Inland Revenue
Te Tari Taake

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QUESTION WE'VE BEEN ASKED

QB 19/16

If property held in a trust is rented out by the trustees 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 the trustees for short-stay accommodation (eg, through Airbnb, Bookabach or Holiday Houses).

It will usually be the trustees renting out the property where the property is either a dedicated short-stay accommodation property, or a property that's sometimes rented out and sometimes used for other purposes (eg, it's used by beneficiaries of the trust).

Key provisions

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

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 the trustees 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 the trustees rent it out for short-stay accommodation (eg, a holiday home or dedicated short-stay accommodation rental property), the income belongs to the trustees, and will generally have to be declared in the trust's tax return. However, some or all of the income may be allocated as beneficiary income, which would mean it's taxed at the beneficiary's tax rate rather than at the trust rate.

Non-capital costs[1] related to earning the income can be deducted. However, such costs will only be partly deductible where the expenditure also relates to private use or non income-earning use of the property.

[1] See [23].

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 the **trustees** of the trust renting out the property for short-stay accommodation.
>
> QB 19/15 deals with situations where it is a **beneficiary** of the trust renting out the property for short-stay accommodation.

[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).

Trustees of the trust renting out the property

7. The most common situations where trustees of a trust may rent out property for short-stay accommodation are where the property is:

- a dedicated short-stay accommodation property; or
- a family holiday home that's also sometimes rented out.

8. In these situations, the income will usually belong to the trustees as they would usually be the only ones with an interest in the land.

9. There could be circumstances where this is not the case, for example, if a beneficiary has leased the property from the trustees, or if it can be shown that a beneficiary has been given the right to possession and use of the property. But the most common situation is that the income will belong to the trustees, so the following discussion is based on that being the case.

10. There are slight differences in the tax treatment where trustees of a trust are renting out property for short-stay accommodation, depending on which rules apply.

Summary of the income tax implications

11. In the situation covered by this QWBA – where the trustees rent out the property – any income from renting the property out for short-stay accommodation will belong to the trustees and will need to be returned by them.

12. 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 trustees. Sometimes in a family trust situation this will not be the case.

13. Although some expenses will be fully deductible, others may be only partly deductible because they also relate to private use or non income-earning use of the property.

14. Table 1 summarises the income tax implications for short-stay accommodation properties held in trust, where the income is derived by the trustees.

TABLE 1: SHORT-STAY ACCOMMODATION PROPERTY — INCOME DERIVED BY THE TRUSTEES

Income	Generally, all amounts received from paying guests are **income to the trustees**. However, if the property is subject to the "mixed-use asset rules" (the MUA rules) – see from [15], the following amounts are **exempt income**: ➢ amounts received for renting the property to associated natural persons (eg, settlors and beneficiaries); and ➢ amounts received from renting the property at "mates' rates" (less than 80% of the market value rent).
Expenditure incurred by and paid by the trustees	The expenditure is **deductible to the trustees**. However, for properties that are also used for non income-earning purposes (eg, used by the beneficiaries of the trust), this is subject to apportionment. *See from [31] for how to apportion expenditure for property subject to the MUA rules, or from [35] for property not subject to the MUA rules.*

<table>
<tr>
<td>Expenditure incurred by the trustees and paid by a beneficiary</td>
<td>
For the beneficiary
The expenditure isn't deductible to the beneficiary, as there is no connection between the expenditure and the beneficiary earning income.

For the trustees

The expenditure is deductible to the trustees. However, for properties that are also used for non income-earning purposes (eg, used by the beneficiaries of the trust), this is subject to apportionment.
But if the beneficiary <u>isn't reimbursed</u> by the trustees, the amount of the expense paid by the beneficiary is income to the trustees as either:

rental income under s CC 1, if paid by the beneficiary for use of and/or ability to use the property, provided the property is not subject to the MUA rules; or
income under s CG 4, to the extent of the deduction the trustees have been allowed, if not paid by the beneficiary for use of and/or ability to use the property, or if the property is subject to the MUA rules.

The net effect of this is that if the beneficiary isn't reimbursed, the trustees don't get the benefit of the deduction. This reflects that the trustees haven't borne the expense.
</td>
</tr>
<tr>
<td>Expenditure incurred by a beneficiary</td>
<td>

If the trustees reimburse the beneficiary (by actual payment or through their 'beneficiary current account'), this is deductible to the trustees. However, for properties that are also used for non income-earning purposes (eg, used by the beneficiaries of the trust), this is subject to apportionment.
If the trustees <u>don't reimburse</u> the beneficiary, the expense can't be deducted by anyone.

In this case, the amount may be rental income, and there may be a settlement on the trust by the beneficiary or a distribution to the beneficiary from the trust.

The amount could only be rental income if the property is not subject to the MUA rules, and the beneficiary incurred the expense for the use of and/or ability to use the property.

Whether there is a settlement on the trust or a distribution from the trust depends on the value of what the beneficiary and the trust are providing each other under the arrangement. This includes the value of expenses incurred by the beneficiary that are of value to the trust and the market value of any use of and/or ability to use the property they get in return for incurring those expenses.

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Which tax rules apply?

15. If the property is sometimes rented out and sometimes used by people associated with the trust (eg, a family holiday home that's sometimes rented out), there are different rules that could apply to determine the precise tax treatment for the property – in particular what counts as income, and the proportion of the expenses that can be deducted.

16. For these properties, the first step will be to work out which rules the property falls into for the particular year:
    - the "mixed-use asset rules" (the MUA rules); or
    - the standard tax rules.

17. QB 19/06 explains how to work out which rules apply for each income year. The factor that determines which rules apply is whether the property is unused for 62 days or more during a year.

18. If property is a mixed-use asset, there are some situations in which the taxpayer can choose to opt out of the tax rules. This is explained in QB 19/06.

19. It's necessary to revisit which tax rules apply each year.

The income is derived by the trustees

20. As noted above, where the trustees are the ones renting out the short-stay accommodation, the income will belong to the trustees.

21. Generally, all amounts the trustees receive from paying guests will be income. However, this doesn't include minor contributions from family or friends who aren't charged rent (eg, if they pay $20 towards their power usage).

22. In addition, if the MUA rules apply, the following amounts will be exempt income:
    - amounts received for renting the property to associated natural persons (eg, the settlor and beneficiaries); 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.

Expenditure incurred by the trustees is deductible to them

23. Because the rental income in this situation belongs to the trustees, non-capital property-related expenditure that's incurred by the trustees will be deductible to them under s DA 1, subject to any apportionment required. These expenses could include things like:
    - interest payments;
    - property and contents insurance premiums;
    - rates;
    - repairs and maintenance;
    - utility bills;
    - advertising costs; and
    - any commission or fee the trust pays to an advertising platform or transaction facilitator (this does not include any service fee the guests pay the platform, just fees the trust pays).

24. Expenses incurred by the trustees will be deductible to the trustees (subject to any apportionment), regardless of whether the expense is paid by the trustees or by a beneficiary.

25. Expenditure will be incurred by the trustees if they either paid or became definitively committed to the expenditure in the income year.

26. This would include where the trustees have incurred the obligation themselves (eg, rates and property insurance). It would also include situations where the trustees have agreed that they'll reimburse a beneficiary for expenditure incurred by the beneficiary. For example, if a beneficiary gets the power, pay-TV or internet connected in their name (which would often be the case, as this would be easier than getting those services connected in the trustees' names). In those situations, the agreement to reimburse the beneficiary is an obligation incurred by the trustees.

27. It may be that someone who is a beneficiary of the trust is also a trustee, and connects services such as power or internet in their individual name. Generally, in this case the person would be incurring the expenditure in their capacity as trustee, so the expenditure would be incurred directly by the trustees.

28. Some or all of the rental income may be allocated as beneficiary income, which would mean it's taxed at the beneficiary's tax rate rather than at the trust rate. However, for the purposes of determining the deductions the trust is allowed, the beneficiary income is treated as trustee income (s DV 9(2)). This means that all the non-capital expenses the trust incurs in relation to the rental activity will be deductible to the trustees, subject to any apportionment required.

Dedicated short-stay accommodation property

29. If the property is a dedicated short-stay accommodation property, the above expenses will be fully deductible; no apportionment is necessary. Depreciation losses on the property's chattels would also be fully deductible.

A holiday home that is sometimes rented out

30. However, if the property is sometimes rented out and sometimes used by people associated with the trust (eg, a family holiday home that's sometimes rented out), the proportion of the expenses that can be deducted will depend on whether the MUA rules or the standard tax rules apply (see from [15]).

If the MUA rules apply to the holiday home

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

32. Use by natural persons who are associated with the trustees counts as "private use" for the apportionment formula in the MUA rules. Use by anyone else for less than 80% market value rent (eg, friends staying and paying "mates' rates") will also be "private use".

33. Persons associated with the trustee will (relevantly) be:

- beneficiaries of the trust;
- settlors of the trust;
- persons associated with beneficiaries of the trust under the "two relatives" test in s YB 4; and

- persons with a power of appointment or removal of trustees – unless within the exclusion for providers of professional services (s YB 11).

The IR620 guide explains how to work out if someone is associated with the trustees.

34. QB 19/07 explains how to calculate the percentage of the mixed expenses that is tax deductible under the MUA rules. The same formula is generally used to calculate the portion of depreciation losses for the property's chattels that is deductible. The exception to this is depreciation losses or depreciation recovery income on disposal, which is dealt with by the depreciation provisions in subpart EE.

If the standard tax rules apply to the holiday home

35. If the standard tax rules apply to the holiday home, expenses that relate solely to the rental activity (eg, advertising fees) will be 100% deductible. But mixed expenses – those that relate to both the rental activity and non income-earning use of the property (eg, use by beneficiaries or settlors of the trust) – need to be apportioned. These mixed expenses would include things like rates, insurance, utility bills, and loan interest.

36. These mixed expenses will usually be deductible based on the total number of nights in the year the property is rented out or available to be rented out. The discussion and examples in QB 19/08 (from [20]) explain how to calculate the percentage of the mixed expenses that is tax deductible. Although QB 19/08 refers to expenditure not being deductible for "private use" (which a trust can't have), the same approach can be used. This is because there will only be the required nexus between the expenditure and the earning of income to the extent the property is rented out or available to be rented out.

37. Depreciation losses on the property's chattels will also be partly deductible. QB 19/08 explains how to calculate the percentage of depreciation losses that is tax deductible.

Income to the trustees if beneficiary not reimbursed for paying trustees' expense

38. For properties that are either dedicated short-stay accommodation properties or holiday homes that are sometimes rented out, the trust will likely have a bank account that guests pay into. Therefore, where the trustees have incurred an obligation themselves (eg, rates and property insurance), they will likely have the funds to pay the expense.

39. But if for whatever reason they didn't, and a beneficiary pays the expense instead, the expense would still be deductible to the trustees as they have incurred the legal obligation.

40. However, if the trustees didn't reimburse the beneficiary (either in cash or through the 'beneficiary's current account'), the amount of the expense paid by the beneficiary will be income to the trustees either:

    - under s CC 1, if:
        - the amount is paid by the beneficiary for the use of and/or ability to use the property; and
        - the property is not subject to the MUA rules; or otherwise
    - under s CG 4, to the extent of the deduction the trustees have been allowed.

41. The net effect of this is that if the beneficiary isn't reimbursed, the trustees don't get the benefit of the deduction. This reflects that the trustees haven't borne the expense.

Reimbursement of expense incurred by beneficiary

42. As noted above, it may be that a beneficiary (who is not also a trustee) incurs an obligation to pay some property-related expenses (such as power bills or internet), because it's easier to have those services connected in an individual's name.

43. Those expenses aren't deductible to the beneficiary, as there's no nexus between the expenditure and the beneficiary earning income. The income from the rental activity belongs to the trustees.

44. However, the trustees may have agreed that they'll reimburse the beneficiary for this expenditure. If they have, the agreement to reimburse the beneficiary is an obligation incurred by the trustees. The trustees can therefore deduct the amount they reimburse the beneficiary (whether by actual payment or through the 'beneficiary's current account'), subject to any apportionment required (see from [30]).

Expenditure incurred by a beneficiary and not reimbursed by the trustees

45. If a beneficiary has incurred a property-related expense that the trustees don't reimburse them for, the expense can't be deducted by anyone.

46. In this case the amount of the expense the beneficiary has paid will be rental income to the trustees, if:

    - the amount is paid by the beneficiary for the use of and/or ability to use the property; and
    - the property is not subject to the MUA rules.

47. There may also be a settlement on the trust or a distribution from the trust. Whether there is a settlement on the trust or a distribution from the trust, and the amount of any such settlement or distribution, will depend on the value of what the beneficiary and the trust are providing each other under the arrangement. This includes the value of property-related expenses incurred by the beneficiary that are of value to the trust and the market value of any use of and/or ability to use the property they get in return for incurring those expenses.

Allocation of deductions if the rental activity is loss-making

48. If the property is not within the mixed-use asset rules and the rental activity is loss-making, the residential rental ring-fencing rules in subpart EL of the Act may limit the deductions that can be allocated to the income year. 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 trustees derive residential income.

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

Examples

Example 1: Trust income and deductions for a dedicated rental property

The B-F Family Trust owns an investment property in Queenstown that's rented out on Airbnb. The property isn't used at all by the settlors (who are deceased) or beneficiaries of the trust – it's a dedicated Airbnb rental property.

The corporate trustee pays all of the property-related expenses from its bank account. This includes the power, internet and pay-TV bills. The connections for those services are in the names of Ani and Charlie, who are beneficiaries (but not trustees) of the trust. The connections were signed up for in Ani and Charlie's names as this was easier. But there's an agreement that the trustee will pay all those expenses.

All of the rental income is income to the trustee. All of the (non-capital) property-related expenses are deductible to the trustee. This includes the power, internet and pay-TV bills, as the trustee pays those. Because the property is only used for rental purposes, the expenses are all fully deductible.

Example 2: Trust income and deductions for a holiday house that's subject to the MUA rules

The Fab Five Family Trust owns the Brown family's holiday house. The Browns use the holiday house for 45 nights during the tax year. The trustees of the Fab Five Family Trust rent it out to friends of the Browns for 15 nights in the year for "mates' rates" of $50 a night, and the trustees rent it out to others for 80 nights in the year for $200 a night.

The trustees have used QB 19/06 to work out the holiday house is a mixed-use asset for the tax year. This is because it was: (a) used privately (by the Browns, who are beneficiaries and settlors of the trust, and by friends for less than 80% of the market value rent), (b) used to earn income, and (c) vacant for 62 days or more. Therefore, the MUA rules apply.

The trustees pay most of the property-related expenses from their bank account. This includes the power and internet bills, even though the connections for those services are in the name of Mrs Brown, who is a settlor and beneficiary of the trust. The connections were signed up for in Mrs Brown's name as this was easier. But there's an agreement that the trustees will pay those expenses. However, Mr and Mrs Brown have a loan (in their names, with a guarantee provided to the bank by the trustees) from when they bought the property and settled it on the trust, and they pay the loan repayments. The trustees reimburse Mr and Mrs Brown for the interest component of the loan repayments. This is recorded in Mr and Mrs Brown's 'beneficiary current accounts'.

The rental income from the full-rate paying guests is income to the trustees. The $50 a night "mates' rates" paid by the Browns' friends isn't income to the trustees – it's exempt because it's less than 80% of the market value rent.

Some of the trustees' expenses are fully deductible. This includes the fees they pay to Airbnb and Bookabach, and the cost of cleaners who come in after the full-rate paying guests.

Other expenses the trustees incur need to be apportioned under the formula in the MUA rules, as they relate to both the rental activity and the private use of the holiday home (by the Browns and their friends who pay less than 80% of market value rent). These expenses include the power and internet bills, as the trustees pay those, and the loan interest that the trustees reimburse Mr and Mrs Brown for. The trustees use QB 19/07 to work out the deductible portion of these mixed expenses.

There may be a settlement on the trust or a distribution from the trust. This depends on the value of what Mr and Mrs Brown and the trust are providing each other under the arrangement.

Example 3: Trust income and deductions for a holiday house that is subject to the "standard rules" not the MUA rules

The We Are Family Trust owns the Miller family's holiday house in a popular tourist destination. The Millers use the holiday house for 90 nights during the tax year, and rent it out as short-stay accommodation for 220 nights in the year.

The trustees have used QB 19/06 to work out the holiday house is not subject to the MUA rules for the tax year, so the "standard rules" apply. This is because the holiday house was not vacant for 62 days or more during the year.

The short-stay accommodation guests pay into the trustees' bank account, and the trustees pay most of the property-related expenses from their bank account. This includes the power, pay-TV and internet bills, even though the connections for those services are in the name of Mr Miller, who is a settlor and beneficiary of the trust. The connections were signed up for in Mr Miller's name as this was easier. But there is an agreement that the trustees will pay those expenses. However, Mr and Mrs Miller have a loan (in their names) from when they bought the property and settled it on the trust, and they pay the loan repayments. The trustees reimburse Mr and Mrs Miller for the interest component of the loan repayments. This is recorded in Mr and Mrs Miller's 'beneficiary current accounts'.

The rental income from the short-stay accommodation guests is income to the trustees.

Some of the trustees' expenses are fully deductible. This includes the fees they pay to the Holiday Houses and Bookabach websites, which they advertise on, and the cost of cleaners who come in after the paying guests' stays.

Other expenses the trustees incur need to be apportioned, as they relate to both the rental activity and the non income-earning use of the holiday home (when it's used by the Millers). These expenses include the power and internet bills, as the trustees pay those, and the loan interest that the trustees reimburse Mr and Mrs Miller for. The trustees use QB 19/08 to help them work out the deductible portion of these expenses.

There may be a settlement on the trust or a distribution from the trust. This depends on the value of what Mr and Mrs Miller and the trust are providing each other under the arrangement.

References

Subject references

income tax
short-stay accommodation
trusts

Legislative references

Income Tax Act 2007 – ss CC 1, CG 4, DA 1, DV 9, YB 4 and YB 11, subpart EE, 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" and "own" in s YA 1

Other references

Hinde, McMorland & Sim, *Land Law in New Zealand* (online ed.), LexisNexis NZ Limited
IR620: *Associated persons definitions for income tax purposes* (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)
QB 19/08: *How do the standard income tax rules apply to a dwelling that I sometimes rent out as short-stay accommodation and sometimes use privately?* (Inland Revenue)
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