Tax Update July 2023

Trust Distributions

As has been well publicised, the Trustee tax rate is set to increase from 1 April 2024 from 33% to 39%. This may not eventuate depending on the outcome of the general election; however, we do note at this stage National has not specifically said it will reverse this Labour policy.

We thought it would be timely to cover off a lesser-known issue which could become a larger problem if the 39% is introduced.

Firstly- let's look at what the 39% increase will actually mean for different Trusts.

Example- No difference

Mary is retired and her family Trust has a rental property which generates net income of $25,000. Mary's only other income is the pension, so her marginal tax rate is 17.5% vs the Trustee income rate of 33%. Each year we distribute the income to Mary as beneficiary income as permitted by the Trust Deed.

Example 2- Difference- but no extra tax to pay

Roger earns a salary and wage of $100,000. Roger also has a family trust with a rental property that earns net income of $25,000. Each year the rental income is retained in the Trust as Trustee income at taxed at 33% because Roger's marginal tax rate is already 33%. From 1 April 2024, by leaving the income in the Trust Roger will be worse off by $1,500 (6% of $25,000). We will therefore recommend to the Trustees we credit the income to Roger as beneficiary income. Effective tax rate will therefore remain 33%.

Example 3- Difference- Extra tax to pay

Shaun earns a salary and wage of $200,000. Shaun also has a family trust which earns $60,000 from investments. Currently the income is retained as Trustee income and taxed at 33% as it is lower than Shaun's marginal tax rate of 39%. Going forward, it will make no difference whether the income is distributed to Shaun or retained as trustee income- the tax rate will be 39%.

What could Shaun do? One thing Shaun could consider is moving the Trust's investments into Portfolio Investment Entities (PIE's). If the Trust elects a 28% prescribed investor rate (PIR) on the PIE's, this is a full and final tax.

Issue

The Income Tax Act used to state that distributions must be made within 6 months of balance date. So for the vast majority of NZ trusts with a March balance date- this means the distributions must be made by 30 September. The legislation was amended in 2010 to allow 12 months for Trusts who are linked to a Tax agent like ourselves. However, many Trust deeds still have the old 6-month clause in them (especially old trusts). This means the Trustees are still bound by the 6 month rule. So what is the problem?

Lets look at Mary's sceario above and see how this could impact her;

Mary is retired and her family Trust has a rental property which generates net income of $25,000. Mary's only other income is the pension, so her marginal tax rate is 17.5% vs the Trustee income rate of 33%. Each year we distribute the income to Mary as beneficiary income as permitted by the Trust Deed. Mary usually sends her info to us soon after balance date and her tax returns are prepared well before 30 September. In 2024 however, Mary encounters some computer issues and is unable to send the information to us until October. We then duly prepare the returns but Mary's Trust has the old 6 month clause in it. This means in theory any beneficiary distribution would be seen as null and void in the IRD's eyes and must be taxed at 39% vs 17.5% i.e. a tax increase of $5,375.

Our Recommendation

We have never seen IRD Audit activity in this area but with the ever improving information available to IRD, and the potential increased revenue gathering opportunity if the 39% does proceed, we think it would be wise for Trustees to review their Trust deeds and amend this clause if it is currently limited to 6 months.

If you have any questions, please do not hesitate to contact us on 09 524 9802

Kind Regards,
The team at Auckland Chartered Accountants

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