

## TRUSTS

**Note:** This section does not apply to superannuation funds, group investment funds, council-controlled organizations, community trusts, or unit trusts.

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### PDF ATTACHMENTS:

- Basic summary of the taxation of income derived by a trustee.
- Interest apportionment for trustees of excess debt NZ trusts.
- Abolition of Gift Duty

### Tax Rates

1. The tax rate that applies to trustees, in relation to trustee income, is 0.33.
2. The tax rate on a taxable distribution from a non-complying trust is 0.45 (regardless of whether the distribution is received by a trustee or a beneficiary of a trust).
3. Individual tax rates for trust beneficiaries who are natural persons, from the 2011-12 income year onwards are:

\$0 - \$14,000	0.105
\$14,001 - \$48,000	0.175
\$48,001 - \$70,000	0.300
\$70,001 upwards	0.330

4. Individual tax rates for the 2010-11 income year are:

\$0 - \$14,000	0.1150
\$14,001 - \$48,000	0.1925
\$48,001 - \$70,000	0.3150
\$70,001 upwards	0.3550

5. The company tax rate, for trust beneficiaries that are companies, is 0.28 for income years from 2011-12 onwards.

6. For the 2008-09 to 2010-11 income years, the company tax rate was 0.30. [Prior to that, for the 2007-08 income years and earlier it was 0.33.]

7. For the tax rates that apply to non-resident beneficiaries, see paragraph 1 onwards in the Non-residents section and the section on Non-resident Beneficiaries below.

### **Recent And Proposed Changes Affecting Trusts**

8. The tax regime that applies to trusts and beneficiaries has been in place for some years. For the benefit of people unfamiliar with the regime, the main scheme underlying the taxation of trustee and beneficiary income, trust distributions, and the tax obligation of settlors, has been summarised in an attached PDF, *to serve as an introduction to the rules*.

9. Changes in recent years include:

- The extension of the time within which beneficiary income can be paid to a beneficiary.
- Provisions included in new and newly re-negotiated tax treaties concerning business profits derived by non-resident beneficiaries.
- Changes to the associated persons rules.
- The introduction of the concept of a “tax charity” and the requirement to register charitable trusts under the Charities Act 2005.
- The application of the thin capitalisation interest apportionment rules to a New Zealand trust that is an “excess debt entity” (as defined).

10. Other changes that could affect trusts, were very recently enacted in the Taxation (Tax Administration and Remedial Matters) Act 2011 (“the Tax Administration Act 2011”):

- The abolition of gift duty on gifts made on or after 1 October 2011.
- Confirmation of the deductibility of use of money interest from the 2010-11 income year onwards.

- Confirmation of the deductibility of tax pooling fees effective from 29 August 2011..

11. Proposals contained in the Taxation (International Investment and Remedial Matters) Bill as reported from the Finance and Expenditure Committee on 9 May 2011 (the “International Investment Tax Bill”) represent significant extensions to the thin capitalisation interest apportionment rules applying to a New Zealand trust that is an “excess debt entity”.

### **Date By Which Beneficiary Income Must Be Allocated**

12. From the 2009-10 income year onwards, the date by which beneficiary income for an income year must be allocated by a trustee is the *later* of the following:

- The date that falls within six months of the end of the income year; or
- The earlier of:
  - the date on which the trustee files the return of income for the year; or
  - the date by which the trustee must file a return of income for the income year.

### **Deductibility Of Expenditure Incurred In Deriving Trustee Income**

13. A beneficiary is not allowed any deductions from beneficiary income. Instead, a trustee is allowed tax deductions treating the beneficiary income as if it was trustee income. To the extent to which it is not beneficiary income, income derived by a trustee is trustee income. When calculating the tax liability of a trustee, all tax deductions relating to both trustee income and beneficiary income can be taken into account.

14. Therefore, it is possible, from a tax perspective, and subject to the terms of the Trust Deed, to distribute all of the income derived by a trustee as beneficiary income, in which case the trustee gets left with a tax loss. If the beneficiary is a non-resident, this can result in some tax complications – see the next section below.

### **Non-resident Beneficiaries**

15. The taxation of beneficiary income derived by a non-resident beneficiary, depends on the type of income derived, and on the effect of a relevant double tax agreement.

16. Non-resident passive income derived by a non-resident beneficiary will be subject to NRWT, which may be reduced or eliminated according to the terms of a relevant double tax agreement. If the non-resident passive income is derived by a trustee, and the trustee is taxed on it (i.e. if it is the equivalent of trustee income in NZ), most new and re-negotiated double tax agreements provide that the trustee is to be treated as the beneficial owner, for the purpose of the NRWT reduction which may be available: for example, Article 8 in the protocol set out in the Schedule to the double tax agreement with Chile states that:

***“With reference to Articles 10, 11 and 12 of the Convention***

*A trustee subject to tax in a Contracting State in respect of dividends, interest or royalties shall be deemed to be the beneficial owner of those dividends, that interest or those royalties.”*

17. The double tax agreement with Chile came into force on 21 June 2006 and has applied to: withholding taxes from 1 January 2007, and all other taxes from income years beginning on or after 1 April 2007. Other relatively new and re-negotiated double tax agreements contain the same provision – see for example: paragraph 4 of Article 3 in the double tax agreement with Australia. (There is more information on this – refer to paragraphs 45-47 in the Non-residents section).

18. Beneficiary income from land or from the sale of land is taxable in New Zealand with no relief under double tax agreements.

19. The tax treatment when a non-resident beneficiary derives beneficiary income sourced from business profits derived by a trustee, is not straightforward. For example, paragraph 7 of Article 7 in the double tax agreement with the Australia (which applies to income subject to withholding tax from 1 May 2010, and to other income for income years beginning on or after 1 April 2010) states:

*“7. Where:*

*(a) a resident of a Contracting State beneficially owns (whether as a direct beneficiary or through one or more interposed trusts) a share of the profits of a business of an enterprise carried on in the other Contracting State by the trustee of a trust other than a trust which is treated as a company for tax purposes; and*

*(b) in relation to that enterprise, that trustee has or would have, if it were a resident of the first-mentioned State, a permanent establishment in that State,*

*then the business of the enterprise carried on by the trustee through such permanent establishment shall be deemed to be a business carried on in the other State by that resident through a permanent establishment situated in that other State and the resident’s share of profits may be taxed in the other State but only so much of them as is attributable to that permanent establishment.”*

20. Section BH (1)(6) states that business profits in a double tax agreement should be read, if possible, as meaning net income. Beneficiary income, however, is income derived by a trustee before any deductions. Therefore, if the net income derived by a trustee is paid as beneficiary income to a beneficiary resident in Australia, there will be some interesting tax implications. Other new and re-negotiated double tax agreements contain the same provision (see paragraphs 69-73 in the Non-residents section for more on this).

### **Deductibility Of Use Of Money Interest And Tax Pooling Fees**

21. Use of money interest is deductible from the 2010-11 income year onwards. The Tax Administration Act 2011 provides for a deduction which supplements the general permission and overrides the capital limitation, the private limitation and the employment limitation.

22. The deduction must be allocated to the income year in which the UOMI is paid.

23. Another amendment in the Tax Administration Act 2011 provides for a deduction for tax pooling fees, effective from 29 August 2011. The deduction must be allocated to the income year in which the pooled funds are transferred by the Commissioner into the taxpayer's tax account.

24. Changes have also been made to when UOMI received is derived for tax return purposes.

25. The circumstances in which funds from a tax pool can be used to settle a tax liability have been significantly expanded.

26. Refer to paragraphs 47 to 59 in the Larger Companies section for more details on all of these changes.

### **Associated Persons**

27. The associated persons rules in Subpart YB have been given a complete overhaul, and the new Subpart YB, other than provisions relating to land, apply from the 2010-11 income year onwards. (The provisions relating to land have applied from 6 October 2009).

28. Within the trust taxation regime, the associated persons rules are relevant for determining:

- Whether a distribution of a gain from a foreign trust should be treated as a taxable distribution. [Section HC 15(5)]
- Whether beneficiary income derived by a minor should be treated as trustee income. [Section HC 36]

- Whether a person has control of the income of a charitable trust, so that the income is not exempt. [Section CW 42]

29. The following persons are associated:

- A trustee of a trust and a person who has benefited or is eligible to benefit under the trust. (This does not apply if the beneficiary is a charitable organisation, described in section LD 3(2) or listed in Schedule 32).
- A trustee of a trust and a relative of a person who has benefited or is eligible to benefit under the trust. (Two persons are relatives if they are within 2 degrees of blood relationship).
- A trustee of a trust and a trustee of another trust, if the same person is a settlor of both trusts. (Spouses and partners are treated as the same person).
- A trustee of a trust and a settlor of the trust. (Note: A person who provides services to a trust for less than market value is not treated as a settlor under the associated persons rules).
- A settlor of a trust and a person who has benefited or is eligible to benefit under the trust. (This does not apply if the beneficiary is a charitable organisation, described in section LD 3(2) or listed in Schedule 32).
- A trustee of a trust and a person who has a power of appointment or of removal of the trustee.
- Persons associated due to a tripartite relationship: person A and person B are associated persons if person B is associated with a third person (Person C) and person C is associated with person A.

[Sections YB 5 to YB 11, YB 14 & YB 16]

30. Exceptions to the above rules of association apply to employee trusts.

[Section YB 15]

### **Thin Capitalisation Rules Applying to Non-complying Trusts**

31. The thin capitalisation rules have applied for some time to a trustee of a non-complying trust settled by a non-resident, if the value of the settlements made (including the value of all settlements made by a person associated with the non-resident) are 50% or more of the value of the settlements made on the trust.

32. The New Zealand group of a trustee of a non-complying trust is, under the current rules, made up of the trustee and all associated persons who:

(a) are resident in New Zealand; or

(b) are carrying on business in New Zealand through a fixed establishment in New Zealand; or

(c) derive income that has a source in New Zealand and for which relief from New Zealand tax under a double tax agreement is unavailable.

33. The worldwide group of the trustee is made up of the trustee and:

(a) the trustee's New Zealand group; and

(b) all non-residents who are associated with the trustee or are members of the trustee's New Zealand group.

34. The International Investments Tax Bill contains an amendment to narrow the ambit of the New Zealand group of a non-complying trust. The New Zealand group will not include associated persons who derive only non-resident passive income from New Zealand. This extension is to apply to income years commencing on 1 July 2011 or later.

### **Thin Capitalisation Rules Applying To Excess Debt NZ Trusts**

*(Refer to the PDF attachment for all the details)*

35. The thin capitalisation interest apportionment rules have applied to a trustee of an excess debt New Zealand trust from the first income year that began on or after 1 July 2009.

36. There are significant amendments to the regime proposed in the International Investment Tax Bill, along the same lines as the amendments proposed for excess debt outbound companies.

37. The application of the regime, including the proposed changes, has been summarised in paragraphs 82 to 100 in the Larger Companies section.

38. However, there are some differences, notably, the group determinations, and the application of the regime. Therefore a completely separate PDF attachment has been prepared setting out the rules that apply to a trustee of an excess debt NZ trust. Please refer to the attachment.

### **Charitable Trusts**

39. In the trust rules, a trust is a "charitable trust" in an income year if:

(a) all income derived or accumulated by the trustee in that or in any earlier income year is held for charitable purposes; and

(b) any income derived by the trustee in the income year is exempt income under either section CW 41(1) (Charities: non-business income) or CW 42(1) (Charities: business income).

40. Sections CW 41 and CW 42, insofar as they relate to the requirement for a taxable trust to be a "tax charity", came into effect on 1 July 2008.

[Sections A 2(1B), CW 41(2) & CW 42(1)(b)]

41. The exemption for non-business income of charities in section CW 41 does not apply if the charitable trust is not a tax charity.

42. The exemption in section CW 42: for the business income of a charitable trust that carries out its charitable purposes in New Zealand, only applies to a charitable trust that is a tax charity. (This exemption also requires that no person with some control over the business is able to direct or divert, to their own benefit or advantage, an amount derived from the business.)

43. A tax charity is defined (in relation to a trust that is a charitable trust) as meaning:

(a) A trustee of a trust, registered as a charitable entity under the Charities Act 2005.

(b) A trustee of a trust that has started, before 1 July 2008, to take reasonable steps in the process of preparing an application for registering the trust as a charitable trust under the Charities Act 2005, and intends to complete the process of preparing the application, and has not been notified by the Commissioner that the trust is not a tax charity.

(c) A trustee of a trust that is non-resident and carrying out its charitable purposes outside New Zealand, and which is, approved as a tax charity by the Commissioner in circumstances where registration as a charitable trust under the Charities Act 2005 is unavailable.

44. It follows from the above that a charitable trust must be registered as a charitable trust under the Charities Act 2005.

45. Registration is essential in order for the exemptions, for non-business income, and for business income where the charitable purpose is carried out in New Zealand, to apply.

46. Classification as a charitable trust is also important in the trust rules because a settlor of a charitable trust is not liable as agent of the trustee (see paragraphs 20-23 in the PDF attachment on the Taxation Of Income Derived By A Trustee). In addition, the exemption in the financial arrangements rules for trustee income derived from the forgiveness of debt applies to charitable trusts.

47. It is important to ensure that the requirements of the Charities Act 2005 are properly complied with before applying to the Charities Commission to be registered. There have been recent instances of:

- The Charities Commission refusing to register a trust as a charity (*In re Draco Foundation (NZ) Charitable Trust* (2011) 25 NZTC 20-0320).
- The Charities Commission removing a society from the register of charitable entities (*In re New Zealand Computer Society Inc* (2011) 25 NZTC 20-0330).

48. In both cases, it was held that, the trust, and the society, respectively, were not established and maintained exclusively for charitable purposes.



## **Gift Duty**

49. Gift duty has been abolished in relation to gifts made on or after 1 October 2011. Please refer to the attached PDF *Abolition of Gift Duty* for all the details.