, financial and cultural redress

4.2.1. The following items are common forms of commercial, financial and cultural redress:

- ▶ **Sites of Significance** – a PSGE may receive an ownership interest (e.g., a fee simple estate) in land that is of particular significance to that claimant group as part of its cultural redress.
- ▶ **Marae restoration and revitalisation gifts** – a PSGE may receive a special purpose gift or grant as part of its cultural redress².
- ▶ **Financial quantum / redress amount** – a cash payment received as compensation.
- ▶ **On-account payments** – an advance payment of the financial redress amount.
- ▶ **Interest on financial redress amount** – interest calculated on the financial redress amount for the period following the signing of an Agreement in Principle or Deed of Settlement until the settlement is finalised.
- ▶ **Deferred selection process rights** – the deferred selection process mechanism allows a claimant more time to decide whether to purchase specific Crown owned properties.
- ▶ **Rights of first refusal** – a PSGE may receive rights of first refusal for certain Crown owned properties.

² A special purpose gift or grant may also include an amount to establish and operate a new governance entity to manage a cultural redress asset.

- ▶ ***Rights of purchase and leaseback*** – a PSGE may receive rights to purchase core Crown owned properties with an obligation to leaseback to the Crown.
- ▶ ***Crown forest licensed land*** – a PSGE may receive the right to purchase forestry land subject to the relevant forestry licence.
- ▶ ***Accumulated rentals on Crown forest licensed land*** – a PSGE may receive rights to accumulated rentals originally derived by the Crown whilst the relevant Crown forest land was owned by the Crown.
- ▶ ***NZUs*** – emissions units issued in relation to pre-1990 forest land.

4.2.2. In addition, a PSGE may receive funding from the Crown or CFRT to meet some of the costs of funding the negotiation.

4.3. Income tax – general principles

4.3.1. Redress received as part of a Treaty settlement will be treated as assessable income to the PSGE if it is income under:

- ▶ Any of the specific income provisions in the ITA 2007;
- ▶ Ordinary concepts; or
- ▶ The financial arrangement rules.

4.3.2. An amount that fits into one of the above categories will be assessable income unless it is specifically treated as either exempt income or excluded income.

4.3.3. A PSGE may be able to claim a deduction for any expenditure incurred in deriving assessable income or incurred in the course of carrying on a business for the purpose of deriving assessable income.

4.3.4. A PSGE's taxable income will be the net of its assessable income and its deductible expenditure. A PSGE's tax liability is dependent upon its tax status:

- ▶ A charity will be exempt from income tax and have nil tax to pay³;
- ▶ A complying trust will be taxed at a rate of 33% on its trustee income;
- ▶ A company will be taxed at a rate of 28% on its taxable income; and
- ▶ A Māori authority will be taxed at a rate of 17.5% on its taxable income.

4.4. An amount derived from a business

4.4.1. An amount that a person derives from a business is income of the person⁴.

³ We note that it is the Crown's policy not to settle with a PSGE that is a charitable entity. However, post-settlement restructure may be an option.

⁴ Section CB 1

4.4.2. There are two parts to the business profits test:

- ▶ there must be a business; and
- ▶ the amount must be derived from that business.

Business

4.4.3. A “business” is defined as:

“any profession, trade, manufacture, or undertaking carried on for pecuniary profit.”

4.4.4. There has to be a continuing activity rather than a one-off transaction or an isolated transaction. Further there must be a genuine intention to make a profit. The New Zealand courts⁵ have decided that the following factors should be taken into consideration in determining whether a business exists:

- ▶ the nature of the activity;
- ▶ the period over which it is engaged in;
- ▶ the scale of operations and volume of transactions;
- ▶ the commitment of time, money and effort;
- ▶ the pattern of activity; and
- ▶ the financial result.

Amount derived from that business

4.4.5. It is not sufficient that a person carries on a business; an amount of income will only be assessable under the business profits test if the amount is derived from that business.

4.4.6. The Court in *CIR v City Motor Service Limited*, *CIR v Napier Motors Limited* [1969] NZLR 1010 stated that the words “from the business” meant something more than “as a result of the fact that the company was carrying on this business” and was equivalent to “from the current operations of the business”.

Application to financial redress

4.4.7. We consider that financial redress should not be treated as business income⁶.

4.4.8. If the PSGE does not undertake any other activities, the Treaty settlement negotiation process should not be considered a “business” in itself. The Treaty settlement negotiation process is a one-off event and while there may be a significant commitment of time and money, the process is not carried on for pecuniary profit. A Treaty settlement negotiation process is entered into to seek compensation for breaches of the Treaty of Waitangi and not a profit. Accordingly, if the PSGE does not carry out any other activities that may be considered a business, the financial redress amount should not be treated as business income as a business does not exist.

4.4.9. If the PSGE does undertake other activities, the financial redress amount should also not be treated as business income as the financial redress amount is not derived from that business.

4.4.10. Our conclusion is supported by statements made by Inland Revenue in the Income Tax Interpretation Statement. The Income Tax Interpretation Statement considered:

- ▶ whether financial redress received by Māori claimant groups as compensation for historical breaches of the Treaty of Waitangi in settlement of claims is income; and
- ▶ whether funding for settlement negotiations provided by the OTS is income.

4.4.11. Inland Revenue concluded that financial redress is not business income based on a similar analysis.

4.5. Ordinary concepts

4.5.1. An amount is also income of a person if it is their income under ordinary concepts⁷.

⁵ The leading Court of Appeal decision is *Grieve v Commissioner of Inland Revenue* (1984) 6 NZTC 61,682

⁶ Section CB 1

⁷ Section CA 1

4.5.2. Income under ordinary concepts is a catch-all provision that aims to bring to tax receipts derived by a taxpayer that have not been brought to tax through the operation of the other sections of the ITA 2007. The scope of this section is not entirely clear. However, items which are generally regarded as capital, or are wind-fall gains and are therefore not "income according to ordinary concepts" should not fall within this provision.

4.5.3. The Courts⁸ have considered that the following characteristics suggest an amount is income:

- ▶ Income is something that comes in
- ▶ Income imports the notion of periodicity, recurrence and regularity; and
- ▶ Whether a particular receipt is income depends on its quality in the hands of the recipient.

4.5.4. While the financial redress amount does "come in" to the PSGE and may be paid in instalments (i.e., a claimant group may receive an amount "on account"), we consider that the financial redress amount should not be treated as income under ordinary concepts. The financial redress is part of a comprehensive settlement of a claimant group's compensation for historical breaches of the Treaty of Waitangi. The Crown's policy for entering into the Treaty negotiations is that it is a comprehensive final settlement and there is no element of regularity or recurrence.

4.5.5. The above view is supported by conclusions made by Inland Revenue in the Income Tax Interpretation Statement that financial redress is not income under ordinary concepts as:

- ▶ Treaty settlements are one-off events;
- ▶ Treaty settlements do not involve a gain from property or services; and
- ▶ the purpose of financial redress is to compensate the claimants for a capital loss caused by breaches of the Treaty.

4.6. Financial arrangements

4.6.1. The financial arrangement rules require a person to apply a spreading method to recognise income or expenditure evenly over the life of the financial arrangement and to perform a base price adjustment calculation at the end of the financial arrangement.

4.6.2. The financial arrangement rules may be applicable when there is a delay between the signing of the Deed of Settlement and finalising the settlement. If the financial arrangement rules applied to the financial redress amount a component of the financial redress amount could be deemed to be assessable interest.

4.6.3. A financial arrangement is defined as including:

"an arrangement under which a person receives money in consideration for that person, or another person, providing money to any person-

⁸ *Reid v C of IR* (1985) 7 NZTC 5,176

(a) *At a future time; or*

(b) *On the occurrence or non-occurrence of a future event, whether or not the event occurs because notice is given or not given”.*

4.6.4. Common examples of financial arrangements include debt instruments and deferred settlements for the purchase of goods.

4.6.5. While Treaty settlements include undertakings by the claimant group, there is no transfer of money or money's worth from the claimant group to the Crown. Therefore the receipt of financial redress should not be considered subject to the financial arrangement rules.

4.6.6. In the Income Tax Interpretation Statement, Inland Revenue concluded that financial redress is not subject to the financial arrangement rules as the Crown does not receive any money or money's worth in consideration for making the settlement.

4.7. GST treatment

4.7.1. To the extent that a claimant group or the Crown is making supplies of goods or services, the GST treatment of that supply should be considered.

4.7.2. The first issue is whether there is a supply of goods and services. The second issue requires the consideration for the supply to be determined. Arguably both the Crown and a claimant group are making supplies:

- ▶ The claimant group is providing the Crown with various undertakings or agreements; and
- ▶ The Crown is transferring land or other goods to the claimant group.

However, what is the consideration for these supplies is not clear (i.e., is each supply consideration for the other supply?)

4.7.3. The GST Interpretation Statement discusses the GST issues arising from Treaty of Waitangi settlements.

4.7.4. In the GST Interpretation Statement, Inland Revenue concluded that GST should not be chargeable as:

- ▶ the undertakings or agreements provided by the claimant group in a Treaty of Waitangi settlement may be a supply of services but the cash or non-cash items received following a Treaty settlement are not consideration for those services but redress for historical wrongs;
- ▶ the transfer of land or other goods by the Crown is a supply of goods but the undertakings or agreements provided by the claimant group is not consideration for those goods.

4.7.5. Based on Inland Revenue's opinion in the GST Interpretation Statement there should not be a GST liability arising from a Treaty settlement.

4.8. Tax indemnities

4.8.1. A claimant group should seek specific tax indemnities in the Deed of Settlement to confirm the income tax and GST of the assets received on settlement. The fact of the analysis by Inland Revenue in its Income Tax Interpretation Statement and GST Interpretation Statement (as well as the analysis contained in this report) does not preclude the need for prudence in negotiations with the Crown. It is entirely appropriate for specific tax indemnities to be included in the Deed of Settlement.

4.9. Tax implications for PSGE relating to assets received on settlement

4.9.1. The Income Tax Interpretation Statement concluded that financial redress should not be treated as income for tax purposes. In the Income Tax Interpretation Statement Inland Revenue referred to cash, the return of land, and rights of first refusal as items of financial redress. However, the arguments set out in the Income Tax Interpretation Statement should apply to other forms of settlement assets received by the PSGE.

4.9.2. We consider the following should be treated as non-assessable capital receipts for income tax purposes:

- ▶ acquisition of sites of significance;
- ▶ financial quantum / redress amount;
- ▶ on-account payments;
- ▶ deferred selection process rights;
- ▶ rights of first refusal;
- ▶ rights of purchase and leaseback; and
- ▶ acquisition of Crown forest licensed land.

Marae restoration and revitalisation gifts

4.9.3. A PSGE may receive an amount to apply towards marae restoration and revitalisation. Based on the same analysis contained in the Income Tax Interpretation Statement, the amount will not be:

- ▶ an amount derived from a business; or
- ▶ income under ordinary concepts.

4.9.4. A marae situated on a Māori reserve has a charitable purpose as long as the marae's funds are not used for a purpose other than:

- ▶ the administration and maintenance of the land or physical structure; or
- ▶ other charitable purposes (i.e., relief of poverty, advancement of education or religion or any other matter beneficial to the community⁹).

4.9.5. Therefore, provided the marae satisfies the above criteria and has registered as a charitable entity under the Charities Act it will be exempt for income tax purposes. If the marae is not exempt it is possible that the amount received is subject to the capital contribution rules¹⁰ which will require either:

- ▶ recognising the amount as income and spreading it over a 10 year period; or
- ▶ reducing the adjusted tax value of depreciable property.

However, the capital contribution rules will only apply to the extent that the amount paid is applied towards depreciable property.

Interest on financial redress amount

4.9.6. Some Deeds of Settlement include a provision whereby the Crown will pay interest calculated on the financial redress amount for the period following the signing of an Agreement in Principle or Deed of Settlement until the settlement is finalised. The settlement interest is not part of the financial redress amount but is negotiated by the parties in the Deed of Settlement in recognition of the time between reaching an agreement and the final settlement.

4.9.7. "Interest" is defined in the ITA 2007 for income tax purposes. As interest income is assessable income the interest received on the financial redress amount will be assessable if it fits within the ITA 2007 definition. We note that the label that a party puts on an amount may suggest that it is interest but is not determinative.

4.9.8. "Interest" is defined as:

"a payment made to the person by another person for money lent to any person, whether or not the payment is periodical and however it is described or calculated;"

⁹ Section YA 1 definition of "charitable purpose"

¹⁰ Section CG 8

- 4.9.9. As the claimant group has not made a loan to the Crown the settlement interest received is not paid in relation to money lent. Accordingly, the interest on the financial redress amount should not be assessable interest income.
- 4.9.10. If the Treaty settlement was a financial arrangement, the financial arrangement rules may result in the interest amount being taxed. However, as referred to above the financial arrangement rules should not apply as the Treaty settlement is not a financial arrangement.
- 4.9.11. Inland Revenue has stated¹¹ that settlement interest received by a PSGE is not taxable income as:

“the true nature of settlement interest is that it is an economic or present value adjustment to maintain the value of the agreed redress. ... the Commissioner considers that given these factors and the unique nature of the treaty settlement process, settlement interest is a capital receipt, being a further instalment of compensation for a capital loss.”

- 4.9.12. The settlement interest calculated on the financial redress amount should be treated as a non-taxable capital receipt to the PSGE.

Accumulated rentals on Crown forest licensed land

- 4.9.13. CFRT receives the rental proceeds collected by the Crown from licenses. These accumulated rentals may be transferred to a claimant as part of commercial redress.
- 4.9.14. The tax consequences arising from the distribution of trust income is dependent upon the tax form of the trust. However, distributions of a trust’s capital are non-taxable receipts. The Privy Council stated in the case of *Sir Graham Stanley Latimer v CIR* (2004) 21 NZTC 18,478:

“what the Crown settled in the present case, i.e., the forest rentals, was tax-exempt income. This constitutes the capital of the Trust.”

- 4.9.15. The accumulated rentals on Crown forest licensed land should be treated as a non-taxable capital receipt to the PSGE.

NZUs

- 4.9.16. The Government introduced a NZU free allocation plan with the introduction of the CCRA. Free NZUs allocated to pre-1990 forest land may be transferred to a claimant group as part of a Treaty settlement.
- 4.9.17. The ITA 2007 does not specifically deal with the free allocation of NZUs. However, the policy intention has always been that the receipt of free NZUs in relation to pre-1990 forest land is capital in nature and should be outside the tax base¹².
- 4.9.18. Comments by Inland Revenue also support the view that the receipt of free NZUs in relation to pre-1990 forest land should be treated as a capital receipt as they were allocated to compensate for the fall in value of land¹³.
- 4.9.19. The free allocation of NZUs should be treated as a non-taxable capital receipt to the PSGE.

Funding contributions

- 4.9.20. The Income Tax Interpretation Statement also considered the income tax treatment of claimant funding provided by the Crown through the OTS. The analysis contained in the Income Tax Interpretation Statement should also apply to funding received by claimants from the CFRT.
- 4.9.21. Inland Revenue considered that the payment is not derived from a business or income under ordinary concepts.
- 4.9.22. Funding contributions should be treated as a non-taxable capital receipt to the PSGE.

4.10. Tax implications for PSGE upon the subsequent transfer of settlement assets

¹¹ Inland Revenue’s QB09-01 *Income Tax Treatment of interest on Treaty of Waitangi Redress for the period from settlement until payment*, Tax Information Bulletin Vol 21, No. 2 (April 2009)

¹² *Emissions Trading Tax Issues: An officials’ issues paper on tax matters arising from the New Zealand Emissions Trading Scheme (September 2007)*

¹³ Refer to comments by Inland Revenue in Tax Information Bulletin Volume 21, No. 8 Part II (October 2009)

4.10.1. A subsequent transfer of settlement assets may trigger a tax liability. We have set out below the issues that may arise when a PSGE transfers the following assets to associated parties or third parties:

- ▶ land;
- ▶ depreciable assets; and
- ▶ NZUs.

Land

4.10.2. Ordinarily profits or gains derived on the sale of land are capital in nature and are not subject to income tax. However, the tax legislation provides a regime that seeks to tax certain profits or gains.

4.10.3. The PSGE will be taxed on any profits or gains arising from the disposal of land if the land was acquired with any purpose or intention of disposal. Given the nature of the Treaty settlement process and the significance of the land acquired by the PSGE it is not likely that the PSGE would acquire the culturally sensitive land intending to dispose of it. However, there will be situations where the claimant group receives commercial land that it intends to sell to other members of its group. The application of this provision is dependent upon the claimant group's circumstances and its potential application to any land transfers needs to be carefully considered.

4.10.4. Any gains or profits arising from a disposal of land will also be taxable if:

- ▶ The PSGE or an associated person carries on a business of dealing in land at the time of acquisition;
- ▶ The PSGE or an associated person carries on a business of developing land at the time of acquisition;
- ▶ The PSGE or an associated person carries on a business of erecting buildings at the time of acquisition;
- ▶ The profits or gains are attributable to changes in the permitted use of the land (e.g., rezoning) if the land is disposed of within 10 years of its acquisition;
- ▶ The profits or gains are derived from an undertaking or scheme that involves development or division work that is not of a minor nature and the work was commenced within 10 years of the acquisition of the land; or
- ▶ The profits or gains are derived from an undertaking or scheme that involves development or division work and significant expenditure on channelling, contouring, drainage and similar activities was incurred.

4.10.5. Applying the above provisions to a fact situation can be complex. In particular, considering the associated person rules. We recommend that a PSGE seeks advice from its tax advisors to determine the possible income tax implications of the disposal of land.

Depreciable assets

4.10.6. A PSGE will derive taxable income to the extent that it disposes of depreciable assets for more than their adjusted tax value (i.e., the tax book value)¹⁴.

4.10.7. The tax depreciation recovery amount is calculated as the lesser of:

- ▶ the difference between the consideration received and an item's adjusted tax value; and
- ▶ the accumulated tax depreciation.

4.10.8. To the extent that the adjusted tax value is more than the consideration received (i.e., market value) and the asset is not a building, the PSGE will be able to claim a deductible tax loss on disposal.

¹⁴ Section EE 48 of the ITA.

NZUs

4.10.9. Any gain derived by a PSGE arising from the transfer of NZUs received in relation to pre-1990 forest land should be excluded income and not taxable provided:¹⁵

- ▶ the NZUs relate to pre-1990 forest land that is held on capital account;
- ▶ the NZUs have not been surrendered under the CCRA; and
- ▶ have been held continuously by the PSGE since their issue.

4.10.10. However, if the PSGE transfers the NZUs to an associated party and they sell the NZUs any gain derived by the associated party may be assessable income and not excluded income as the associated party will not have held the NZUs continuously since their issue¹⁶.

4.10.11. A disposal / transfer of NZUs is zero-rated for GST purposes¹⁷.

¹⁵ Section CX 51B of the 2007 ITA

¹⁶ The Taxation (Annual Rates, Returns Filing, and Remedial Matters) Bill 2011 contains an amendment which will treat a gain derived by an iwi entity from the disposal of NZUs as exempt income if the iwi entity acquired the NZUs from another iwi entity that received the NZUs from the Crown provided it was a claimant under a Treaty settlement at the time of the original transfer from the Crown.

¹⁷ Section 11A(1)(s) of the GST Act

5. Understanding structuring needs

Key points

Identify the iwi's current goals and future plans.

Formulate a clear understanding of the iwi's structuring needs to ensure that the PSGE Group structure complements the iwi's plans / intentions.

5.1. Introduction

- 5.1.1. In addition to an understanding of a claimant group's current state, it is important that the claimant group's structuring needs (both current and future) are identified.
- 5.1.2. In addition to identifying a claimant group's structuring needs, it is important to prioritise these needs as it may be difficult to establish a PSGE group structure that satisfies all of an iwi's structuring needs (i.e., there is no "template" structure that should be used for all claimant groups).
- 5.1.3. As strategic and operational discussions may be ongoing, clear and precise structuring principles or drivers can be difficult to formulate in the early stages. Therefore, a degree of structural flexibility is required to ensure that the group structure model will not unduly or unnecessarily constrain the iwi's future activities and aspirations once determined.

5.2. Typical structuring needs

- 5.2.1. The following items are typical structuring needs that may be significant to a claimant group:

Land protection – ensuring that any culturally significant assets such as waahi tapu can be adequately safeguarded for commercial risk and reconnected with its people.

Effective commercial management – the ability to apply appropriate commercial and management skills and processes when and where necessary in order to generate wealth for the iwi.

Affordability – to ensure all administration and compliance costs are manageable and relative to the iwi's operations and capacity.

Commercial robustness and flexibility – to quarantine and manage risk, and the ability to adapt to changing commercial / investment circumstances and opportunities in the future.

Distribution flexibility – the ability to distribute in a tax efficient manner both indirect collective benefits (in the short term) through distributions to marae and provide non-charitable benefits to members of the iwi (in the long-term).

Consistency with tikanga – to ensure that the legal structure is consistent with the intrinsic values of the iwi in a quasi mainstream, quasi tikanga structure.

Simplicity and role clarity – to keep the structure as simple as practicable and clarify each component's role in achieving the iwi's strategic objectives, so that the entire structure is easily understood by those in governance and management roles as well as individual iwi members.

Investment flexibility – the ability to invest in a wide range of entities and activities to ensure that the funding of future enterprises are not limited by the original PSGE structure.

Representation and accountability – to ensure that any structure implemented can incorporate best practice governance and operational models and policies.

6. Identification and discussion of advantages and disadvantages of options

Key points

As each entity has inherent tax advantages and disadvantages it is important that an iwi has considered its structuring needs to ensure that it does not establish an entity that is inefficient or overly restrictive.

Remember, some of the tax entities are suitable options for the PSGE but some tax entities are more appropriate to be part of the PSGE group and not the PSGE itself.

6.1. Introduction

6.1.1. There are a number of legal and tax entities available for a claimant group's PSGE and its PSGE group structure.

6.1.2. The OTS has compiled "Twenty Questions on Governance" setting out matters that should be disclosed as part of the Treaty negotiations process. The Twenty Questions require consideration of the structure and mechanics of the PSGE and issues of representation, accountability and transparency.

6.1.3. A claimant needs to consider whether the OTS has imposed any restrictions on:

- ▶ The legal and tax form of the PSGE at the time of settlement; and
- ▶ The legal and tax form of the PSGE post-settlement.

6.1.4. Summarised below are the advantages and disadvantages of the following types of legal / tax entities:

- ▶ Charitable entity;
- ▶ Complying trust;
- ▶ Company;
- ▶ Māori authority;
- ▶ LTC; and
- ▶ LP.

6.1.5. The following table sets out whether the tax entity is an appropriate vehicle for the PSGE itself or whether it should only be use as part of the wider PSGE group structure:

<i>PSGE Options</i>	<i>PSGE Group Options</i>
Complying trust	Charitable entity ¹⁸
Māori authority	Complying trust
	Company ¹⁹
	Māori authority
	LTC
	LP

6.1.6. The summary should not be considered exhaustive. Whether or not a particular type of entity should have a role in a claimant group's PSGE group structure depends upon the claimant group's structuring needs, existing structure and its future plans.

6.2. Charitable entities

Constitutional requirements

¹⁸ As referred to above, a PSGE may decide to become a charitable entity post-settlement.

¹⁹ A company may be used as a PSGE for iwi collectives where the shareholders of the company will be the PSGEs of each of the iwi members.

- 6.2.1. A trust, incorporated society or a company may be a charitable entity. The legal form of the entity (i.e., whether it was established pursuant to the CTA, the Incorporated Societies Act 1908 or the Companies Act) is not determinative of its charitable status but whether the entity has a charitable purpose as evidenced by its constitutional documents.
- 6.2.2. An entity may seek to obtain charitable status if its constitutional document (i.e., trust deed, constitution, rules) satisfies the following requirements:
- ▶ Have an exclusively “charitable purpose” or object at general law;
 - ▶ Exist for the benefit of the community or an appreciably significant section of the community;
 - ▶ Not be carried on for the private pecuniary profit of any individual;
 - ▶ Have provision in its constituting document for its assets to be given to another charity in the event of it being wound up; and
 - ▶ Have no power to amend its rules to detract from the above charitable requirements.
- 6.2.3. “Charitable purpose” is defined in the Charities Act²⁰ and:
- “includes every charitable purpose, whether it relates to the relief of poverty, the advancement of education or religion, or any other matter beneficial to the community.”*
- Further, a marae has a charitable purpose if the:
- “marae is situated on land that is a Māori reservation referred to in Te Ture Whenua Māori Act 1993 and the funds of the marae are not used for a purpose other than-*
- (i) The administration and maintenance of the land and of the physical structure of the marae;*
 - (ii) A purpose that is a charitable purpose other than under this paragraph.”*
- 6.2.4. The issue of what is “any other matter beneficial to the community” can be complex and a substantial body of case law has been developed since the Charitable Uses Act 1601 was passed in England. Accordingly, specialist legal advice should be sought to ensure that an entity is eligible to register under the Charities Act and that it maintains its registration.

²⁰ Section 5

Tax implications

- 6.2.5. The Crown's policy is to only settle Treaty settlement assets upon entities that represent the individual claimant group members (i.e., where members are beneficially entitled to the settlement assets). Therefore as the beneficiaries of charities are "charitable purposes" as opposed to individuals it is the Crown's policy not to settle with a PSGE that is a charity.
- 6.2.6. Although the Crown will not settle Treaty settlement assets upon a charity, there is no prohibition of subsequently converting the PSGE to a charity after settlement. Therefore, as soon as practicable after the settlement assets are transferred to the PSGE, the PSGE could convert into a charitable entity and register with the Charities Commission to obtain tax-exempt status.

Advantages

- 6.2.7. A charitable entity is a simple and cost effective option from an administrative perspective. Charitable status removes the need to prepare and file income tax returns. However, all registered charitable entities will be required to satisfy ongoing annual filing requirements with the Charities Commission in order to maintain their tax-exempt status.
- 6.2.8. A charitable entity is exempt from paying income tax, having resident withholding tax withheld on interest income and allowed rebates to be claimed by the payee on donations made to the entities.

Disadvantages

- 6.2.9. As referred to above, the "charitable purposes" of a charitable entity is its beneficiary (in effect). A charitable PSGE will only be able to distribute to those iwi members who have relevant needs that are within the scope of the charitable purposes of the charitable entity.
- 6.2.10. A charitable PSGE must not distribute business income to charitable purposes that do not benefit New Zealand (e.g., education grants to Australian resident iwi members wishing to undertake education in Australia).
- 6.2.11. The assets of a charitable PSGE are effectively locked-in to the charitable structure as the common law requires charities to apply assets and income towards charitable purposes (including upon wind-up).
- 6.2.12. A charitable PSGE effectively pays 28% tax on non-refundable credits attached to investment income (e.g., dividends from tax-paying companies)²¹.

6.3. Complying trust

Constitutional requirements

- 6.3.1. A trust will exist where a person (a settlor) transfers property to another person or persons (the trustees) who hold the property for the benefit of specific persons (the beneficiaries) and the three certainties have been satisfied, namely:
- ▶ Certainty of intention to establish a trust;
 - ▶ Certainty of the nature of the trust property; and
 - ▶ Certainty that the beneficiaries can be identified.
- 6.3.2. In broad terms there are two types of trusts: fixed and private discretionary trusts. A fixed trust arises when the beneficiary has a fixed entitlement / interest in the trust's capital and income. A private discretionary trust arises where the beneficiaries do not have fixed entitlements and any share a beneficiary receives of the trust's capital or income is determined by the trustee's discretion. Typically a trust established as a PSGE will be a private discretionary trust.
- 6.3.3. The duties and obligations of the trustees are determined by the Trustee Act and the trust deed. Specialist legal advice should be sought to ensure that the trust deed is drafted to reflect the intention and the needs of the claimant group.

Tax implications

²¹ A tax-exempt shareholder cannot use imputation credits against its own tax liability (because it has none) and cannot claim a refund for the credits from Inland Revenue.

- 6.3.4. A trust established by a New Zealand resident settlor that meets its tax obligations will generally qualify as a “complying trust” for income tax purposes²². Therefore, a private discretionary trust formed to act as the PSGE will generally be a complying trust.
- 6.3.5. A complying trust will be subject to tax at 33% on any “trustee income”. However, any income that is “beneficiary income” is taxed in the hands of the relevant beneficiary at their marginal tax rate.
- 6.3.6. “Trustee income” and “beneficiary income” are defined for income tax purposes. The term “beneficiary income” is defined to include income paid to a beneficiary of a trust within 6 months after balance date or before the relevant tax return is due for that year in which the trust earned the income. “Trustee income” is defined as an amount of income derived by a trustee of a trust that is not beneficiary income²³.
- 6.3.7. Distributions of the trust’s capital to a beneficiary should be tax exempt.

Advantages

- 6.3.8. A PSGE that is a complying trust should have the ability to pay or apply the trust’s income or capital, or both, to or for the benefit of any or all of its beneficiaries. A PSGE that is a complying trust should not have the same distribution restrictions as a charitable entity.
- 6.3.9. The potential for taxable income to be distributed to beneficiaries and taxed at their marginal tax rates and not the trustee rate of 33%.

Disadvantages

- 6.3.10. Any income retained by the complying trust will be taxed at the unrecoverable rate of 33%.

6.4. Company

Constitutional requirements

- 6.4.1. A company is incorporated by registering at the Companies Office. A company must have at least one director and one shareholder and must have issued at least one share.
- 6.4.2. A company is governed by the Companies Act. However, a company is able to adopt a constitution setting out its rules and procedures.

Tax implications

- 6.4.3. A company will be subject to tax at 28% on its net taxable income.

²² Section HC 10

²³ Section HC 7, trustee income also includes beneficiary income that is derived by a minor.

- 6.4.4. A New Zealand company is required to maintain an imputation credit account and record all debits and credits to that account. A credit arises when tax is paid by the company. The company is able to attach the credit to dividend distributions. A shareholder is able to claim a credit for any imputation credits it receives against its taxable income.

Advantages

- 6.4.5. A company structure is a simple and familiar structure.
- 6.4.6. A company structure provides limitation of liability thereby allowing risk from commercial activities to be quarantined.

Disadvantages

- 6.4.7. Any income derived by the company will be taxed at the unrecoverable rate of 28%.
- 6.4.8. The process for distributing a company's after tax profits is more formal than distributions by trusts, limited partnerships and LTCs.

6.5. Māori authority

Constitutional requirements

- 6.5.1. The Māori authority tax regime has been specifically designed to suit the needs of Māori organisations. As such, it can offer benefits not available elsewhere in the tax system.
- 6.5.2. Both ordinary companies and complying trusts are able to elect into the Māori authority regime. As referred to above, the Māori authority regime is a tax concept only and from a legal and commercial perspective the entities remain either a trust or a company.

Tax implications

- 6.5.3. A PSGE that is either a company or a trust may immediately elect to become a Māori authority for income tax purposes on the basis that it "receives and manages assets"²⁴ transferred as part of a Treaty settlement on behalf of Māori claimants and is contemplated by the Deed of Settlement of the claim as performing these functions.
- 6.5.4. As a Māori authority, the PSGE will be taxed at 17.5% instead of the ordinary company tax rate of 28% or the complying trust rate of 33%.
- 6.5.5. Any post-tax profit plus Māori authority credits can be distributed to the Māori authority's members. A Māori authority distribution will be income of the member if the amount is a TMAD²⁵. However, if the Māori authority distribution is not a TMAD it will be exempt income in the hands of the member²⁶.
- 6.5.6. A Māori authority distribution will be a TMAD if its source is income of the Māori authority that is²⁷:
- ▶ Derived by the Māori authority in the 2004 / 05 income year or a later income year; and
 - ▶ Is not exempt income of the Māori authority.

²⁴ Section HF 2(2)(d) or section HF 2(3)(e). We note that an entity that only receives an "on account" payment is unlikely to be eligible to elect into the Māori authority regime.

²⁵ Section CV 11

²⁶ Section CW 55

²⁷ Section HF 7

- 6.5.7. A Māori authority being able to convert non-refundable tax credits (such as imputation credits attached to company dividends) into refundable tax credits.

Advantages

- 6.5.8. A PSGE's eligibility to become a Māori authority is not dependent upon the tax status of its shareholders or beneficiaries as the case may be.
- 6.5.9. A PSGE that is a Māori authority has distributive flexibility and may make non-taxable distributions of capital or distribute after-tax profits to its members with refundable credits attached.
- 6.5.10. For commercial and legal purposes the PSGE will remain either a trust or a company.

Disadvantages

- 6.5.11. The PSGE will be unable to offset tax losses against other group entities unless both are Māori authorities and are at least 66% commonly owned. The PSGE's members will be unable to directly access its tax losses as the 66% threshold for common ownership does not exist.

6.6. Look-through company

Constitutional requirements

- 6.6.1. A LTC is a tax entity that provides the limited liability protection of an ordinary company but is a transparent vehicle for tax purposes. Ordinary companies are able to elect into the LTC tax regime provided the eligibility criteria are satisfied. LTC status only applies for income tax purposes.

Tax implications

- 6.6.2. A LTC is treated as a "flow-through" entity for tax purposes, meaning that the LTC itself will not be taxed.
- 6.6.3. Adherence to strict eligibility criteria must be maintained for a company to retain its LTC status. A LTC must have five or fewer owners ("look-through counted owners") and only natural persons, trustees or another LTC may hold shares in a LTC. Trustees of a trust are treated as one owner provided that all income allocated to the trust from the LTC for the income year and the three preceding income years is retained by the trust and not paid out as beneficiary income. If amounts are distributed as "beneficiary income", the pattern of distributions for that income year and the three preceding income years determines the number of look-through counted owners.
- 6.6.4. A LTC's shareholders will account for the LTC's income (or loss) directly. However, there is a loss limitation rule that limits a shareholder's deduction for its share of any tax loss to the adjusted tax book value of their investment in the LTC. The shareholder's investment is the sum of the equity, goods, assets, services provided to the LTC, any amounts paid by the shareholder on behalf of the LTC (i.e., shareholder current account credit balances) and their share of any third party debt which the shareholder has guaranteed.
- 6.6.5. For tax purposes the shareholders are treated as owning all of the property of the LTC. Therefore any disposal of shares in the LTC is treated as a disposal of underlying LTC property. A tax liability may crystallise at this stage depending upon the nature of the assets (i.e., land, depreciable property, trading stock and financial arrangements) and whether certain *de minimis* exemptions have been breached.
- 6.6.6. The disposal provisions are also deemed to apply if the company revokes its LTC election or ceases to qualify as a LTC. However, in these situations there are no *de minimis* exemptions.
- 6.6.7. As a LTC is excluded from the definition of "company" for income tax purposes the tax issues pertaining to the payment of dividends will not apply.

Advantages

- 6.6.8. Flow-through tax treatment which allows shareholders access to tax losses as they arise subject to the loss limitation rules.
- 6.6.9. The tax status of the shareholders are preserved (i.e., the profits of the business will be taxed at each shareholder's marginal tax rate).

- 6.6.10. A LTC is purely a tax concept and from a commercial perspective the entity will operate in the same manner as a company structure.
- 6.6.11. As a LTC is a separate commercial entity any commercial risk from the LTC's business is limited to its assets.

Disadvantages

- 6.6.12. A company may only elect into the LTC regime if its shareholders are LTCs or private discretionary trusts that meet the criteria for the counted owners' test.
- 6.6.13. Any change of shareholding or failure to satisfy the LTC criteria would trigger a deemed disposal and shareholders will be taxed on any taxable gains / losses arising from the deemed disposal of their share of the assets (e.g., depreciation recovery income). For example, this will occur if a shareholder PSGE transfers its interest in a LTC to a separate group holding entity.

6.7. Limited partnership

Constitutional requirements

- 6.7.1. A LP is an entity that provides limited liability protection for its members similar to a company but for tax purposes is taxed as a general partnership with income and expenditure attributed to its members.
- 6.7.2. A LP consists of at least one limited partner and one general partner. The limited partner provides capital and their liability is limited to their capital contributions. The limited partner does not have any management involvement. The general partner's function is to manage the partnership business. A person cannot be a general and limited partner of the same LP at the same time.
- 6.7.3. A LP must be registered on the Limited Partnerships Register managed by the Companies Office.
- 6.7.4. A LP is governed by its Partnership Deed and the LP Act.

Tax implications

- 6.7.5. A LP is treated as a "flow-through" entity for tax purposes, meaning it is not taxed itself.
- 6.7.6. The limited partner accounts for the LP's income (or loss) directly. However, there is a loss limitation rule that limits a limited partner's deduction for its share of any tax loss to the amount of the limited partner's basis or economic exposure in the LP. A limited partner's basis is calculated as the total of its capital contributions, share of LP income and share of LP debt guaranteed by the limited partner²⁸.
- 6.7.7. For tax purposes the limited partners are treated as owning all of the LP's property. Therefore any change in a limited partner's interest in the partnership property (i.e., if a new limited partner joins the LP) is treated as a disposal of the property. A tax liability may crystallise at this stage depending upon the nature of the assets owned (i.e., land, depreciable property, trading stock and financial arrangements) and whether certain *de minimis* exemptions have been breached.
- 6.7.8. The taxing of the LP's net income would be a separate matter from distribution or entitlement to that income by the limited partner. Income does not need to be distributed to limited partners and can be retained by the LP. The general partner would have control over when and how the retained funds are distributed.

Advantages

- 6.7.9. A LP can make cash distributions to its limited partners at no further tax cost.
- 6.7.10. Flow-through tax treatment allows limited partners to access tax losses as they arise subject to the loss limitation rules.
- 6.7.11. The tax status of the limited partners are preserved (i.e., the profits of the business will be taxed at each limited partner's marginal tax rate).

²⁸ Currently the loss limitation rule for LPs is more restrictive than the LTC rule. However, the Taxation (Annual Rates, Returns Filing, and Remedial Matters) Bill 2011 contains an amendment to clarify that a limited partner's basis includes loans made by the limited partner to the LP and the limited partner's current account balance. It is proposed that the amendment will apply retrospectively from 1 April 2008.

6.7.12. As a LP is a separate commercial entity any commercial risk from the business is limited to the assets of the LP, and the limited partners are quarantined from any liability.

Disadvantages

6.7.13. A LP is an accepted commercial entity but is a less familiar structure in the New Zealand scene.

6.7.14. A LP may cost more to establish than the other possible options.

6.7.15. The final dissolution of a LP would trigger a deemed disposal of all of its assets and the limited partners may be taxed on any gains / losses arising from the deemed disposal of their share of the assets (e.g., depreciation recovery income). This will occur if a limited partner transfers its partnership interest in the LP to a separate group holdings entity.

6.8. Summary table of governance, legal and tax features of each entity

	Charity	Complying Trust	Company	Tax entity		Limited partnership
				Māori authority	Look-through company	
Establishment						
▶ Number of legal entities required	1 (company / trust)	1 (trust)	1 (company)	1 (company / trust)	1 (company)	3 (limited partnership, limited partner and general partner)
▶ Legal documentation required	Constitution / Trust Deed	Trust Deed	Constitution	Constitution / Trust Deed	Constitution	Partnership agreement and 2 constitutions if the limited partner and general partner are companies
▶ Legislative governance	Charities Act and Companies Act / CTA	Trustee Act	Companies Act	Companies Act if a company, Trustee Act if a trust, Te Ture Whenua Māori Act 1993	Companies Act	LP Act
▶ Commercial risk	If a company, the shareholders' liability for losses is limited to their share of ownership of the company. If a trust, the trustees' liability is unlimited but the trust deed may contain an indemnity from the trust fund.	The trustees' liability is unlimited but the trust deed may contain an indemnity from the trust fund.	Limitation of liability	If a company, the shareholders' liability for losses is limited to their share of ownership of the company. If a trust, the trustees' liability is unlimited but the trust deed may contain an indemnity from the trust fund.	Limitation of liability	Limited partner's liability is limited to the extent of their contribution to the limited partnership. General partner has a residual liability if the limited partnership is unable to satisfy its unpaid debts or liabilities.

	Tax entity					
	Charity	Complying Trust	Company	Māori authority	Look-through company	Limited partnership
Business decision making						
▶ Strategic and significant decision making	If a company, directors and shareholders involved in major transactions. If a trust, the trustees but for some major transactions the trust deed may require iwi approval.	Trustees but for some major transactions the trust deed may require iwi approval	Directors and shareholders involved in major transactions	If a company, directors and shareholders involved in major transactions. If a trust, the trustees but for some major transactions the trust deed may require iwi approval.	Directors and shareholders involved in major transactions	Typically, the general partner and the limited partner in specific situations ²⁹
▶ Day to day decision making	Key management personnel under the guidance of the directors / trustees	Key management personnel under the guidance of the trustees	Key management personnel under the guidance of the directors	Key management personnel under the guidance of the directors or trustees	Key management personnel under the guidance of the directors	General partner
▶ Authority to contract	Directors / trustees	Trustees	Directors	Directors / trustees	Directors	General partner
▶ Ongoing compliance	Charities Commission filing obligation for 1 entity	Inland Revenue filing obligation for 1 entity	Inland Revenue and Companies Office filing obligations for 1 entity	Inland Revenue and Companies Office filing obligations for 1 entity	Inland Revenue and Companies Office filing obligations for 1 entity	Inland Revenue and Companies Office filing obligations for 3 entities

²⁹ Section 31(3) and the Schedule of the Limited Partnerships Act 2008 specify the “activities that do not constitute taking part in management of limited partnership” that may be undertaken by a limited partner. The listed activities include approving a variation of the partnership agreement, approving or vetoing investment in assets worth more than ½ the value of the LP’s assets and approving a change in the general nature of the LP’s business.

	Tax entity					
	Charity	Complying Trust	Company	Māori authority	Look-through company	Limited partnership
▶ Authority to make distributions	Directors must authorise dividends and certify that after payment of the dividend the company will be solvent / Trustees must authorise distributions in accordance with the trust deed	Trustees resolve to make distributions of income or capital	Directors authorise dividend and certify that after payment of the dividend the company will be solvent	Directors must authorise dividends and certify that after payment of the dividend the company will be solvent / Trustees must authorise distributions in accordance with the trust deed	Directors authorise dividend and certify that after payment of the dividend the company will be solvent	General partner authorises distribution and certifies that after payment of the distribution the limited partnership will be solvent
▶ Change to management	Shareholders have power to appoint / remove directors or if a trust, the trust deed should provide a mechanism for the changing of trustees	The trust deed should provide a mechanism for the changing of trustees	Shareholders have power to appoint / remove directors	Shareholders have power to appoint / remove directors or if a trust, the trust deed should provide a mechanism for the changing of trustees	Shareholders have power to appoint / remove directors	Partnership agreement should provide the mechanism for changing the general partner or if the general partner is a company, its shareholders have the power to appoint / remove directors of the general partner
Tax issues						
▶ Income tax profile	Exempt	Trustee income taxed at 33%	Taxed at 28%	Taxed at 17.5%	Flow-through entity	Flow-through entity
▶ Direct access to tax losses	N/A	No	No	No	Access, subject to loss limitation rule	Access, subject to loss limitation rule
▶ Tax implications on changes in investors	N/A	N/A	May impact on carry forward of tax losses and imputation credits	May impact on carry forward of tax losses and Māori authority credits	Disposal provisions triggered	Disposal provisions triggered

7. The tax implications of winding up and merging of existing entities

Key points

As part of the PSGE structure and settlement process each iwi should consider whether it is appropriate to restructure, merger or wind up any existing entities.

Remember to seek tax and accounting advice prior to any restructure of entities.

7.1. Introduction

- 7.1.1. A claimant group should carry out a stocktake of its existing entities to determine whether they are required going forward and whether the Treaty settlement is the appropriate time for an entity to be wound up, merged or restructured. The negotiation of settlement legislation provides an opportunity to restructure existing entities such as charitable trusts and Māori Trust Boards.
- 7.1.2. The mechanisms and implications of winding up, merging or restructuring entities are determined by the governing documents (i.e., constitution, trust deeds) and the assets / liabilities that the entities have. The issues that might arise as part of this process are outlined below. A claimant group should seek advice from legal and accounting specialists prior to undertaking any form of restructure.

7.2. Charities

- 7.2.1. Due to a common law requirement (which is often built into charitable constitutions or trust deeds) to apply assets and income towards charitable purposes (including upon wind-up), assets owned by a charitable entity can be effectively locked-in to a charitable structure. Therefore, typically a charitable entity is wound upon by distributing / resettling its assets on another charitable entity. Alternatively, the CTA contains a mechanism allowing the merging of charitable trusts or the modification of charitable objects.
- 7.2.2. Alternatively, if a claimant group wishes to remove charitable status from the assets it could request that the transfer of the charitable entity's assets to a member of the claimant group's PSGE group is prescribed in the settlement legislation³⁰.
- 7.2.3. Provided the charity has tax exempt status there should be no income tax implications on its wind up.

7.3. Complying trust

- 7.3.1. The trust deed of the complying trust will determine how its assets should be distributed upon its wind up. To the extent that the trust deed is unduly restrictive, a claimant group could request that the transfer and wind up be prescribed in the settlement legislation.
- 7.3.2. A distribution of the complying trust's capital should not be taxable in the hands of the recipient.

³⁰ Refer to Ngāti Porou Claims Settlement Act 2012 and Ngāti Whatua Orakei Claims Settlement Bill as examples.

7.4. Company

- 7.4.1. An existing company (other than a Māori authority) may either amalgamate (merge) with another company or be liquidated (wound up).
- 7.4.2. An amalgamation may occur pursuant to the Companies Act and results in one company (the amalgamating company) merging with another company (the amalgamated company) and only the amalgamated company continues in existence following the date of amalgamation.
- 7.4.3. The general treatment of the amalgamation transaction is that the amalgamated company succeeds to all of the rights and obligations of the amalgamating company for the year of amalgamation and all prior tax years.
- 7.4.4. A “liquidation” is defined widely for income tax purposes and includes the removal of a company from the register of companies under the Companies Act. A company may be put into voluntary liquidation by a special resolution of shareholders appointing a liquidator.
- 7.4.5. A company must repay its liabilities and may either make an in specie distribution of its remaining assets to its shareholders upon liquidation or sell those assets and make a cash distribution to its shareholders. The tax treatment of the distribution is the same. The distribution will be a dividend that is taxable to the shareholders to the extent that the distribution exceeds the company’s available subscribed capital (i.e., the amounts paid up by the shareholders for the issued shares).
- 7.4.6. To the extent that the company has any imputation credits or tax losses available, these will be forfeited following liquidation.

8. PSGE group structuring models and application to Iwi X

Key points

It is important that the PSGE and PSGE group options are thoroughly considered prior to the settlement date.

Consider how potential future activities / investments would fit into a proposed PSGE group structure – it is best to get it right in the first place.

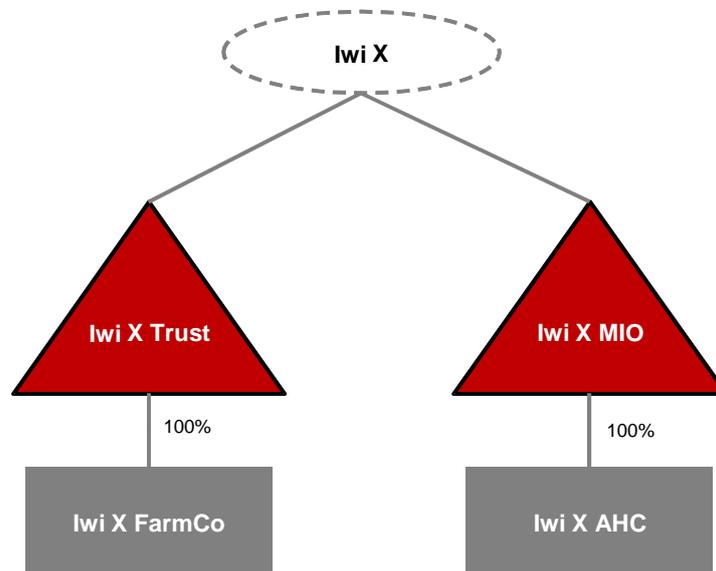
There are numerous PSGE group structure options and only a sample has been considered in this section.

Remember that determining the preferred PSGE group structure is a process that requires a stocktake of current entities, a clear understanding of the iwi's structuring needs and consideration of future operations, funding requirements and distributive needs.

8.1. Iwi X

8.1.1. Three scenarios are outlined to illustrate how the various entity types may be used to establish a PSGE group structure. The scenarios are for illustrative purposes only and should not be considered a recommended or preferred structure for a particular claimant group.

8.1.2. To assist in illustrating the concepts and principles discussed in this report, a fictitious Iwi X is used.



Stock take of current state

8.1.3. Iwi X's existing iwi structure consists of:

- ▶ Iwi X Trust - A trust established by deed under the CTA and recognised as the mandated body for Treaty of Waitangi settlement negotiations with the Crown.
- ▶ Iwi X FarmCo – A wholly owned subsidiary of Iwi X Trust that operates a farm;
- ▶ Iwi X MIO - A trust established by deed and recognised by Te Ohu Kai Moana Trustee Limited as a MIO under the Māori Fisheries Act 2004; and

- ▶ Iwi X AHC - A wholly owned subsidiary of Iwi X MIO that owns and manages certain fisheries assets.

8.1.4. All of the existing members of Iwi X's structure have registered as charitable entities under the Charities Act and their income will be exempt for tax purposes.

8.1.5. The Iwi X example contains only charitable entities as a charitable group is a widely used structure. However, an iwi's existing structure may consist of different types of entities including private discretionary trusts that are taxed either as complying trusts or Māori authorities.

Commercial redress package

8.1.6. The Settlement redress outlined in the Crown offer to Iwi X includes a financial and commercial redress package comprising of:

- ▶ principal financial quantum of \$50 million;
- ▶ the gifting of 3 properties of significance to Iwi X;
- ▶ the opportunity to purchase licensed Crown forest land with associated accumulated rentals and NZUs;
- ▶ rights of deferred selection process over certain non-core Crown properties;
- ▶ rights of purchase and leaseback of certain core Crown properties; and
- ▶ rights of first refusal over certain Crown properties

8.1.7. It is proposed that Iwi X's Deed of Settlement will include a clause whereby Iwi X will receive interest at a rate of 6% per annum on the principal financial quantum for the period from the date the Deed of Settlement is signed to the date the settlement legislation is enacted.

8.1.8. Iwi X has received funding from the Crown and CFRT to assist its Treaty negotiation process.

Needs and aspirations for the future state

8.1.9. Iwi X has the following strategic goals:

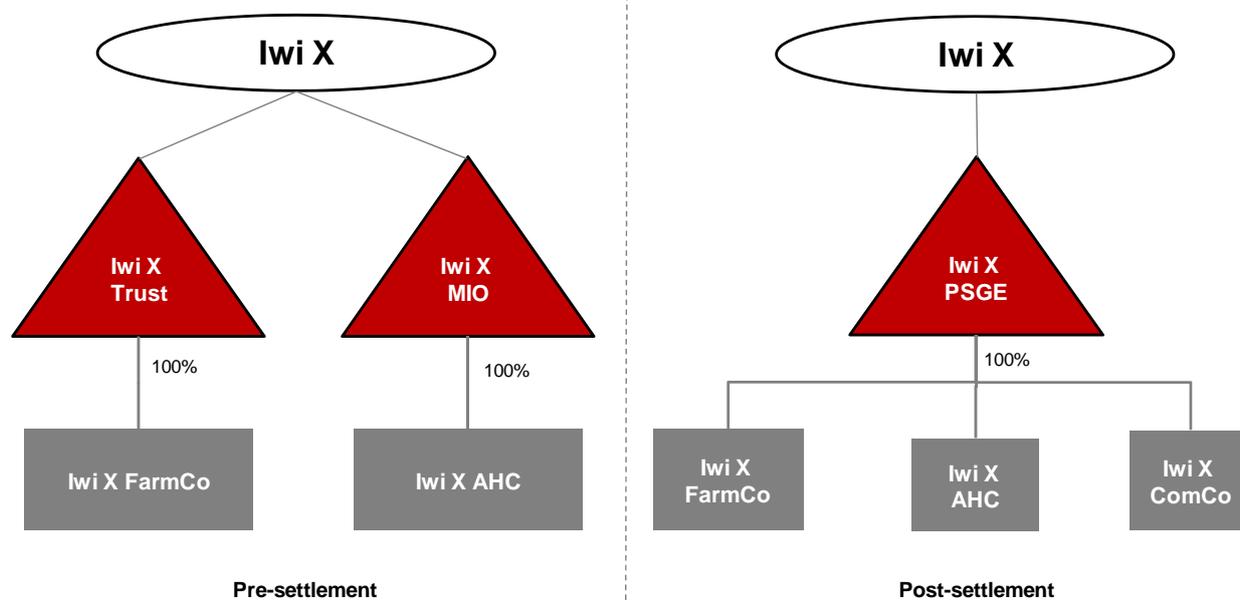
- ▶ safeguarding its sites of significance for future generations; and
- ▶ developing income streams to fund educational opportunities and health initiatives to benefit members.

Future income earning operations

8.1.10. A table follows illustrating the tax treatment for each of the four scenarios using the below example:

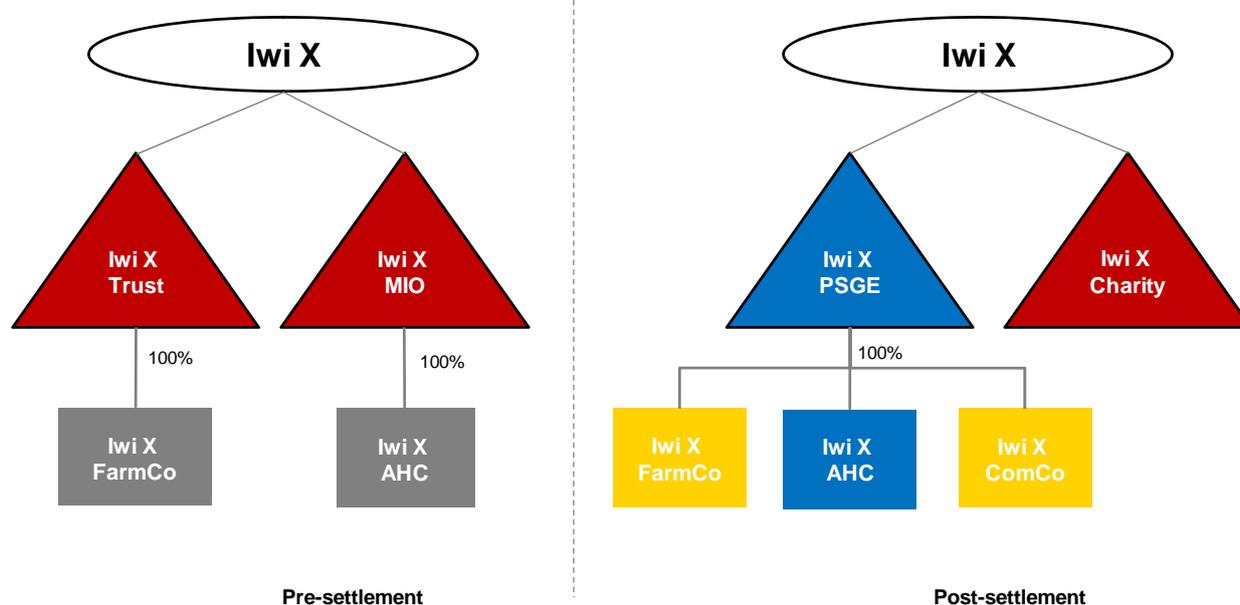
- ▶ Iwi X ComCo derives rental income from a commercial property; and
- ▶ Iwi X ComCo derives dividend income from an investment in a third party.

8.2. Charitable group



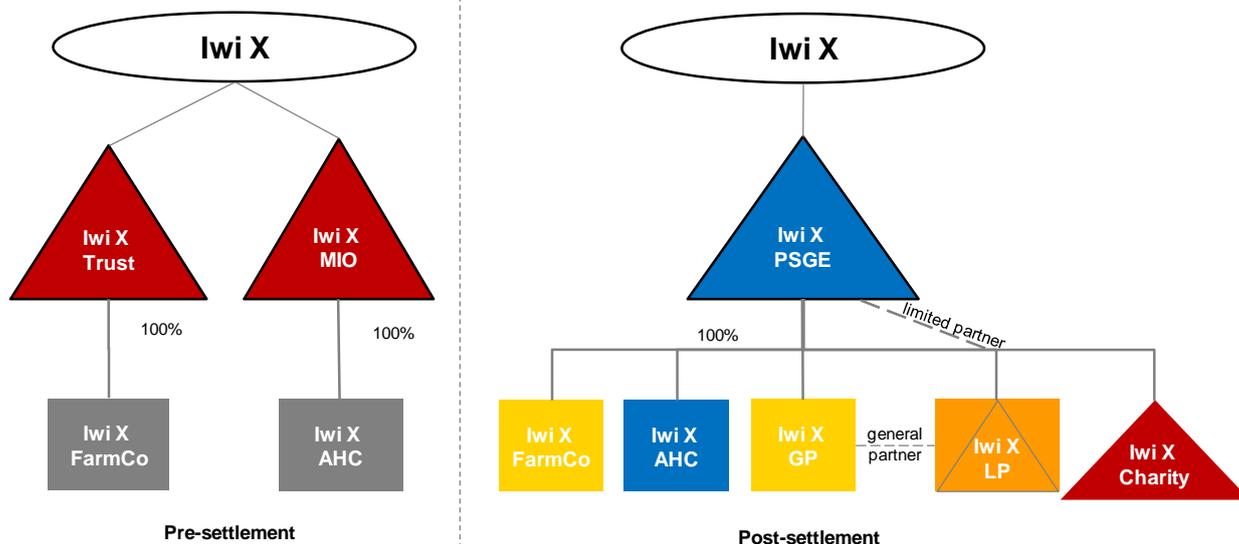
- 8.2.1. Iwi X establishes a private discretionary trust, Iwi X PSGE, to receive settlement redress. All items included in the commercial redress package should be treated as non-assessable capital receipts for income tax purposes. Similarly, any interest received on the principal financial quantum will also be a non-assessable capital receipt.
- 8.2.2. Iwi X PSGE establishes a wholly owned subsidiary company, Iwi X ComCo, to undertake its commercial activities.
- 8.2.3. The settlement legislation provides that upon settlement Iwi X Trust and Iwi X MIO and their assets (Iwi X FarmCo and Iwi X AHC) will merge with Iwi X PSGE and that Iwi X PSGE is the MIO.
- 8.2.4. As soon as practicable after the settlement assets are transferred to Iwi X PSGE, both Iwi X PSGE and Iwi X ComCo convert into charitable entities.
- 8.2.5. Iwi X PSGE exercises a right of first refusal and purchases commercial property. Iwi X PSGE transfers the commercial property to Iwi X ComCo. Iwi X ComCo will derive assessable rental income from the commercial property. However, as Iwi X ComCo will be a charitable entity, no tax will be paid.
- 8.2.6. Iwi X ComCo purchases shares in a third party company and receives dividend income with imputation credits attached. As Iwi X ComCo is a charitable entity, it will not receive any benefit from the imputation credits as they are not refundable.
- 8.2.7. Iwi X PSGE may distribute its income and capital in accordance with its charitable purposes.

8.3. Hybrid Group - Māori authority PSGE



- 8.3.1. Iwi X establishes a private discretionary trust, Iwi X PSGE, to receive settlement redress. All items included in the commercial redress package should be treated as non-assessable capital receipts for income tax purposes. Similarly, any interest received on the principal financial quantum will also be a non-assessable capital receipt. Iwi X PSGE will elect to be a Māori authority for tax purposes.
- 8.3.2. Iwi X PSGE establishes a wholly owned subsidiary company, Iwi X ComCo, to undertake its commercial activities. Iwi X establishes a charitable trust, Iwi X Charity, to make charitable distributions and carry out Iwi X's cultural and social objectives.
- 8.3.3. The settlement legislation provides that upon settlement Iwi X Trust and Iwi X MIO and their assets (Iwi X FarmCo and Iwi X AHC) will merge with Iwi X PSGE and that Iwi X PSGE is the MIO. Iwi X FarmCo and Iwi X AHC convert from charitable entities to companies under the settlement legislation. Iwi X AHC elects into the Māori authority regime. Iwi X FarmCo will be taxed as a company.
- 8.3.4. Iwi X PSGE exercises a right of first refusal and purchases commercial property. Iwi X PSGE transfers the commercial property to Iwi X ComCo. Iwi X PSGE should not suffer any tax on the subsequent transfer of the commercial property on the basis that it will be immediately transferred to ComCo and there will be no gain on sale. Iwi X ComCo will derive assessable rental income from the commercial property which will be taxed at 28%. The tax payments will generate imputation credits.
- 8.3.5. Iwi X ComCo purchases shares in a third party company and receives dividend income with imputation credits attached.
- 8.3.6. Iwi X ComCo will be able to distribute its after tax profits to Iwi X PSGE as dividends with imputation credits attached. Iwi X PSGE will be able to convert the non-refundable imputation credits into refundable Māori authority credits that can be attached to TMADs made to Iwi X PSGE's members.
- 8.3.7. Iwi X Charity may receive distributions from Iwi X PSGE to enable it to carry out its charitable purposes.

8.4. Hybrid Group – using limited partnership



- 8.4.1. Iwi X establishes a private discretionary trust, Iwi X PSGE, to receive settlement redress. All items included in the commercial redress package should be treated as non-assessable capital receipts for income tax purposes. Similarly, any interest received on the principal financial quantum will also be a non-assessable capital receipt.
- 8.4.2. Iwi X PSGE establishes a wholly owned company, Iwi X GP, to act as the general partner, of Iwi X LP, a limited partnership. Iwi X PSGE will be the limited partner of Iwi X LP. Iwi X establishes a charitable trust, Iwi X Charity, to make charitable distributions and carry out Iwi X's cultural and social objectives.
- 8.4.3. The settlement legislation provides that upon settlement Iwi X Trust and Iwi X MIO and their assets (Iwi X FarmCo and Iwi X AHC) will merge with Iwi X PSGE and that Iwi X PSGE will be the MIO. Iwi X FarmCo and Iwi X AHC convert from charitable entities to companies under the settlement legislation. Iwi X AHC elects into the Māori authority regime. Iwi X FarmCo is taxed as a company.
- 8.4.4. Iwi X PSGE exercises a right of first refusal and purchases commercial property. Iwi X PSGE transfers the commercial property to Iwi X LP. As Iwi X PSGE is the only limited partner of Iwi X LP, for tax purposes no transfer occurs. Rental income derived by Iwi X LP will be attributed to Iwi X PSGE as the limited partner and taxed at Iwi X PSGE's marginal tax rate (17.5%).
- 8.4.5. Iwi X LP purchases shares in a third party company. As Iwi X LP is a limited partnership, for tax purposes, Iwi X PSGE is treated as the owner of the shares and will derive dividend income with imputation credits attached.
- 8.4.6. Iwi X PSGE will be able to distribute its after tax profits to its members as TMADs.
- 8.4.7. Iwi X Charity may receive distributions from Iwi X PSGE to enable it to carry out its charitable purposes.

8.5. Example of tax implications of various group structures

	Charitable Group	Hybrid - Māori authority	Hybrid - Limited partnership
Iwi X ComCo			
Net rental income	200	200	
Dividend income			
Cash	72	72	
Imputation Credits	28	28	
Total income	272	300	
Tax	-	84	
less ICs received	-	(28)	
Further Tax Payable	-	56	
Cash available for distribution	272	216	
Iwi X PSGE			
Net rental income	-	-	200
Dividend income			
Cash	272	216	72
Imputation Credits		84	28
Total income	272	300	300
Tax	-	53	53
less ICs received		(84)	(28)
Further Tax Payable	-	-	25
Cash able to be distributed to Iwi X	272	216	247
Refundable tax credits	0	84	53