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WEEKLY COMMENT: FRIDAY 29 JULY 2022

1. This week and next week, I am reviewing the new tax return information and disclosure requirements that apply to trusts from the 2022 income year onwards. The *Taxation (Income Tax Rate and Other Amendments) Act 2020* inserted sections 59BA and 59BAB into the *Tax Administration Act 1994* ("the TAA"), relating to domestic trusts, and applying for the 2021-22 and later income years:

   (a) Section 59BA sets out the trust tax return information requirements for the 2021-22 income year onwards; and

   (b) Section 59BAB allows the Commissioner to request information from the 2014-15 income year onwards.

2. The *Tax Administration (Financial Statements – Domestic Trusts) Order 2022* ("the Trusts OIC") was made on 7 March 2022 under s 21C of the TAA, and came into force on 31 March 2022, setting out minimum requirements for the preparation of financial statements of a trust for the purposes of s 21B of the TAA.

3. Inland Revenue issued Operational Statement OS 22/02 "Reporting requirements for domestic trusts" on 6 April 2022, published in *Tax Information Bulletin* Vol. 34, No. 4, May 2022, setting out the Commissioner's approach to applying the trust information gathering powers contained in s 59BA and s 59BAB of the TAA.

Minimum requirements for financial statements for trusts

4. Section 59BA(1) of the TAA states that a trustee of a trust who derives assessable income for a tax year must file a return for the tax year of all income derived in the corresponding income year by the trustee as trustee of the trust.

5. A non-active trust that files a declaration (form IR633) under s 43B of the TAA is excused from filing a tax return.

6. Unless a trust is excluded, by s 59BA(3), from the information requirements, s 59BA(2) sets out that the information in a tax return by a trust includes a statement of profit or loss and a statement of financial position.

7. Inland Revenue notes in Operational Statement OS 22/02, pages 25 – 50, that:

   (a) If a trustee is not required to file a return that complies with s 59BA(2), then they are not required to prepare the financial statements required by the Trusts OIC;

(b) While the financial statements are not required to be provided to the Commissioner with the return, they must be available if the Commissioner later requests them;

(c) The information required to be provided with the return (the statement of profit and loss and statement of financial position) should be copied from the Trusts OIC financial statements.

8. Inland Revenue issued a Special Report on 11 March 2022 providing information about minimum standards for financial statements, published in *Tax Information Bulletin*, Vo. 34, No. 3, April 2022, pages 7 – 9. Inland Revenue notes that:

(a) Non-standard balance dates used for accounting purposes are permitted, but if business income is derived, he Commissioner's approval under s 38 of the TAA is required for a non-standard balance date;

(b) The minimum requirements apply to income years ending on or after 31 March 2022, therefore;

(i) For trusts with balance dates before 31 March 2022, the minimum requirements will apply for the 2022-23 and later income years;

(ii) For trusts with standard and late balance dates, the minimum requirements apply for the 2021-22 and later income years;

(c) Valuation of assets and liabilities can be at market value, cost or adjusted tax value, however, adjusted tax value can only be used for assets producing assessable income (including income derived on sale of the asset).

Core requirements for all trusts

9. The financial statements must:

(a) Include a statement of profit or loss showing income derived, and expenditure incurred, by the trust during the return year;

(b) Include a statement of financial position setting out the assets, liabilities, and net assets of the trust as at the end of the return year;

(c) Be prepared using the double-entry method of recording financial transactions;

(d) Use the prescribed valuation principles (see paragraph 11 below) and disclose the valuation method adopted for land, buildings, and shares/ownership interests, however, a different valuation method can be adopted for each of these categories;

(e) Include relevant amounts required to complete the forms the Commissioner has prescribed under s 35 of the TAA.

10. New Box 34 in the IR6 trust tax return for 2022 concerns the profit and loss account and requires the following disclosures:

(a) Box 34A: Trust's net profit/loss before tax (Inland Revenue states this is accounting profit/loss);

(b) Box 34B: Trust's tax adjustments;

(c) Box 34C: Trust's untaxed realised gains/receipts.

11. New Boxes 35, 36 and 37 in the IR6 trust tax return for 2022 relate to the statement of financial position:

(a) New Box 35A: Associated persons financial arrangements (Inland Revenue states this should encompass all loans **to** associated persons, excluding certain beneficiary accounts represented under the category "Current account year-end balances" in Box 37C);

(b) New Box 35B: Land - Inland Revenue notes that:

(i) Land and buildings will need to be valued separately, which can be done using the apportionment used in the most recent rating valuation under the *Ratings Valuations Act 1998*;

(ii) If the purchase price allocation rules in s GC 20 of the *Income Tax Act 2007* were applied to determine the purchase price of an asset, the same apportionment methodology must be used in the year of acquisition and can be used in future years;

(c) New Box 35C: Valuation method for land:

(i) This can be historical cost, market value for which the most recent rating valuation can be used as a proxy, or adjusted tax value if the asset produces assessable income (including under the bright-line test on disposal);

(ii) If there is more than one asset in a particular category and different valuation methodologies have been applied, the valuation method that reflects the highest proportion of assets in the category in terms of dollar value should be disclosed;

(d) New Box 35D: Buildings – as for land, apportionment can be based on the most recent rating valuation under the Ratings Valuations Act 1998, but if the purchase price allocation rules have applied, the same apportionment must be used for the year of purchase, and can be used for subsequent years;

(e) New Box 35E: Valuation method for buildings – refer to the comments under Box 35C valuation methods for land;

(f) New Box 35F: Shares/ownership interests – the value of shares and ownership interests is required to be stated;

(g) New Box 35G: Valuation method for shares/ownership interests – same rules as for land and buildings – see the comments under Box 35C;

(h) New Box 35H: Total assets: the sum of the amounts in Boxes 35A, 35B, 35D and 35F;

(i) New Box 36A: Associated persons financial arrangements – Inland Revenue notes that:

(i) This should encompass all loans **from** associated persons, excluding certain beneficiary accounts represented under the category "Current account year-end balances";

(ii) Beneficiary accounts payable on demand are not shown in Box 36A, but are recorded in the "Current account year-end balances" in Box 37C;

(j) New Box 36B: Total liabilities – this is a re-statement for the amount in Box 36A;

(k) New Box 37A: Owner's equity – Inland Revenue notes that:

(i) A trust does not have an "owner" or "equity", but for the trust disclosure rules, the term "owners' equity" is used and means the total "trust corpus" and total "trust capital";

(ii) "Trust corpus" is the sum of all settlements made on the trust less the sum of all distributions of trust corpus made to beneficiaries over the life of the trust - a settlement that does not increase the trust corpus (because the settlement does not give rise to value that can be distributed to beneficiaries) is not included in the statement of financial position but is included in the disclosures of settlements (which will be discussed in next week's *Weekly Comment*);

(iii) "Trust capital" is the net assets less the trust corpus – it is the sum of all taxable and non-taxable income retained and gains/losses made by the trust less the sum of all distributions of trust capital made to the beneficiaries over the life of the trust;

(iv) Owners' equity does not include beneficiary accounts as this is represented under the category "Current account year-end balances";

(l) New Box 37B: Drawings – Inland Revenue notes that in the context of a trust, drawings should reflect the total amount of funds/assets/value withdrawn from the trust by beneficiaries during the year;

(m) New Box 37C: Current account year-end balances – Inland Revenue notes that in the context of a trust, this should reflect the closing balance of all beneficiary accounts at year-end (which will be discussed in next week's *Weekly Comment*).

Simplified reporting trusts

12. A trust qualifies for simplified reporting requirements for an income year (meaning the additional information set out in paragraph 13 below need not be included in the financial statements) if it has:

(a) Less than $100,000 assessable income;

(b) Less than $100,000 deductible expenditure, and

(c) Total assets in the statement of financial position (including both private and income producing assets) valued at less than $5 million (using valuation principles set out in paragraph 11 above) as at balance date.

Trusts that are not simplified reporting trusts

13. For trusts that do not qualify for simplified reporting for an income year, the financial statements must:

(a) Be prepared applying the principles of accrual accounting;

(b) Include a statement of accounting policies;

(c) Disclose comparable figures for the previous income year to the extent that the trustee has that information – see paragraph 14 below;

(d) Include a reconciliation between net profit/(loss) and taxable income;

(e) Include an appropriate fixed asset and depreciation schedule;

(f) For trusts with forestry and livestock businesses:

  (i) Include information about the cost of timber at year-end and a reconciliation of movements in the cost of timber during the income year;

  (ii) Include details of livestock valuation methods, valuations, and calculations for tax purposes;

(g) Include the following details of transactions between the trust and associated persons, unless the transaction is minor and incidental to the activities of the trust, or the transaction is at market value (or disclosures have been separately made in prescribed forms):

  (i) The names of associated persons;

  (ii) The nature of the association;

  (iii) The nature of the transactions; and

  (iv) The amounts involved.

14. Inland Revenue notes that:

(a) The opening balances of assets, liabilities and equity will need to be calculated in order to calculate the closing balances for the purposes of preparing financial statements to the minimum standards prescribed in the Trusts OIC, for each year that they are required to make the s 59BA(2) disclosures;

(b) However, comparable figures may not be known for the 2021-22 income year and these are not expected to be included in the financial statements required by the Trusts OIC for the 2021-22 income year except to the extent that the trustee has that information;

(c) Opening values of assets and liabilities should be based on the valuation principles in paragraph 11 above;

(d) The same valuation method must be used for the financial statements and for the disclosures in the IR6 forms;

(e) The value of net assets, which is the equity of the trust, should reflect the difference between the value of total assets and total liabilities:

  (i) For the 2021-22 tax year, the net assets should be allocated between Trust Corpus, Trust Capital and the respective Beneficiary Accounts, as accurately as possible based on known information;

  (ii) In future years, the trustee should be able to accurately record the opening and closing balances based on the movement in assets and liabilities;

(f) Trustees will not be required to re-create records for the lifetime of the trust but will be required to value and record all the assets held by the trust as at the beginning of the 2021-22 tax year;

(g) Trustees are required by s 45 of the *Trusts Act 2019* to keep records of the trust property that identify the assets, liabilities, income, and expenses of the trust, so it is expected that going forward trustees will maintain sufficient records to calculate the opening balances of assets, liabilities, and equity for any year that they are required to prepare financial statements.

15. New Boxes 27U to 27AC in Form IR6B Trust Beneficiary Details set out disclosure requirements concerning beneficiary account movements. A line-by-line reconciliation is required, from the opening to closing balance of all beneficiary accounts.

16. Inland Revenue notes that for the purposes of movements in the beneficiary's account, beneficiary income that is allocated to the income year in the period after the end of the income year referred to in s HC 6(1B) of the *Income Tax Act 2007* is not included the reconciliations.

17. The disclosures required are as follows:

(a) New Box 27U: Opening balance;

(b) Add distributions:

(i) New Box 27V: Accounting income;

(ii) New Box 27W: Corpus;

(iii) New Box 27X: Capital gains;

(iv) Inland Revenue notes that all distributions are required to be disclosed, not just beneficiary income, as in the past;

(c) Deduct drawings:

(i) New Box 27Y: Provision of trust property/services at less than market value;

(ii) New Box 27Z: Distribution of trust assets (other than cash);

(iii) New Box 27AA: Debts owed by a beneficiary that have been forgiven by the trustee;

(iv) New Box 27AB: Other transfers of value that vest absolutely in the beneficiary, including cash and other assets paid out from the trust and tax paid on behalf of the beneficiary;

(d) New Box 278AC: Closing balance, which is the sum of boxes 27U to 27AB.

18. A beneficiary account reconciliation will be required for every beneficiary who has had a movement in their beneficiary account during the year.

Arun David

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