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WEEKLY COMMENT: FRIDAY 17 MAY 2024

1. The *Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Act 2024* (the “Multinational Tax Amendment Act 2024”), with a date of assent of 28 March 2024, contains a number of major amendments. Over the next three weeks, I will be looking at the changes to the trust taxation rules.

Increase in the trustee tax rate to 39%

2. Effective for the 2024-25 and later income years, the trust tax rate set out in clause 3 of Part A of Schedule 1 of the Income Tax Act 2007, has been increased to 39%, subject to an increased list of exclusions:
 - (a) A “legacy superannuation fund” joins the list of trusts in clause 6 to which a 28% tax rate applies – see paragraphs 3-5 below;
 - (b) A new clause 6B is being inserted which retains the trustee tax rate of 33% for the following trusts, to the extent that the income is not a taxable distribution from a non-complying trust taxed at 45% under clause 4:
 - (i) A disabled beneficiary trust, as defined in new s HC 39(2) – see paragraphs 7-8 below;
 - (ii) An estate referred to in new s HC 8B, which section concerns a trustee of an estate of a deceased person for the income year in which the person died and the subsequent 3 income years – see paragraphs 9-10 below;
 - (iii) A lines trust, as defined in s YA 1 – see paragraphs 11-12 below;
 - (iv) A de minimis trust, as defined in new s HC 40 for an income year - see paragraphs 13-14 below.

Legacy superannuation funds

3. “Legacy superannuation funds” will be taxed at 28% on all their income, the same as a widely-held superannuation fund, under Schedule 1, Part A, new clause 6(d).
4. A “legacy superannuation fund” is defined in s YA 1 as a scheme that previously qualified as a widely-held superannuation fund and is either:
 - (a) A restricted workplace savings scheme, as designated by the *Financial Markets Conduct (Designation of Restricted Schemes) Order 2016*; or

- (b) Treated as a registered scheme that is a superannuation fund by s 59A(1)(b) of the *National Provident Fund Restructuring Act 1990*.
5. In the Special report: 39% trustee tax rate issued in April 2024 (the “39% rate SR”) Inland Revenue notes that:
- (a) Many widely-held superannuation funds are “restricted” schemes that are closed to new members, therefore, over time, these funds would fall out of the widely-held superannuation fund definition due to declining membership (the definition of “widely-held superannuation fund in s YA 1 requires that the fund has 20 or more persons as set out in s HM 14(1));
 - (b) Superannuation funds have an increased risk of over-taxation as all their income is trustee income - they cannot make beneficiary income allocations to mitigate over-taxation;
 - (c) For the 2024–25 and later income years, legacy superannuation funds are subject to a 28% tax rate, similar to widely-held superannuation funds, which ensures that these funds are not worse off simply due to declining membership;
 - (d) Private family trusts operated as retirement savings vehicles and “Schedule 3” (single-person) schemes are not included within the legacy superannuation fund definition, because, generally, the settlors of these trusts retain a large degree of control over these trusts and do not need to invest on arm’s length terms, and providing a lower tax rate for these types of trusts would be inconsistent with the widely-held requirements for retirement savings vehicles like PIEs;
 - (e) A trust operated as a retirement savings vehicle that does not qualify for the widely-held superannuation fund or legacy superannuation fund definitions would still be eligible to be a de minimis trust (and able to apply the 33% tax rate) if trustee income for the income year does not exceed \$10,000 (after deductible expenses) – see paragraphs 13-14 below.
6. Note that the discussion and explanations in the 39% rate SR have been repeated in *Tax Information Bulletin* Vol. 36, No. 4, May 2024, pages 43 – 63 (“the Multinational Tax Act TIB”).

Disabled beneficiary trust

7. Effective from the 2024-25 income year onwards, the trustee tax rate of 33% set under new clause 6B in Schedule 1, Part A, applies to a “disabled beneficiary trust”, defined in new s HC 39 as a trust:
- (a) With 1 or more beneficiaries who are all disabled beneficiaries, a term defined in s HC 39(3) as meaning persons on one of the following support payments for at least part of the income year or in the year they turned 65 or the income year before that year:
 - (i) The Disability Allowance;
 - (ii) The Child Disability Allowance (made to the main carer of a child with a serious disability);
 - (iii) The Supported Living Payment on the ground of restricted work capacity; or

- (iv) The Jobseeker Support Health and Disability (if this has been paid for at least 6 months);
 - (b) To which disabled beneficiaries can be added or removed, as long as there is at least one disabled beneficiary remaining;
 - (c) From which no person other than a disabled beneficiary may ever receive distributions, except on the dissolution of the trust if no disabled beneficiaries are alive.
8. Inland Revenue notes in the 39% rate SR that the above means that:
- (a) Support payments can be made for some, or all, of the relevant income year;
 - (b) Trustee income derived by a trust settled for the care of a person who becomes disabled and starts receiving Government support part way through an income year can be taxed at the 33% rate for that income year;
 - (c) The targeted rules do not have an income test, but three of the four eligible support payments are income-tested;
 - (d) A disabled beneficiary under 16 years of age is excluded from the minor beneficiary rule.

Trustee income in income year of person's death and following 3 income years

9. Effective from the 2024-25 income year onwards, new s HC 8B applies to a trustee of an estate of a deceased person for the income year in which the person died and the subsequent 3 years. The trustee tax rate is set under new clause 6B in Schedule 1, Part A, at 33%.
10. Inland Revenue notes in the 39% rate SR that:
- (a) Deceased estates are taxed at 33% for this initial period because, unlike ordinary trusts, deceased estates may not be able to use beneficiary income allocations to mitigate over-taxation if the beneficiaries of the deceased estate are not yet known, or potential claims against the deceased estate have not yet been resolved;
 - (b) These rules are not limited to deceased estates created after the enactment of the Multinational Tax Amendment Act 2024: existing deceased estates are eligible provided they are still within the time limit (income year the estate was created, plus the three following income years) – i.e. the rules apply to deceased estates created on or after 1 April 2021;
 - (c) If a deceased estate is not wound up by the end of the third income year following the income year the estate was created, it will be subject to the 39% trustee tax rate;
 - (d) After the end of the third income year following the income year the trust was created, deceased estates can be de minimis trusts if they earn no more than \$10,000 trustee income (after deductible expenses).

Lines Trust

11. Effective from the 2024-25 income year onwards, the trustee tax rate of 33% set under new clause 6B in Schedule 1, Part A, applies to a “lines trust”, defined in s YA 1 as meaning a trustee of a trust that:

(a) Has had shares allocated or transferred to or vested in it, being shares in:

(i) An energy company as defined in s 2(1) of the *Energy Companies Act 1992* under an approved establishment plan under that Act;

(ii) A company under s 76 of the *Energy Companies Act 1992*;

(iii) A company to which have been transferred assets and liabilities of the Crown under s 16 of the *Southland Electricity Act 1993*; and

(b) Continues to hold shares described in paragraph (a).

12. Inland Revenue notes in the 39% rate SR that:

(a) A lines trust (or an energy consumer trust) is a trust that owns shares in an electricity distribution company;

(b) The 33% trust tax rate applies because these trusts have an increased risk of over-taxation as they may face administrative issues or restrictions in their trust deeds that impact their ability to make beneficiary income allocations.

De minimis trust

13. Effective from the 2024-25 income year onwards, a trust is a de minimis trust in an income year, under new s HC 40, if the net income of the trustee for that income year, excluding any income treated as trustee income under s HC 35 (beneficiary income of minors – see paragraphs 18-20 below) or s HC 38 (beneficiary income of certain close companies (which will be discussed in next week’s *Weekly Comment*), is \$10,000 or less.

14. Inland Revenue notes in the 39% rate SR that:

(a) Trusts with more than \$10,000 trustee income (after deductible expenses) are subject to the 39% trustee tax rate on all of their trustee income (i.e., this is an all or nothing rule under which all trustee income is taxed at either 33% or 39%);

(b) Eligibility for the de minimis is determined on a per-trust basis, per income year, therefore, if a person has settled multiple trusts, each trust can separately qualify as a de minimis trust;

(c) However, settling multiple trusts, or fragmenting an existing trust into multiple trusts, to take advantage of the 33% tax rate for trustee income of a de minimis trust would raise tax avoidance concerns for the Commissioner of Inland Revenue.

Trustee income vs beneficiary income

15. The increase in the tax rate applies to “trustee income”, defined in s HC 7 as an amount of income derived by a trustee, to the extent to which it is not beneficiary income, and including:
- (a) Minor’s beneficiary income to which s HC 35 applies, which, under the replaced s HC 7(2) and HC 35(2), applying from the 2024-25 income year onwards, will be subject to the 39% tax rate;
 - (b) Close companies’ beneficiary income, which, under the new s HC7(2B) applying from the 2024-25 income year onwards, will be subject to the 39% tax rate;
 - (c) Property settlements that are excluded from corpus by s HC 4(3), HC 4(4) and HC 4(5), being:
 - (i) A resettlement from another trusts that would be beneficiary income or a taxable distribution to a beneficiary if it had been distributed to a beneficiary and the beneficiary was resident in NZ;
 - (ii) A property settlement for which the settlor is allowed a deduction; and
 - (iii) A property settlement that would have been income of the settlor (as if the settlor had been a NZ resident if a non-resident at the time of the settlement) but for the fact of the settlement.
16. Trustee income does not include beneficiary income, apart from the specific inclusions of minor’s beneficiary income and close companies’ beneficiary income, as discussed above.
17. Beneficiary income will continue to be taxed at the beneficiary’s marginal tax rate. In the 39% rate SR Inland Revenue notes the following types of beneficiary income:
- (a) Income distributed or paid to a beneficiary: for example, cash transferred to the beneficiary;
 - (b) Income allocated to a beneficiary by crediting the beneficiary’s current account (i.e., the cash is still with the trust but can be called upon by the beneficiary): for example, trustees allocating an amount to a beneficiary by making a journal entry in the trust’s accounts to the beneficiary’s current account;
 - (c) Income that is allocated to a beneficiary for them to possess at a future date or event: for example, the trustees settle an amount on a sub-trust for a beneficiary.

Minor beneficiary rule

18. Section HC 35 has been amended so that beneficiary income of minors that is treated as trustee income under that section is taxed at the trustee tax rate of 39%, regardless of the amount of trustee income derived (i.e., the de minimis rule does not apply to beneficiary income of minors treated as trustee income under s HC 35).

19. There are a number of exclusions that apply in s HC 35, s HC 36 and s HC 37, which override the beneficiary income of minors rule in s HC 35. These exclusions will continue to apply. They include circumstances such as where:
- (a) The total amount of beneficiary income earned by the minor from the trust in the income year is \$1,000 or less;
 - (b) The trust paying the beneficiary income is a testamentary trust; or
 - (c) All settlements on the trust were made by a person who is neither a relative or guardian of the minor (nor a person associated with a relative or guardian).
20. Inland Revenue has explained the operation of the minor beneficiary rule in Part 6 of interpretation statement IS 24/01 Taxation of trusts, published in *Tax Information Bulletin* Vol. 36, No. 2, March 2024.



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