

12 October 2023

By email: public.consultation@ird.govt.nz

Re: PUB00375 – Taxation of Trusts

1. The New Zealand Law Society Te Kāhui Ture o Aotearoa welcomes the opportunity to comment on the above Interpretation Statement (draft guidance).
2. This submission has been prepared with the assistance of the Law Society's Tax Law Committee.¹

Part 2: Settlers

Trustee owes the beneficiary money

3. The draft guidance does not clarify whether 'current account' balances in a trust would meet the definition of 'money owing'.
4. This was considered in detail in the Commissioner's Operational Position of 2 September 2019,² which stated that:

[A] beneficiary that simply has money vested in interest or in possession, where such sums remain with the trustee, does not become a settlor under s HC 27(2) Income Tax Act 2007 on that basis. The existence of an amount that is "beneficiary income" in relation to a particular beneficiary, which is (for example) held by the trustee in a current account that contains amounts to be distributed to that beneficiary, does not make that beneficiary a settlor. The fact that the amount could be called for by the beneficiary, and would be provided by the trustee if they did, does not make the beneficiary a settlor on the basis of deciding not to do so.
5. That Law Society considers this to be the correct position. There is no "transfer" where a beneficiary simply does not take money owed to them by the trust. This would make logical sense, as an omission to "transfer" (from trustee to beneficiary) should not be seen to be a "transfer" itself for the purposes of determining if there is a "transfer of value" from beneficiary to trustee.
6. Further, while section HC 27(6) confirms that sums owed by a trust of not more than \$25k and held on current account will not be financial assistance to a trust and will not constitute a settlement, it does not mean that sums above this amount will be a settlement. Section HC 27(6) would seem to operate as a safe harbour and confirm there is no risk of there being a settlement below this amount, but that does not necessarily mean that section HC 27(2)(b) makes amounts held on current account above \$25k a settlement. In our view, and depending on the circumstances, amounts above this \$25k amount held on current account may still not be financial assistance and therefore not a settlement.

¹ Information about the Tax Law Committee can be found [here](#).

² <https://www.taxtechnical.ird.govt.nz/-/media/project/ir/tt/pdfs/tib/volume-31---2019/tib-vol31-no8.pdf?la=en>, page 113.

7. Further, where the beneficiary is owed money, there can be instances where the beneficiary is unaware of amounts owed to them. Again, the Law Society does not consider this would necessarily amount to a settlement.
8. We recommend the addition of a further paragraph,³ to make clear that a beneficiary will not necessarily become a settlor merely by having a "current account balance". This would encapsulate the "transfer of value" concept which section HC 27 aims to cover. It would also be helpful to provide an example of this after paragraph 2.43.

Control over a trustee or settlor

9. Paragraphs 2.72 to 2.81 consider section HC 28(6) which, broadly, deals with situations where a person obtains trustee powers and deems the person to be a settlor. More specifically, section HC 28(6) is drafted to capture situations where a person acquires the rights or powers of a trustee for the purpose of controlling a trust and the purpose of that acquisition is to divert benefit to themselves or their nominee.
10. The guidance seems to suggest this section will apply anytime a person acquires trustee powers. Paragraph 2.81 states that this section could apply, even when the acquirer is already a beneficiary. This suggests that any acquisition by a person of a trustee entity or trustee powers, will automatically make the beneficiary the settlor, even where there is no intention by that person to divert benefit to themselves.
11. In the Law Society's view, the correct interpretation is that section HC 28(6) is drafted narrowly to only apply where a person acquires trustee powers, combined with a purpose of diverting benefits to themselves. The use of the word "and" in this manner is typically cumulative,⁴ requiring that both limbs are satisfied for section HC 28(6) to apply. To make this clear, and to avoid overstating its effect, we recommend that paragraph 2.81 is redrafted. Further, it should confirm that a person who is already a beneficiary that is entitled to profits, cannot also become settlor under section HC 28(6), if they are already entitled to profits of the trust.
12. For completeness, paragraph 2.83 of the guidance further states "the Commissioner will take a purposive interpretation of s HC28(6) to ensure the provision does not apply in situations in which Parliament would not have intended". As noted, the Law Society considers the guidance interprets section HC 28(6) too broadly, and in a way that applies section HC 28(6) in a manner that Parliament did not intend. In contrast, we agree with example 7 in the guidance, which illustrates what Parliament intended section HC28(6) to capture.

Part 4: Income derived by trustees

Miscellaneous comment

13. Paragraph 4.1 notes that the trust rules are "concerned with the taxation of income derived by trustees and beneficiaries". It may be appropriate to revisit this wording, as it is inconsistent with terminology used elsewhere in Part 4 and Part 5 (for example, paragraph 4.3 and the first bullet point of paragraph 5.8) and the general definition of beneficiary income (which refers to "income derived in an income year *by a trustee* of a trust").

³ Where appropriate, in the vicinity of paragraphs 2.35 and 2.36.

⁴ See, for example, the Law Commission's report *Legislation Manual Structure and Style* (Report 35, 1996), at paragraph 183; Parliamentary Counsel Office (at A3.3 to A3.11, noting that the ambiguities warned of do not apply to section HC 28(6), being a paragraphed provision joined by 'and').

14. In the first line of paragraph 4.7, the word “also” could be removed for clarity (noting that paragraph 4.6 has already established that income means an amount that is income under a provision in part C).

Part 5: Beneficiary income

Definition of “beneficiary income”

15. At paragraph 5.6, the reference to Resident Withholding Tax (RWT) substitution payments appears to be incomplete. For these payments to be beneficiary income, they must still meet the requirements of section HC 6(1).

Vesting and paying amounts

16. At paragraph 5.15, it is noted that beneficiary income can take the form of money’s worth, with the example given that *“a trustee could derive income in the form of cash sales, but vest or pay that income in or to the beneficiary by transferring assets of an equivalent value (provided the distribution is of the income derived by the trustee)”*.
17. Further guidance should be provided on how the Commissioner will determine that a non-cash distribution is a distribution of income derived by the trustee where the form of the income and distribution are different (the example given being income in the form of cash sales and assets transferred of an equivalent value). Examples could be used to demonstrate the level of tracing required.
18. It would be useful to expand the guidance to the treatment of other types of non-cash distributions from a trustee to a beneficiary; for example, the provision of services for less than market value consideration, rent-free accommodation (e.g., in a family home or rental property), or the provision of an interest-free loan from the trust to beneficiary. These would give rise to a transfer of value from the trust to the beneficiary and would therefore be a distribution.
19. The Commissioner should clarify that such distributions should be treated as excluded income under section HC 20 (assuming the trust is a complying trust, noting the parallel comment in paragraph 8.5 in respect of rent-free accommodation provided by foreign or non-complying trusts).
20. The guidance should also specify circumstances in which it would consider these common examples of non-cash distributions to be beneficiary income.

Vesting absolutely in interest

21. At paragraphs 5.22 and 5.23, it would be useful to confirm how s HC 27(6) applies. That is, when an amount of beneficiary income is paid but continues to be held by the trustee (with the beneficiary having either a right to present or future possession of the amount), will this be considered an amount owing to the beneficiary? (Refer to comments above, paragraphs 3 to 8).

Part 6: Minor beneficiary rule

Treated as trustee income

22. The mention of use of money interest and possible penalties at paragraph 6.5 appears to be out of context. This comment is generally applicable to all calculations of trustee income (rather than just trustee income that arises where the minor beneficiary rule has been applied).

23. At paragraph 6.7, it appears the section reference in the final line should be HC 26(1) or HC 26(1)(e), instead of HC 26(1)(a). This should be confirmed.

Exclusions

24. At paragraph 6.14, the *de minimis* exclusion is described as “\$1,000 per trust”. We recommend this is clarified to make it clear that the *de minimis* is also applied on a per beneficiary basis (consistent with the wording at s HC 35(4) and QB 07/02).

Exclusions for beneficiary income derived from particular sources

25. Paragraph 6.20 does not appear to fit under this heading, as the exclusion is focused on the identity of the beneficiary (and whether they are minor in receipt of a child disability allowance under the Social Security Act 2018) rather than the source of the income.

Trustee may treat multiple settlements made on the same terms as one trust

26. Paragraphs 6.23 and 6.24 refer to the rule in section HC 3 that provides a trustee may treat multiple settlements made on the same terms as one trust.
27. The Law Society considers this should be expanded to provide guidance on the circumstances in which the Commissioner would consider settlements to be made “on the same terms” (for example, settlements following a change in the beneficiaries of the trust, or revising or updating the trust deed, or other factors the Commissioner considers would be relevant).
28. The Commissioner should also include discussion on what the outcome would be if it is determined that a settlement is not made “on the same terms”. For example, whether the trustees would be prevented from offsetting income from the “new trust” against carried forward losses of the original trust, and whether the trustees would be required to separately register the “new trust” for tax purposes.

Miscellaneous comment

29. At Example 15, there appears to be a drafting error with Brandon described as being 12 years old at the time of distribution. However, based on the facts, Rob would be 12 years old in 2022 while Brandon would be 7 years old. We suggest this is remedied to avoid confusion.
30. Example 17 could be expressed more clearly. For example, the third paragraph could be rephrased as follows:

The first settlement fails the requirements of s HC 36(1)(a) because it is a settlement by a relative. However, the second settlement meets the requirements of s HC 37, meaning that this is a mixed trust and that the exclusion from the minor beneficiary rule will apply if the first settlement meets the requirements of ss HC 36(3) and HC 36(4).

Part 7: Trustee income

Foreign-sourced amounts – resident trustees

31. At the final bullet point of paragraph 7.21, we suggest that the current drafting be replaced with the following, to better reflect the requirement at section HC 26(1)(e):

the amount is not beneficiary income of a minor that is treated as if it were trustee income.

32. At paragraph 7.22, in the first line, we suggest that the nature of the registration contemplated be made clear (e.g. “For trusts that are not registered *under s 59B of the TAA*”).

Part 8: Distributions from trusts

Taxation on taxable distributions

33. Paragraphs 8.97 to 8.108 discuss the taxation of taxable distributions. We understand that the Commissioner's view to taxing taxable distributions at the non-complying trust tax rate does not remove the trustees' liability for income tax on previous trustee income. Instead, the trustee is required to satisfy their income tax obligations which will then reverse the non-complying trust distribution in the relevant period, i.e., the trust is able to regain complying trust status for a prior distribution. This approach is referred to in Trusts and Estates Income Tax Rules (IR288),⁵ which says:

Any distributions made from a non-complying trust to the beneficiary is taxed at 45%. If the trust subsequently gains its complying status, that distribution will be reversed.

34. The analysis supporting this should be included in paragraphs 8.97 to 8.108.

Further assistance

35. Thank you for the opportunity to provide feedback on the draft guidance. If you have any questions or wish to discuss the Law Society's feedback further, please contact aimee.bryant@lawsociety.org.nz.

Nāku noa, nā



David Campbell
Vice President

⁵ <https://www.ird.govt.nz/-/media/project/ir/home/documents/forms-and-guides/ir200---ir299/ir288/ir288-2020.pdf?modified=20210329201228&modified=20210329201228#:~:text=The%20trustee%20must%20pay%20tax,their%20own%20personal%20tax%20return>, page 17.