Inland Revenue
Te Tari Taake

GENERAL ARTICLE

Proposed increase in the trustee tax rate to 39%

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This article provides high-level guidance around how Inland Revenue may view some taxpayer transactions and structural changes regarding the proposed increase in the trustee tax rate.

Budget 2023 proposals

1. Where a trustee of a trust derives income, that income will generally be either beneficiary income (taxed at the beneficiary's tax rate) or, to the extent it is not beneficiary income, trustee income (currently taxed at the rate of 33%).

2. The Government has proposed that from the 2024/25 income year, the tax rate applying to trustee income will increase to 39% to align with the top personal tax rate. These changes were included in the **Taxation (Annual Rates for 2023–24, Multinational Tax, and Remedial Matters) Bill** introduced on 18 May 2023. The proposals in the Bill are not legislation until enacted and are subject to change through the parliamentary process. More information can be found on the Tax Policy website.

Inland Revenue guidance

3. Inland Revenue acknowledges that there are many reasons why New Zealanders might establish a trust aside from tax planning. Examples of other reasons include estate or succession planning, asset protection and providing for those who cannot provide for themselves.

4. However, trusts do have a different tax treatment (and potentially tax advantages) compared with companies and other entities. Since the increase in the trustee tax rate was proposed, Inland Revenue has been asked to provide guidance around how it may perceive some taxpayer transactions and structural changes. This article provides high-level guidance based on Inland Revenue's interpretation of the current law.

Situations raised with Inland Revenue

5. Inland Revenue comments below on specific transactions and structural changes that have been raised.

6. **A company is owned by a trust and changes its dividend paying policy.** This change might be to pay out retained earnings before the proposed increase in the trustee tax rate, or to reduce dividends following the proposed increase in the trustee tax rate (eg so that they are only paid when funds are needed by the trust). It is accepted that, subject to some constraints such as those imposed under the Companies Act 1993, companies can legitimately make decisions about whether or not, or the extent to which, they retain or distribute profits. Inland Revenue considers that where a company changes its dividend paying policy while taking into account the funding needs of shareholders and applicable tax rates, this is unlikely, without more (such as artificial or contrived features), to be tax avoidance. An example of where Inland Revenue might have concerns is where, despite it being possible for a company

to "pay" a dividend by crediting shareholder current accounts, the company objectively has no real ability to pay those credit balances if it was to be liquidated.

7. **A trustee distributes income to a beneficiary so it is taxed to the beneficiary rather than at the trustee tax rate** (resulting in less tax payable). Inland Revenue considered the use of a discretionary trust and the tax implications of trustees allocating income to low-tax-rate beneficiaries in Scenario 2 of QB 23/02. In brief, Inland Revenue considers that even though tax considerations influence a trustee's choice as to how to allocate income, a distribution of income to a beneficiary in accordance with the trust deed, trust law and tax law is unlikely, without more (such as artificial or contrived features), to be tax avoidance. Avoidance concerns might arise where, despite legal compliance, in reality the beneficiary is not entitled under the trust or will not benefit from the distribution. Such factual variations are discussed in QB 23/02.

8. **A trustee adopts a company structure and transfers its income-earning assets to the company.** Inland Revenue considers that incorporating a company to hold income-earning assets while taking into account applicable tax rates is unlikely, without more (such as artificial or contrived features), to be tax avoidance. Examples of some circumstances where Inland Revenue might have avoidance concerns around the use of a holding company are set out in Revenue Alert 18/01 (in the context of where a holding company is interposed between an existing operating company and a trust) and Revenue Alert 21/01 (in the context of where personal services income is diverted by structuring revenue-earning activities through a company).

9. **A trustee chooses to wind up the trust.** Inland Revenue considers that winding up a trust is unlikely, without more (such as artificial or contrived features), to be tax avoidance.

10. **A trustee chooses to invest in a portfolio investment entity (PIE)** instead of other available investment options, such as bonds or term deposits. The tax consequences of this type of investment decision are discussed in Scenario 3 of QB 23/01, which concludes the investment would be unlikely, without more (such as artificial or contrived features), to be tax avoidance.

Situations where Inland Revenue may have concerns or ask further questions

11. Inland Revenue will be gathering and analysing information to identify changes in behaviour that reduce a customer's exposure to the increased trustee tax rate, and will engage with those customers to examine the purposes for those changes. Based on current law, some examples of behaviours that might cause Inland Revenue to have concerns or ask further questions include:

- allocating income to a beneficiary taxed at a lower rate under an arrangement in which that amount is resettled back on the trust (rather than being paid to or left owing to the beneficiary), such that the beneficiary is not in reality benefiting from the distribution;
- allocating income to a beneficiary taxed at a lower rate by crediting the beneficiary's current account where the beneficiary has no knowledge of the allocation or no expectation of receiving the income, which may indicate that they are not in reality benefiting from the distribution. For completeness, Inland Revenue notes that while there may be an expectation or requirement under trust law that the beneficiary is provided with information or can access their accounts, this is not always what occurs in practice and this can lead to the beneficiary not meeting their own tax obligations in relation to the income allocated;
- replacing dividend income with loans in an artificial manner such that the loans do not reflect the reality of the arrangement. Relevant factors that might be considered in analysing the reality of a loan include the term of the loan, the interest and repayment terms, the history of payments made on the loan, and the commercial reality of the borrower making loan repayments;
- artificially altering the timing of (bringing forward or deferring) any taxable or deductible payment, particularly where it is linked to existing contractual terms or practice for the date for payment; and
- creating or increasing income or expenditure that does not reflect the reality of the structure or arrangement (eg interest, dividends or management fees or other similar transactions between related parties).

12. Customers should think carefully before undertaking these or similar behaviours or entering into any artificial or contrived arrangements to reduce exposure to the increased 39% trustee tax rate. If they require certainty about Inland Revenue's view of a transaction, customers should apply for a binding ruling.

Existing guidance

13. Inland Revenue's existing published statements of relevance to the above discussion include the following:

- Interpretation Statement IS 23/01: **Tax avoidance and the interpretation of the general anti-avoidance provisions sections BG 1 and GA 1 of the Income Tax Act 2007** explains Inland Revenue's view of the law on tax avoidance in Aotearoa New Zealand.

- Question's We've Been Asked QB 23/01: **Income tax: scenarios on tax avoidance – 2023 No 1** explains how Inland Revenue's approach to tax avoidance set out in IS 23/01 applies in three scenarios. Scenario 3 considers where a taxpayer chooses to reinvest in a PIE, taking into account after-tax returns.
- Questions We've Been Asked QB 23/02: **Income tax: scenarios on tax avoidance – 2023 No 2** explains how Inland Revenue's approach to tax avoidance set out in IS 23/01 applies in two scenarios. Scenario 2 considers the use of a discretionary trust and the tax implications of trustees allocating income to low-tax-rate beneficiaries.
- Revenue Alert 21/01: **Diverting personal services income by structuring revenue earning activities through a related entity such as a trading trust or a company** sets out the circumstances in which Inland Revenue will consider this arrangement is tax avoidance.
- Revenue Alerts 18/01 and 18/01a: **Dividend stripping** and **Questions and answers** discuss dividend avoidance and when proceeds from share sales are at high risk of being treated as a dividend for income tax purposes.
- Interpretation Statement IS 24/01: **Taxation of trusts** explains the taxation of trusts under the trust rules in the Income Tax Act 2007, including specifying when income is required to be taxed in the hands of the beneficiary.

About this document

General articles cover an assortment of items that do not fall within the other stated publication types on the IR Tax Technical website.