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QUESTION WE'VE BEEN ASKED

QB 19/15

If property held in a trust is rented out by a beneficiary of the trust for short-stay accommodation, who should declare the income, and what deductions can be claimed?

This "Question We've Been Asked" (QWBA) explains how the income tax rules apply if property held in a trust is rented out by a beneficiary of the trust for short-stay accommodation (eg, through Airbnb, Bookabach or Holiday Houses).

The most common situation where it will be a beneficiary renting out a property held in trust is where the property is the beneficiary's family home.

Key provisions

Income Tax Act 2007 – ss CC 1, DV 9, GC 5 and YA 1

Tax Administration Act 1994 – s 43B

Key terms

Guest means a person provided with short-stay accommodation in return for payment.

Renting out and similar terms are used in this QWBA to refer to granting a licence for the use of the property by short-stay accommodation guests.

Short-stay accommodation means accommodation provided for up to four consecutive weeks in a dwelling that is not the guest's ordinary residence. It doesn't include accommodation provided to residential tenants, boarders or care home residents, and it doesn't include student or emergency accommodation.

Trust is sometimes used in this QWBA as meaning the trustees of the trust, where this is helpful for simplicity.

Question

If property held in a discretionary trust is rented out by a beneficiary of the trust for short-stay accommodation, who should declare the income, and what deductions can be claimed?

Answer

If property is held in a discretionary trust and a beneficiary rents all or part of it out for short-stay accommodation (eg, the property is the beneficiary's home), the income belongs to the beneficiary as they're the one granting the licence to the guests to stay.

Non-capital costs[1] related to earning the income can be deducted, though some of these costs will only be partly deductible because they also relate to private use of the property.

[1] See [19].

Explanation

Who is renting out the property?

1. Under New Zealand's tax rules, rental income from land belongs to the owner of the land and they must declare it to Inland Revenue.

2. Owning land is not limited to having the legal title. Under the Income Tax Act 2007 (the Act), someone will own land if they have an estate or interest in land. This could be freehold, leasehold, or any other interest in land.

3. Beneficiaries of a discretionary trust do not have an interest in the trust property simply by virtue of being beneficiaries. So in many situations where a property is held in a trust, it will be only the trustees, who legally own the land, who have an interest in the land. This will generally be the case, for example, for a dedicated short-stay accommodation property, or for a holiday home that is also sometimes rented out to third parties. Where only the trustees have an interest in the land, it will be the trustees renting out the property, and the rental income will belong to the trustees.

4. However, in some situations there will be different people with interests relating to the same underlying piece of land, and they will all be "owners" of land for income tax purposes. If this is the case, and the property is rented out, the rental income will belong to the person whose land interest is affected.

5. For example, if a beneficiary of a trust has a right to the possession of the property, or if they in fact occupy it, they will have an interest in land as defined in the Act. A right to possession of land is specifically defined as an "interest in land" (s YA 1). Even if a beneficiary did not have the right to possession of the property, if they occupy it there will be, legally, what's called a "tenancy at will",[2] which gives rise to an interest in land.[3] The most common situation where a beneficiary will have an interest in the land is where the property is the beneficiary's family home.

6. Where a beneficiary has an interest in the land and they rent the property out to short-stay accommodation guests, it is their interest that is affected. It is their right to possession of the property, or their interest as tenant at will, that is impinged on by the property being rented out, not the trustees' legal interest in the land. As such, if a beneficiary has an interest in the land and rents out all or part of the property for short-stay accommodation, the income will be theirs.

This QWBA deals with situations where it is a **beneficiary** of the trust renting out the property for short-stay accommodation.

QB 19/16 deals with situations where it is the **trustees** of the trust renting out the property for short-stay accommodation.

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[2] Hinde, McMorland & Sim, *Land Law in New Zealand* (online ed.), LexisNexis NZ Limited, at 11.022, and *The Laws of New Zealand* (online ed.), LexisNexis NZ Limited, "Lessor and Lessee" paras 108–112, and "Trusts" para 99.

[3] Hinde, McMorland & Sim, *Land Law in New Zealand* (online ed.), LexisNexis NZ Limited, at 10.010(c).

A beneficiary of the trust is renting out the property

7. As noted above, the most common situation where a beneficiary of a trust is deriving the short-stay accommodation income from renting out a property held in a trust, is where the property is the beneficiary's home.

Summary of the income tax implications

8. In this situation, it will be the beneficiary deriving the short-stay accommodation income because it is their interest in land that is affected by the property being rented out.

9. The beneficiary may be eligible to use a simplified method for meeting their tax obligations, known as the "standard-cost method". This is discussed from [17]. Otherwise, the deductibility of the (non-capital) property-related expenses depends on whether the expense is incurred by the person deriving the income – in this case the beneficiary. Sometimes in a family trust situation this will not be the case.

10. In addition, while some expenses will be fully-deductible, others may be only partly deductible because they also relate to private use of the property.

11. Table 1 summarises the income tax implications for short-stay accommodation properties held in trust, where the income is derived by a beneficiary of the trust.

Table 1: Short-stay accommodation provided in trust property that is a beneficiary of the trust's home – income derived by beneficiary

Income	Generally, all amounts received from paying guests are **income to the beneficiary**. However, some amounts may be **exempt**. This will be the case: - if DET 19/02 (discussed below) is used; or - if DET 19/02 isn't used and the "mixed-use asset rules" (the MUA rules) apply (see from [14]).
Expenditure incurred by the trustees and paid by a beneficiary **OR** **Expenditure incurred by a beneficiary**	**For the beneficiary** • If the beneficiary pays all of the property-related outgoings, they may be eligible to use standard-cost determination DET 19/02. This is a simplified method for meeting the tax obligations for the short-stay accommodation activity. If DET 19/02 is used: - the short-stay accommodation income the beneficiary gets from the property is **exempt** up to the amount of the standard-costs; - only income over the amount of the standard-costs needs to be declared; - the beneficiary **can't deduct** any of their actual expenditure, unless it's for something not covered by the standard-costs and they have assessable income from providing the short-stay accommodation (ie, their income from providing the short-stay accommodation exceeds their standard-costs). • If DET 19/02 isn't used, the expenditure is **deductible to the beneficiary**, subject to apportionment for private use (usually as per QB 19/05).

	For the trustees • The amount of any expenses incurred by the trustees and paid by the beneficiary is rental **income to the trustees**. This will be cancelled out by the expenditure being **deductible to the trustees** because it's incurred by them. *If the trust is a "non-active trust" and has filed a non-active trust declaration (IR633), the trustees don't need to file a return (s 43B of the Tax Administration Act 1994). Otherwise, the trustees do need to file a return and include the rental income and deduction.*
Expenditure incurred by and paid by trustees	The expenditure is **not deductible** to anyone, unless the beneficiary pays rent to the trustees (including through reimbursement of the expense, on account of the right to use the property).

The beneficiary's income and deductions

Income

12. Generally, all of the amounts received from paying guests will be income, and, for the reasons discussed at [1] to [6], the income is derived by the beneficiary.

13. The beneficiary may be eligible to use a simplified method (in DET 19/02) for meeting their tax obligations from providing the short-stay accommodation (discussed from [17]). If they use this method, some or all of the income will be exempt, and it will only be necessary to return income over a certain level. This reflects the typical costs incurred in providing short-stay accommodation in your home.

14. If DET 19/02 isn't used and the MUA rules apply there may also be some exempt income. The MUA rules could apply, for example, if a separate dwelling (eg, a sleepout) on the same property as the beneficiary's home is rented out, or if the home is vacant for 62 days or more in the year (eg, if the beneficiary was away for an extended holiday and the home was unused during that time).

15. If the MUA rules apply, the following amounts will be exempt income:
    - amounts received for renting the property to associated natural persons (eg, close relatives of the beneficiary such as their children, grandchildren, siblings or in-laws); and
    - amounts received from renting the property at "mates' rates" (less than 80% of the market value rent).

    What will be income or exempt income under the MUA rules is discussed in detail in QB 19/07.

Deductions

16. Often where a beneficiary's home is held in a trust the beneficiary will pay all of the outgoings for the property, irrespective of who the expenses are legally incurred by (eg, rates, insurance, repairs and maintenance, and any loan repayments for the property).

17. Where the beneficiary's home is used to earn short-stay accommodation income (ie, through renting out a room or the whole property from time to time) and the beneficiary pays all of the property-related outgoings, they may be eligible to use standard-cost determination DET 19/02. This is a simplified method for a taxpayer meeting their tax obligations from providing short-stay accommodation in all or part of their home.

18. If DET 19/02 is used, income up to the amount of set standard-costs is exempt. Only income in excess of the standard-costs needs to be returned. No deductions for expenditure actually incurred are allowed, unless the expenditure is for things not covered by the standard-costs in the determination.

19. If DET 19/02 isn't used, non-capital property-related expenses the beneficiary pays will be deductible to the beneficiary, subject to appropriate apportionment for any expenses that don't solely relate to the income-earning use of the property. Deductible expenses would include things like:

- interest payments;
- property and contents insurance premiums;
- rates;
- repairs and maintenance;
- utility bills;
- advertising costs; and
- any commission or fee the beneficiary pays to an advertising platform or transaction facilitator (this does not include any service fee the guests pay the platform, just fees the beneficiary pays).

20. Expenses that relate solely to the rental activity (eg, advertising fees) will be 100% deductible. But mixed expenses – those that relate to both the private use of the home and the rental activity – need to be apportioned. These mixed expenses would include things like rates, insurance, utility bills, and loan interest.

21. Generally, the appropriate basis for apportionment will be as discussed in QB 19/05. But in some situations a different basis may be required. For example, if a separate dwelling (eg, a sleepout) on the same property as the beneficiary's home is rented out, or if the home is vacant for 62 days or more in the year (eg, if the beneficiary was away for an extended holiday and the home was unused during that time). In those situations, QB 19/06 explains how to work out which tax rules apply. If the MUA rules apply, there is a formula for apportioning expenses, and periods of private use (including use that gives rise to exempt income) will restrict the availability of deductions. If the MUA rules don't apply, QB 19/06 will refer readers to the appropriate guidance on apportionment.

22. Depreciation losses on chattels in the property owned by the beneficiary and available for use by paying guests will also be deductible either in full or in part (depending on whether the chattels are used solely by paying guests). QB 19/05 explains how to calculate the percentage of depreciation losses that is tax deductible (except if the home was vacant for 62 days or more in the year – in which case see QB 19/07).

Allocation of deductions if the rental activity is loss-making

23. If the rental activity is loss-making, the residential rental ring-fencing rules in subpart EL of the Act may potentially limit the deductions that can be allocated to the income year.

24. Those rules will often not apply where the property the beneficiary is renting out is their main home. However, the rules could apply in some situations, for example, if a principal settlor of the trust has a separate main home, or if the property the beneficiary is renting out is not their main home.

25. Any deductions that can't be allocated to the year because of the ring-fencing rules will be carried forward to the next year the beneficiary derives residential income.

26. The ring-fencing rules will not apply if the short-stay accommodation is provided in a dwelling that is a mixed-use asset for the purposes of the MUA rules. For example, this could be the case for a separate dwelling (eg, a sleepout) on the same property as the beneficiary's home. There are separate rules called the "expenditure quarantine rules" that may apply in this situation if the rental activity is loss-making – see QB 19/07.

27. There is more information about the residential rental ring-fencing rules in *Tax Information Bulletin* Vol 31, No 8 (September 2019), from page 53.

The trustees' income and deductions

28. In the family home context, it's likely that most of the property-related expenditure will be incurred by the beneficiary who lives there. However, some expenditure will be incurred by the trustees, for example, the rates and possibly property insurance.

29. Often the beneficiary who lives in the property will pay the property-related outgoings incurred by the trust as part of the arrangement that allows them to live in the property. The payment of those amounts by the beneficiary would be rental income to the trustees under s CC 1.

30. However, this rental income would be offset by the trustees being able to deduct the expenditure, as it's incurred by them in deriving the rental income.

31. If the trust is non-active, the trustees **may not need to file a tax return**. A return would not be required if the trust:

- is a complying trust (an ordinary New Zealand trust with New Zealand resident trustees and settlors);
- is a non-active trust;
- has submitted a non-active trust declaration (IR633) to Inland Revenue; and
- hasn't stopped being a non-active trust since making the declaration.

32. Essentially, a trust will be a non-active trust if it hasn't derived (or been deemed to have derived) any income for the year and doesn't have any deductions for the year. There also can't have been any transactions involving assets of the trust that give rise to income to any person, or to fringe benefits to any employee or former employee.

33. In determining whether a trust is "non-active", the following payments aren't taken into account (s 43B(3) of the Tax Administration Act 1994):

> (a) reasonable fees paid to professional trustees to administer the trust; or
>
> (b) bank charges or other minimal administration costs totalling not more than $200 in the tax year; or
>
> (c) interest earned on trust assets in any bank account during the tax year, to the extent to which the total interest does not exceed $200; or
>
> (d) **insurance, rates, and other expenditure incidental to the occupation of a dwelling owned by the trust and incurred by the beneficiaries of the trust**.
>
> [Emphasis added]

34. So if a beneficiary is paying the trustee-incurred outgoings for the property because they live there, while those amounts may technically be rent, if the trust doesn't otherwise have income or make any payments other than those mentioned at [33], it may be able to submit a non-active trust declaration (see the requirements at [31]). If the trust meets the requirements and does this, the trustees won't need to file a tax return so long as the trust continues to be non-active.

35. Trusts that **aren't** non-active trusts will have to file a tax return. Example 1 explains what rental income the trustees will have and what deductions they can claim when a

beneficiary lives in property held in the trust, uses it to provide short-stay accommodation, and pays the outgoings incurred by the trustees.

Could s GC 5 apply to deem adequate rent to be paid from the beneficiary to the trust?

36. Section GC 5 is a provision in the Act that may apply where property is leased to someone who uses the property in deriving income. If no rent is payable by the lessee, or the rent is inadequate, s GC 5 could deem "adequate rent" to be paid by the lessee and derived by the lessor.

37. "Lease" is defined in s GC 5(5) as meaning a tenancy of any duration (it also includes a sublease or bailment). As noted at [5], where a beneficiary of a trust lives in property held in the trust, there will be a tenancy at will, which meets the definition of "lease".

38. Section GC 5 will only apply to certain leases (listed in s GC 5(2)). This includes a lease by a person to a relative. "Relative" (defined in s YA 1) includes a person connected with another person by being the trustee of a trust under which a relative has benefitted or is eligible to benefit.

39. So in a family trust situation, where a beneficiary is living in trust property and using it to derive income (eg, renting out a room for short-stay accommodation), s GC 5 could potentially apply to deem "adequate rent" to be paid by the beneficiary to the trust.

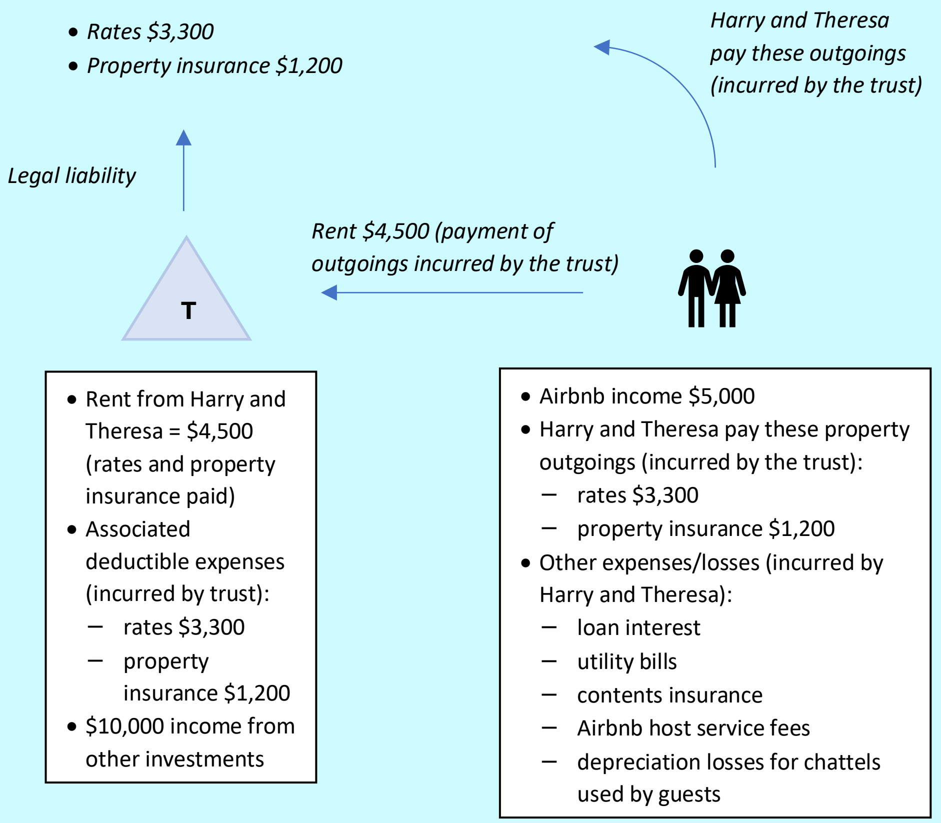
40. However, the Commissioner would not apply s GC 5 in this situation. This is because s GC 5 is aimed at ensuring income can't be assigned to someone else through leasing income-producing property to a relative or related company at a nominal rent. That mischief isn't present in the trust context, where a trust can legitimately allocate any income as beneficiary income. The Commissioner will not use s GC 5 to deem there to be "adequate rent" paid for a lease in a situation where the lease isn't creating an opportunity for a tax benefit through the shifting of income from one person to another.

Provision of below market value accommodation to the beneficiary

41. If the trust is a complying trust (an ordinary New Zealand trust with New Zealand resident trustees and settlors), the trustees allowing a beneficiary to live in the trust-owned property rent-free or for less than market rent will be an exempt distribution from the trust (ss CW 53 and HC 20). However, if the trust is a foreign trust or a non-complying trust, this will be a taxable distribution from the trust, and not subject to the ordering rules (s HC 15(6)). As to the value of the distribution, see from [8.6] of IS 18/01: *Taxation of Trusts*.

Example 1

Trust income and deductions when a beneficiary living in trust property pays property outgoings



Harry and Theresa's home is held in a family trust. They settled the trust when they bought the home, and they are beneficiaries of the trust. They have a spare room and rent it out on Airbnb, earning $5,000 from this during the year.

Because they live in the property, Harry and Theresa pay the following outgoings that are incurred by the trust: the rates ($3,300 for the year) and the property insurance ($1,200 for the year).

Harry and Theresa have other expenses related to earning the Airbnb income: loan interest (the home loan is in their names), utility bills, contents insurance, and Airbnb host service fees. They also have depreciation losses for chattels in the home that guests can use.

Because Harry and Theresa are paying the outgoings for the property that are incurred by the trust (the rates and property insurance), on the basis they can live there, those amounts would be rent to the trust. The trust can deduct the amount of the rates and property insurance because it has incurred them, having a legal liability to pay them. The result is that the rent and the deductions for the trust net off. However, the trust has $10,000 income from other investments so is not a "non-active trust". As such, the trustees need to file a tax return, which will need to include the rental income and associated deductions (even though they net off).

If Harry and Theresa meet the criteria to use Inland Revenue's "standard-cost" determination (DET 19/02), they might choose to do that, to simplify their tax obligations. But otherwise, they'll need to return all of the Airbnb income they receive, and can deduct a portion of the rates, property insurance and other expenses (and depreciation losses) they have. QB 19/05 will help them work out what proportion of their expenses they can claim as deductions.

References

Subject references

income tax
short-stay accommodation
trusts

Legislative references

Income Tax Act 2007 – ss CC 1, CW 53, DV 9, GC 5, HC 15, HC 20, subpart EL and the definitions of "**estate** in relation to land, **interest** in relation to land, **estate or interest in land**, **estate in land**, **interest in land**, and similar terms ", "land", "own" and "relative" in s YA 1
Tax Administration Act 1994 – s 43B

Other references

DET 19/02: *Standard-cost household service for short-stay accommodation providers* (Inland Revenue)
Hinde, McMorland & Sim, *Land Law in New Zealand* (online ed.), LexisNexis NZ Limited
IR633: *Non-active trust declaration* (Inland Revenue)
IS 18/01: *Taxation of Trusts* (Inland Revenue)
QB 19/05: *What are my income tax obligations if I rent out my home or a separate dwelling on my property as short-stay accommodation?* (Inland Revenue)
QB 19/06: *What income tax rules apply if I have a dwelling that I sometimes rent out as short-stay accommodation and sometimes use myself?* (Inland Revenue)
QB 19/07: *How do the mixed-use asset income tax rules apply to a dwelling that I sometimes rent out as short-stay accommodation and sometimes use privately?* (Inland Revenue)
Tax Information Bulletin Vol 31, No 8 (September 2019) (Inland Revenue)
The Laws of New Zealand (online ed.), LexisNexis NZ Limited