Commissioner of Inland Revenue v Diamond

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I INTRODUCTION

In New Zealand, s YD 1 of the Income Tax Act 2007 (the Act) governs the tax residency of natural persons. If a person is a tax resident under the Act, his or her worldwide income is taxable in New Zealand.[1] Tax residency is usually obvious under the bright-line rules in s YD 1: a person is a New Zealand tax resident if he or she is present in the country for more than 183 days in a 12-month period;[2] tax residency ceases when a person has been absent from New Zealand for over 325 days.[3] Yet irrespective of the bright-line rules, a person who has a "permanent place of abode" in New Zealand is also a tax resident. This can make tax residency difficult to determine, as "permanent place of abode" is not defined in the Act. *Commissioner of Inland Revenue v Diamond* is the first decision in which the Court of Appeal has considered what it means to have a permanent place of abode in New Zealand.[4] This is significant because, although double tax agreements or foreign tax credits often provide relief from double taxation, such relief may not always be available, may only be partial and is in any case inconvenient to claim. Moreover, those who incorrectly assume they are not tax residents will face tax liability, interest[5] and penalties.[6]

II BACKGROUND

The dispute concerned Mr Diamond's tax liability between 2004 and 2007. The Commissioner claimed that Mr Diamond had been a tax resident under s OE 1(1) of the Income Tax Acts of 1994 and 2004 by

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1 Income Tax Act 2007, s BD 1(5).

2 Section YD 1(3).

3 Section YD 1(5).

4 *Commissioner of Inland Revenue v Diamond* [2015] NZCA 613, (2015) 27 NZTC ¶22-035 [*Diamond* (CA)].

5 Tax Administration Act 1994, pt 7. Interest is imposed (and is recoverable by the Commissioner as unpaid tax) under s 120D. The quantum of interest is calculated under s 120E.

6 Part 9. The penalty sought by the Commissioner from Mr Diamond was a penalty of 20 per cent of the tax shortfall for an "unacceptable tax position" pursuant to s 141B(4).

virtue of having a "permanent place of abode" in New Zealand (now s YD 1(2) of the 2007 Act).[7]

Facts

Mr Diamond was a New Zealand citizen and resident who had served in the New Zealand Army for 25 years between 1978 and 2003.[8] In 1981, Mr Diamond married Wendy Diamond and they had four children together. The couple separated in 1994.[9] Two years later, Ms Diamond purchased a property in Waikato (the Waikato Esplanade property). To assist Ms Diamond in raising a mortgage, Mr Diamond agreed to purchase the property in their joint names. In 1998, he agreed to have his name on the certificate of title of another property that Ms Diamond wished to purchase (the subsequent home of Ms Diamond and the couple's children; the Waingaro Road property). Ms Diamond sold the Waikato Esplanade property to Mr Diamond and moved into the Waingaro Road property. The Waikato Esplanade property was rented out from 1998 onwards.[10] To manage the properties, the Diamonds formed a partnership in 2000.[11]

Mr Diamond left the army in 2003 and obtained similar work overseas. His longest period of time overseas was with a private security company in Iraq spanning eight years between 2004 and 2012.[12] Even though Mr Diamond and his ex-wife were separated, he supported her and the children while he was overseas. Mr Diamond's income was paid into an American bank account, to which Ms Diamond had access with a debit card.[13]

In 2005, the Diamonds decided to incorporate a company, with Mr Diamond holding one share, and Ms Diamond holding the remaining 99. The company's portfolio eventually expanded to four properties (including the Waikato Esplanade and Waingaro Road properties). Once the Waikato Esplanade property was transferred to the company, Mr Diamond became its beneficial owner.[14] During Mr Diamond's time in Iraq, Ms Diamond managed the rental properties through the company, with outgoings covered by drawing on Mr Diamond's foreign bank account.[15] In 2009, the Diamonds divorced.[16]

7 *Diamond* (CA), above n 4, at [1].
8 At [6].
9 At [7].
10 At [8].
11 At [9].
12 At [6].
13 At [7].
14 At [9].
15 At [9].
16 At [7].

After his time in Iraq, Mr Diamond resided and worked in Australia.[17] He returned to New Zealand approximately every five or six months to see his children. He would stay with his ex-wife and visit friends and family.[18] The address listed on his arrival and departure cards on these occasions was that of his ex-wife. Mr Diamond had no intention to return to New Zealand after 2003 other than as a visitor.[19]

III THE COURTS BELOW

The Commissioner was successful in the Taxation Review Authority (TRA).[20] Judge Sinclair held that the Waikato Esplanade property was available for Mr Diamond to live in — he was the beneficial owner and could end the periodic tenancy.[21] The Judge also held that Mr Diamond "continued to have a strong and enduring relationship with New Zealand".[22] According to Clifford J in the High Court, Judge Sinclair approached the permanent place of abode test on the basis of a two-step test, relying on *Case Q55*.[23] This approach involves, first, determining whether the taxpayer has a dwelling available at which he or she can reside, and second, an assessment of the taxpayer's overall connection with New Zealand.

In the High Court, Clifford J allowed Mr Diamond's appeal. His Honour considered that Judge Sinclair's two-step approach was incorrect, and found that there was no other basis for Mr Diamond having a permanent place of abode in New Zealand.[24] Clifford J held that the Waikato Esplanade property had never been Mr Diamond's home, and that he had no connection to it beyond owning it for investment purposes. While Mr Diamond clearly had an ongoing connection with New Zealand, without the Waikato Esplanade property itself having the characteristics of a permanent place of abode, Mr Diamond was not a New Zealand tax resident.[25] According to his Honour, having a "permanent place of abode" means "to have a

17 At [6].
18 At [10].
19 At [15].
20 *Diamond v Commissioner of Inland Revenue* [2013] NZTRA 10, (2013) 26 NZTC ¶2-009.
21 At [62]–[63].
22 At [77].
23 *Diamond v Commissioner of Inland Revenue* [2014] NZHC 1935, (2014) 26 NZTC ¶21-093 at [23], citing *Case Q55* (1993) 15 NZTC 5,313 (TRA).
24 At [35]–[36].
25 At [74]–[75].

home in New Zealand", which Mr Diamond did not.[26] The Commissioner appealed.[27]

IV THE COURT OF APPEAL DECISION

The issue on appeal was which of two alternative interpretations of "have a permanent place of abode" should prevail. The Commissioner submitted that if a person has a dwelling in which he or she can abide (even if he or she has never lived in it), the dwelling can be assessed on the totality of circumstances to determine whether it is the person's permanent place of abode. Mr Diamond contended that a dwelling could not be a person's permanent place of abode unless abiding usually occurred in it on a permanent basis.[28]

The Court of Appeal concluded that the Waikato Esplanade property was not Mr Diamond's permanent place of abode.[29] It was an investment property and had never been Mr Diamond's home, nor did he intend it to be. It could not, therefore, constitute a dwelling with which he had enduring and permanent ties. None of the other connections Mr Diamond had with New Zealand could alter that conclusion. The Commissioner's appeal was therefore dismissed.

Two-step Approach?

In the Court of Appeal, the Commissioner again submitted that the test for determining whether a taxpayer has a permanent place of abode involves a two-step analysis.[30] The Commissioner contended that the plain meaning and legislative history of the provision supported her approach. First, the Commissioner argued that the plain meaning of the provision was consistent with a first step based on the availability of a dwelling, "place of abode" essentially connoting a place where abiding *can* occur.[31] Secondly, the Commissioner argued that the legislative history of the provision supported this two-step approach. Amendments to the Income Tax Act 1976 in 1988 were, according to the Consultative Committee on Full Imputation and International Tax Reform (the Valabh Committee), intended "to make it easier for a person to become a New Zealand resident and harder to

26 At [55]–[56].
27 *Diamond* (CA), above n 4.
28 At [24].
29 At [62]–[64].
30 At [25].
31 At [26].

cease to be one".[32] The Commissioner submitted that the purpose of the amendment was to protect the tax base against erosion, and to enlarge the concept of residency by including those who might have a house available to them.[33]

The Court rejected the two-step approach contended for by the Commissioner. The Court's view was that availability of a property was not intended to be a first step in a two-step test, and that the extent of the authority of *Case Q55* is that mere unavailability for a period of time does not cancel a dwelling's status as a permanent place of abode.[34] According to the Court, a two-step approach "blurs the lines between connection with and enduring residence in a particular dwelling, and general cultural, personal, financial and other connections to New Zealand more broadly".[35] The Court held that only the former is relevant to establishing tax residence. Thus, the Commissioner's approach would import uncertainty into the permanent place of abode test.[36]

Interpretation of "Permanent Place of Abode"

The Court considered each of the words in the phrase individually, and then made observations as to the meaning of the phrase as a whole.[37] The Court found that, on its plain meaning and in its statutory context, "permanent place of abode" means something more than the mere availability of a dwelling. The phrase implies actual usage by the taxpayer of the property in question as a residence.[38] The Court also viewed the bright-line tests in s OE 1 as supporting such an interpretation. This is because the permanent place of abode test in s OE 1(1) overrides the bright-line tests, suggesting that a permanent place of abode is a place where the taxpayer habitually resides, even if time is spent overseas.[39]

The Court then considered this interpretation against the purpose of the section.[40] Examining the section's legislative history, the Court looked at the change in wording of the predecessor section, s 241(1) of the Income Tax Act 1976, from "home" to "permanent

32 Consultative Committee on Full Imputation and International Tax Reform *International Tax Reform Full Imputation Part 2: Report of the Consultative Committee* (July 1988) [Valabh Committee Report] at [2.4.8]; and *Diamond* (CA), above n 4, at [28].
33 *Diamond* (CA), above n 4, at [30].
34 At [46].
35 At [55].
36 At [55].
37 At [48]–[49].
38 At [48].
39 At [49].
40 At [50].

place of abode".[41] The change followed judicial consideration of s 241(1) in *Geothermal Energy New Zealand Ltd v Commissioner of Inland Revenue*.[42] In that case, Beattie J altered the Inland Revenue Department's longstanding interpretation of s 241(1) and considered "home" to be "the centre of gravity for the time being of the [taxpayer's] life" — that is, where his or her immediately family live, or the centre of his or her "interests and affairs".[43] The new "permanent place of abode" wording echoed Australian tax legislation, the interpretation of which was considered in *Federal Commissioner of Taxation v Applegate*.[44] In that case, Fisher J's conceptualisation of "permanent place of abode" was wider than Beattie J's interpretation of "home" and was held to be a person's "fixed and habitual place of abode".[45] The Court of Appeal found Fisher J's observation helpful.[46]

As to the Commissioner's contention that the legislative history of s OE 1 (in particular, comments made by the Valabh Committee) indicated an intention to broaden the tax base and include individuals in Mr Diamond's circumstances, the Court found such an interpretation went beyond the ordinary and natural meaning of the words. A plain indication of such would be necessary in the language of the provision, as a finding of tax residency has serious implications for taxpayers.[47] With respect, this was a sound observation by the Court. The Valabh Committee's primary concern related to the effects of the rules for calculating continuous periods under the 365-day test in s 241(1) of the Income Tax Act 1976 as it was before it was amended in 1988.[48] The rules at the time meant a taxpayer could easily cease to be a tax resident by disposing of his or her permanent place of abode, being out of the country continuously for 29 days, or having a permanent place of abode overseas.[49] Any broadening of the tax base, therefore, was directed towards those concerns — not to overinclusivity on some other basis, such as ownership of a residential investment property that otherwise would not meet the permanent place of abode test.

41 Income Tax Amendment Act 1980, s 10.
42 *Geothermal Energy New Zealand Ltd v Commissioner of Inland Revenue* [1979] 2 NZLR 324 (SC).
43 At 346.
44 *Federal Commissioner of Taxation v Applegate* (1979) 27 ALR 114 (FCA).
45 At 128.
46 *Diamond* (CA), above n 4, at [51].
47 At [50].
48 Valabh Committee Report, above n 32, at [2.4.4]; and Income Tax Amendment Act (No 5) 1988, s 23(1).
49 At [2.4.6].

Approach to Assessing Permanent Place of Abode

Having rejected the Commissioner's two-step analysis, the Court concluded that having a permanent place of abode is a question of fact, and an overall assessment is required.[50] Such an assessment is contextual and turns on the circumstances of each case. In this regard, the Court did not offer a definitive test, instead calling for an "integrated factual assessment" directed at determining "the nature and quality of … use" the person habitually makes of a particular dwelling.[51] Under this approach, neither mere availability nor unavailability of a dwelling (as in *Case Q55*) is sufficient by itself.[52] Examining a number of decisions of the TRA,[53] the Court produced a non-exhaustive list of factors relevant to the inquiry, including:[54]

- the taxpayer's continuity and duration of presence in the dwelling and New Zealand;
- his or her durability of association with the place; and
- the closeness or otherwise of the taxpayer's connection with the dwelling (also considering the situation in surrounding periods of absence from New Zealand).

The factual inquiry is focused on the tax years in question, although evidence of circumstances before and after those years may be helpful in determining whether the taxpayer had a permanent place of abode in New Zealand in the relevant years.[55] Finally, merely providing a home for family in New Zealand while the taxpayer lives elsewhere would not necessarily be sufficient to meet the permanent place of abode test.[56]

The Court did not provide a definitive statement as to whether or not investment properties can be a person's permanent place of abode. At least in Mr Diamond's case, the Waikato Esplanade investment property could not be his permanent place of abode because he had never lived in it, nor did he intend to.[57] The Court did suggest, however, that one would need to have lived in the relevant property at some point before it could be considered his or her permanent place of abode.[58]

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50 *Diamond* (CA), above n 4, at [57].
51 At [58].
52 At [58].
53 At [53], n 53.
54 At [59].
55 At [60].
56 At [61].
57 At [62].
58 At [53].

Consequences of the Decision

While the result in *Diamond* is undoubtedly correct, with respect, the Court's reasoning has not clarified the law as much as would be desirable. The Court's rejection of a two-step approach is unfortunate because s YD 1 of the Act appears to mandate such an approach (although not the version proposed by the Commissioner). It appears to be the case that a person must first "have" a dwelling before considering whether it is his or her "permanent" place of abode. The wording therefore lends itself to a two-step analysis.

Secondly, it is not clear exactly how investment properties should be treated. According to the Court, having lived in the property previously may be necessary. With respect, this leaves open the question of whether a person who has never lived in a particular residential property but intends to do so in the future would have a permanent place of abode in New Zealand. Residential investment properties are a key area of concern when it comes to double taxation under s YD 1 and so a clearer statement on the law would have been useful.

Finally, the Court did not discuss what it means to "have" a permanent place of abode. One can assume that the previous law is therefore unchanged. To "have" a property can therefore include a parent's home lived in prior to leaving New Zealand[59] or a property owned or held by a family company or trust.[60]

V CONCLUSION

Commissioner of Inland Revenue v Diamond is a welcome decision because it both clarifies the law and rejects the rather problematic view previously favoured by the Commissioner. It is obviously especially welcome for residential investment property owners in circumstances similar to Mr Diamond's. However, the decision was a missed opportunity for clarifying this area of the law. This issue is not likely to affect many taxpayers who own property in New Zealand and decide to move overseas because double tax agreements and foreign tax credits usually provide relief in such circumstances. Nevertheless, there is still a small risk of double taxation, as well as backdated liability, interest and penalties.

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59 Inland Revenue Department *Interpretation Statement 14/01 — Tax residence* April 2014 at [44]. (Note: This *Interpretation Statement* has now been replaced by *Interpretation Statement 16/03 — Tax residence* September 2016.)

60 At [69].