

Regulatory Impact Statement: Minimum standards for financial statements prepared by domestic trusts

Coversheet

Purpose of Document	
Decision sought:	<i>Setting minimum standards for financial statements prepared by domestic trusts</i>
Advising agencies:	<i>Inland Revenue</i>
Proposing Ministers:	<i>Minister of Revenue</i>
Date finalised:	<i>21 February 2022</i>
Problem Definition	
<p>Increased disclosure requirements for trusts were enacted in December 2020 for the 2021–22 and later income years to help evaluate the effectiveness of the new top personal tax rate of 39% and gain insight into the use of structures and entities by trustees in New Zealand.¹ The disclosure requirements do not apply to certain categories of trusts, including foreign trusts, so for the purposes of this regulatory impact statement (RIS) we have referred to the disclosure rules as relating to domestic trusts only.</p> <p>The disclosure rules include the requirement for trustees of domestic trusts to prepare financial statements. The rules do not specify what level of detail the financial statements should be prepared to.</p> <p>There would be uncertainty regarding the level of detail the financial statements must be prepared to if minimum standards were not set. This would affect the quality of data collected and possibly lead to non-compliance with the disclosure rules.</p>	
Executive Summary	
Background	
<p>In December 2020, amendments were made to the Tax Administration Act 1994 (TAA) that introduced increased disclosure requirements for trustees of domestic trusts for the 2021–22 and later income years. These disclosure rules were introduced to gain insight into the effectiveness of the top personal tax rate of 39% and to provide better information to understand and monitor the use of structures and entities by trustees.</p> <p>The disclosure rules apply to trusts that have assessable income and do not fall within certain exclusion categories. The rules include the requirement for these trusts to prepare a statement of profit or loss and a statement of financial position.</p>	

¹ Cabinet paper CAB-20-SUB-0490, *Legislative approval for the introduction of a new top personal tax rate*, November 2020: <https://taxpolicy.ird.govt.nz/publications/2020/2020-ir-cab-20-sub-0490>

The TAA does not specify what information trustees must include in these financial statements. There would be uncertainty regarding the level of detail the statements must be prepared to if minimum standards were not set. This would affect the quality of data collected and possibly lead to non-compliance with the rules.

Officials considered whether to adopt accounting standards set by the External Reporting Board (XRB), set minimum standards by secondary legislation, or set minimum standards by primary legislation. These options are analysed in further detail in Section 2.

Proposal

Officials propose setting minimum standards for financial statements prepared by domestic trusts by Order in Council (OIC) made under a generic financial reporting provision of the TAA.

Setting minimum standards would provide increased certainty, support compliance with the disclosure rules, and improve the quality of data collected.

Officials consider that an OIC is the appropriate instrument for setting these standards, as it creates consistency in the legislative framework for different entity types (companies, foreign trusts and domestic trusts). This approach also enhances the transparency of the standards and subjects them to review by the Minister of Revenue and the consent of the Executive Council, thereby assuring taxpayers that appropriate processes have been undertaken.

Consultation and stakeholders' views

The proposed minimum standards have been designed based on feedback received in consultation and are aimed at striking a balance between supporting the Government's trust disclosure rules objectives and minimising compliance costs for trusts. The proposed minimum standards provide simplified reporting requirements for an estimated 75% of affected trusts.

Officials undertook targeted and public consultation in 2021. Stakeholders broadly supported setting minimum standards by OIC, as it would increase certainty for trustees regarding their reporting obligations.

Although the new disclosure rules introduced in December 2020 were not the focus of officials' consultation in 2021, submitters raised concerns regarding the expected significant compliance costs of the rules for trustees. A number of submitters recommended legislative amendments to exclude small trusts from the trust disclosure rules, or to defer the implementation of the rules for one year to allow trustees to restructure out of the rules or give them more time to prepare. Matters relating to the implementation or scope of the wider disclosure rules are outside the scope of this RIS.

Limitations and Constraints on Analysis

Data limitations

Inland Revenue records indicate that approximately 180,000 domestic trusts (excluding estates) report assessable income each year and will be subject to the disclosure rules in section 59BA of the TAA. Trusts that report assessable income file an IR6 form (income tax return for estates and trusts). IR6 data from the 2019–20 year has been used to estimate various income and expenditure thresholds for determining which trusts should be eligible for simplified reporting requirements (see section 2).

A trust that derives business income must either file an IR10 financial statement form or file a set of financial statements with Inland Revenue. Some trusts without business income voluntarily file an IR10 form or other financial forms with Inland Revenue.

Approximately 180,000 complying trusts filed returns for the 2019–20 year. Of these trusts, 125,000 trusts derived business income and/or filed financial statements with Inland Revenue (approximately 110,000 filed an IR10). Officials have used IR10 data from the 2019–20 year for these trusts to estimate various asset thresholds to determine which trusts should be eligible for simplified reporting requirements (see section 2). The estimates for the total number of trusts affected by asset thresholds are extrapolated from data from the 110,000 trusts that filed an IR10 in the 2019–20 year.

During consultation on proposed minimum standards in 2021, some submitters indicated that if trustees file an IR10, they report accounting income, along with total assets and liabilities including non-income earning assets and liabilities. Other submitters have indicated that when trustees file an IR10 they will report only business income, business assets and business liabilities. The variable quality of this data is a significant limitation on any analysis based on the IR10 data (i.e., the number of trusts captured by different asset thresholds)

As noted in the regulatory impact assessment (RIA) for the new 39% rate,² Inland Revenue has a limited understanding of the compliance costs that trusts will face with the increased disclosure requirements and how large the costs will be. This has constrained the ability of officials to accurately determine the quantum and nature of compliance costs of the proposed minimum standards.

Other constraints

The disclosure rules in section 59BA of the TAA were introduced to support the integrity of the new 39% rate and to provide better information to understand and monitor the use of structures and entities by trustees. The objectives of the disclosure rules are Government priorities. The proposed minimum standards for financial statements prepared by domestic trusts are constrained by these objectives and the rules set out in section 59BA:

- Consideration of the disclosure rules in section 59BA is outside the scope of this proposal. Although officials have progressed some minor amendments to section 59BA, the purpose of this project is to set minimum standards for financial statements prepared by domestic trusts, not revisit the disclosure rules enacted in December 2020.
- The disclosure rules in section 59BA were introduced for the 2021–22 and later income years. It is important that the disclosure rules apply for the 2021–22 income year – the first year of the new 39% personal tax rate – so that the rules can help the Commissioner of Inland Revenue identify whether trusts are being used to avoid paying the new 39% rate. The proposal to set minimum standards for financial statements prepared by domestic trusts has been developed in the context of the requirement for domestic trusts to prepare a statement of profit or loss and a statement of financial position for the 2021–22 and later income years.

² Page 9, *Regulatory Impact Statement – Introducing a new top personal tax rate*, Inland Revenue, November 2020. <https://taxpolicy.ird.govt.nz/publications/2020/2020-ria-top-personal-income-tax-rate>

- Officials consider that a class of trusts cannot be exempted from the disclosure requirements in section 59BA by an OIC made under section 21C of the TAA. Such an exemption would require amending section 59BA itself. A proposed OIC would supplement the requirements in section 59BA and provide increased certainty regarding reporting obligations – it cannot override the obligation in section 59BA for trusts to prepare financial statements. The proposal to set minimum standards by OIC is constrained in the amount of relief that can be provided to trusts; the OIC cannot fully exempt classes of trusts from the obligation to prepare financial statements. However, the minimum standards *can* provide partial relief by prescribing simpler standards for certain classes of trusts.
- The disclosure rules rely on a number of other existing regimes in the TAA. For example, non-active trusts excluded from the requirement to file a return under section 43B of the TAA are exempt from the new disclosure rules. One way to provide further relief for smaller trusts from the disclosure rules could be to expand the non-active trust definition. Issues relating to the non-active trust definition, and whether that definition is broad enough, are beyond the scope of this project. The limited relief provided by the non-active trust definition places additional pressure on the level of relief provided by the minimum standards.

Responsible Manager

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s 9(2)(a)

21 February 2022

Quality Assurance

Reviewing Agency: Inland Revenue

Panel Assessment & Comment: The Quality Assurance reviewers at Inland Revenue have reviewed *Regulatory Impact Statement: Minimum standards for financial statements prepared by domestic trusts* and consider that the information and analysis summarised in it **meets** the quality assurance criteria of the Regulatory Impact Statement framework.

Section 1: Diagnosing the policy problem

What is the context behind the policy problem and how is the status quo expected to develop?

1. In November 2020, Cabinet agreed to introduce the new top personal income tax rate of 39%. As an integrity measure, Inland Revenue recommended also increasing the trustee tax rate from 33% to 39%. The integrity risk from trusts arises because income retained in a trust is taxed as trustee income at 33% as a final tax. There is no additional tax when the income is subsequently distributed to a higher rate beneficiary, so they do not need to pay the top personal tax rate on any such distributions.³
2. Cabinet decided to defer the decision on whether to increase the trustee income tax rate to 39% to a later date pending information on whether there is a behavioural response to avoid paying the new personal income tax rate. Cabinet agreed to collect information from trustees to test compliance and effective operation of the 39% top personal income tax rate and provide better information to understand and monitor the use of structures and entities by trustees (CAB-21-MIN-0484 refers).
3. The Taxation (Income Tax Rate and Other Matters) Act 2020 was enacted on 7 December 2020 and introduced the new top personal tax rate of 39% and increased disclosure requirements for trusts for the 2021–22 and later income years. The disclosure rules are contained in section 59BA of the TAA and support the Commissioner’s ability to assess compliance with the new 39% personal income tax rate and assist the Commissioner in understanding and monitoring the use of structures and entities by trustees.
4. These disclosure rules apply to trustees of trusts that derive assessable income in a tax year and do not fall within specific exclusions.⁴ The rules apply for the 2020–21 and later income years and require trustees to prepare a statement of profit or loss and a statement of financial position. Trustees must disclose the following information in the form prescribed by the Commissioner:
 - a. the amount and nature of settlements received (settlements do not need to be disclosed if they are minor services incidental to the activities of the trust and are provided to the trustee at less than market value);
 - b. settlor details, including details of previous settlors if not previously supplied to the Commissioner;
 - c. the amount and nature of distributions made⁵ and details of beneficiaries who received the distributions; and

³ For more information refer to IR2020/454: *Tax policy report: Introducing a new top personal income tax rate* (13 November 2020) and the Regulatory Impact Statement – *Introducing a new top personal tax rate* (23 November 2020), <https://taxpolicy.ird.govt.nz/publications/2020/2020-ir-cab-20-sub-0484>

⁴ Section 59BA(3) of the TAA excludes certain trusts from the disclosure rules. The exclusions largely relate to trusts that already have reporting requirements under other regimes. Examples include non-active trusts, trusts eligible to be Māori authorities, foreign trusts and charitable trusts.

⁵ Settlements do not need to be disclosed if they are minor services incidental to the activities of the trust and are provided to the trustee at less than market value. There is no corresponding exclusion for distributions. A retrospective amendment to section 59BA(2)(d) of the TAA has been included in the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill to ensure that non-cash, minor distributions that are incidental to the activities of the trust do not need to be disclosed. This Bill is expected to be enacted by the end of March 2022.

- d. appointer details.⁶
5. The total volume of trusts in New Zealand has been estimated to be over 400,000.⁷ Inland Revenue records indicate that approximately 180,000 domestic trusts report assessable income each year and may be affected to some extent by the new disclosure requirements.
 6. For the 2019-20 income year approximately 125,000 trusts derived business income and/or filed financial statements with Inland Revenue (approximately 110,000 filed an IR10 form). The remaining 55,000 domestic trusts will be most affected by the requirement to prepare financial statements. These are trusts that report assessable income to Inland Revenue but do not currently report business income or file any financial statements.
 7. The Trusts Act 2019 introduced increased compliance requirements, including the requirement for each trustee of a trust to keep core documents. This includes records of the trust property that identifies the assets, liabilities, income, and expenses of the trust and that are appropriate to the value and complexity of the trust property. The RIA for the new 39% rate noted that the new trust disclosure rules will increase compliance costs for trustees on top of recent changes to the Trusts Act.⁸ The compliance costs relating to the keeping and preparation of financial records do not arise solely from the new trust disclosure rules in the TAA.

What is the policy problem or opportunity?

8. Section 59BA of the TAA requires domestic trusts that derive assessable income, and that do not fall within certain exclusions, to prepare statements of profit or loss and statements of financial position. Section 59BA does not specify what level of detail these statements should be prepared to. In the absence of minimum standards, there is significant uncertainty for trustees subject to these rules regarding their reporting requirements.
9. In particular, uncertainty would arise as to the level of detail the financial statements must be prepared to. This would affect the quality of data collected and possibly lead to non-compliance with the rules.

⁶ The name, date of birth, tax jurisdiction, tax file number and tax identification number must be disclosed for each person having a power under the trust to appoint or dismiss a trustee, to add or remove a beneficiary, or to amend the trust deed.

⁷ In 2013, the Law Commission estimated that: "While the exact number is unknown, and probably unknowable, estimates of the number of trusts currently in New Zealand range between 300,000 to 500,000. (Page 6, *Review of the Law of Trusts: A Trusts Act for New Zealand*, the Law Commission, September 2013. <https://www.lawcom.govt.nz/sites/default/files/projectAvailableFormats/NZLC%20R130.pdf>).

There are approximately 400,000 trusts on Inland Revenue records as of February 2022. This provides a lower bound for an estimate for the number of trusts in New Zealand.

⁸ Page 5, *Regulatory Impact Statement – Introducing a new top personal tax rate*, Inland Revenue, November 2020. <https://taxpolicy.ird.govt.nz/publications/2020/2020-ria-top-personal-income-tax-rate>

Consultation

10. Based on feedback received in targeted consultation, officials progressed changes in early 2021 to the list of exemptions from the disclosure rules in section 59BA to reduce compliance costs.⁹
11. In June 2021, Inland Revenue undertook targeted consultation on aspects of the new financial reporting requirements with 11 stakeholders.¹⁰ The purpose of the consultation was to provide an early reasonableness check of officials' proposals before public consultation occurred later in 2021. The consultation questions included whether it was appropriate to set the minimum requirements for financial statements prepared by domestic trusts by an OIC made under section 21C of the TAA and what information requirements may cause practical difficulties.
12. Before an OIC is made under section 21C of the TAA, the Minister of Revenue must consult with professional accounting bodies. Consultation undertaken by Inland Revenue officials in 2021 satisfies this requirement. Most submitters agreed it was appropriate to set the minimum requirements for the financial statements through an OIC. A small number did not express a view. No submitters opposed setting minimum standards by OIC.
13. The minimum standards proposed in June 2021 were largely based on the minimum standards for financial statements prepared by foreign trusts. Consultation feedback was that the minimum standards for financial statements prepared by companies was a more appropriate starting basis for domestic trusts, as the foreign trusts regime is complex and would impose more compliance costs. Officials revised the proposed minimum standards to align with the minimum standards for companies more closely.
14. An officials' issues paper on proposed minimum standards for financial reporting by domestic trusts was released for public consultation on 15 October 2021 with a submission due date of 15 November 2021.¹¹ A total of 17 submissions were received. The main themes arising from consultation were:
 - a. **Support for OIC:** The proposal to set minimum financial reporting standards by OIC was supported, as it would increase certainty for trustees regarding reporting obligations.
 - b. **Relief for small trusts:** Submitters engaged on how small trusts should be defined for the purposes of the OIC relief and the scope of that relief.

⁹ In January 2021, officials undertook targeted consultation to establish whether the list of exemptions in section 59BA(3) of the TAA should be expanded to reduce compliance costs. Based on this consultation, officials made recommendations to Ministers and changes were included in the Taxation (Annual Rates for 2020–21, Feasibility Expenditure, and Remedial Matters) Bill, by Supplementary Order Paper, enacted in March 2021. The changes extended the list of exempt trusts and introduced provisions that permit the Commissioner to vary the disclosure requirements for a trustee or class of trustees in order to minimise compliance costs.

¹⁰ The stakeholders were Chartered Accountants Australia and New Zealand, the Corporate Taxpayers Group, the New Zealand Law Society, the Trustees Companies Association, the External Reporting Board, CPA Australia, Accountants and Tax Agents Institute of New Zealand, Stats NZ, the Department of Internal Affairs—Charities Services, the Ministry of Business, Innovation and Employment, and the Ministry of Justice.

¹¹ Officials' issues paper: *Reporting requirements for domestic trusts*, Inland Revenue, October 2021. <https://taxpolicy.ird.govt.nz/publications/2021/2021-ip-reporting-requirements-domestic-trusts>. Simultaneously to this consultation, Inland Revenue published a draft Operational Statement setting out the Commissioner's approach to applying the trust information reporting obligations in sections 59BA and 59BAB. Consultation on this document ran from 15 October to 30 November. The finalised Operational Statement is expected to be published in March 2022.

- c. **Technical matters:** Submitters engaged on a range of technical matters that should be required in the OIC, the most significant relating to valuation methods, associated person disclosures, and disclosures relating to beneficiary accounts.
 - d. **High compliance costs:** Although outside the scope of this RIS, submitters considered that the trust disclosure rules will result in some trusts incurring significant compliance costs. It was suggested that this could be addressed by legislating a one-year deferral of the disclosure rules to allow trustees to structure out of the rules or give them more time to prepare. In addition, submitters suggested that legislative amendments could provide small trusts an exemption from all the disclosure requirements.
15. After analysing submissions on the issues paper, officials undertook further discussions with eight submitters on the OIC to better understand their concerns and test whether Inland Revenue's updated proposed minimum standards would be reasonable. This feedback has been used to further develop the proposed minimum standards.
16. Some feedback received in consultation related to the disclosure rules in section 59BA rather than the proposed minimum standards to be set by OIC. Based on this feedback officials have recommended to Ministers some legislative changes to help reduce compliance costs for affected trusts for inclusion in the Taxation (Annual Rates for 2021–22, GST, and Remedial Matters) Bill. This Bill is expected to be enacted by the end of March 2022.

What objectives are sought in relation to the policy problem?

17. There are two objectives sought in relation to the proposal to set minimum standards for financial statements prepared by domestic trusts:
- a. The minimum standards should support the objectives of the disclosure rules, which are to ensure that the Commissioner has sufficient information to evaluate the effectiveness of the new 39% rate and gain insight into the use of structures and entities by trustees in New Zealand.
 - b. The minimum standards should reduce unnecessary compliance costs for trusts subject to the disclosure rules.

Section 2: Deciding upon an option to address the policy problem

What criteria will be used to compare options to the status quo?

18. The following criteria will be used to compare options for minimum standards for financial statements prepared by domestic trusts:
 - a. **Minimising compliance costs:** The minimum standards should strike a balance between ensuring the Commissioner has sufficient financial information to meet the Government's trust disclosure rules objectives and minimising unnecessary compliance costs.
 - b. **Achieving the Government's objectives:** The minimum standards should positively impact on the quality of data collected to help evaluate the effectiveness of the new 39% rate and gain insight into the use of structures and entities by trustees.
 - c. **Ensuring consistency with existing frameworks:** The minimum standards should be consistent where possible with previous minimum standards set for companies and foreign trusts and should align with accounting standards and principles where appropriate.
 - d. **Proportionality:** The minimum standards should be tailored to the size of the trust. Smaller trusts should have simplified reporting requirements.

What scope will options be considered within?

19. Officials consider that minimum standards for financial statements prepared by domestic trusts should be set by OIC made under section 21C of the TAA. Section 21C is a generic financial reporting provision that empowers the Governor-General, by OIC on recommendation of the Minister of Revenue, to prescribe minimum requirements for financial reporting for certain classes of taxpayers.
20. Two similar OICs have been made under the same section:
 - a. the [Tax Administration \(Financial Statements\) Order 2014](#) sets out the minimum standards for financial statements of companies; and
 - b. the [Tax Administration \(Financial Statements—Foreign Trusts\) Order 2017](#) sets out the minimum standards for financial statements of foreign trusts.
21. The options considered in this regulatory impact statement (RIS) are focused on setting minimum standards for financial standards prepared by domestic trusts. Amendments to section 59BA are outside the scope of this RIS.
22. During rounds of consultation in 2021, officials received feedback on a wide range of issues relating to the disclosure rules in section 59BA of the TAA, the proposed minimum standards, and interpretative and guidance matters. The options and proposals discussed in this RIS have been developed based on this consultation feedback.
23. Inland Revenue undertook public consultation on a draft Operational Statement in 2021 regarding the Commissioner's approach to applying the trust information gathering powers contained in section 59BA and section 59BAB of the TAA. Matters relating to the Operational Statement or interpretation of section 59BA are also outside the scope of this RIS.

24. The options are also considered within the context of the previous OICs made under section 21C to set minimum standards for companies and foreign trusts.

What options are being considered?

25. Based on consultation feedback, the proposed minimum standards have been developed using the minimum standards for financial reporting by companies as a starting basis. A key difference between the proposed minimum standards for domestic trusts and the minimum financial reporting standards for companies is the simplified reporting requirements for an estimated 75% of affected trusts.
26. Set out below are the key options for:
- a. setting the minimum standards for financial statements prepared by domestic trusts;
 - b. timing of the OIC;
 - c. simplified reporting requirements for certain trusts; and
 - d. trusts eligible for simplified reporting requirements.
27. Further detail on other differences between the proposed minimum standards for domestic trusts and the minimum standards for companies are set out in Appendix A. Appendix B contains a detailed summary of the proposed minimum standards.

Setting minimum standards for financial statements prepared by domestic trusts

Option One – Maintain status quo and do not set minimum standards

28. Regardless of whether minimum standards are set by secondary or primary legislation, section 59BA(2)(a) of the TAA requires domestic trusts that derive assessable income, and that do not fall within certain exclusion categories, to prepare a statement of profit or loss and a statement of financial position.
29. In the absence of minimum standards for financial statements, there would be uncertainty regarding the level of detail the statements must be prepared to. This would undermine the Government's objectives for the disclosure rules by negatively impacting the quality of data collected and possibly lead to non-compliance with the disclosure rules.

Option Two – Adopt existing accounting standards frameworks set by the External Reporting Board

30. The External Reporting Board (XRB) sets accounting standards frameworks for for-profit and public benefit entities (both not-for-profit and public sector entities) that are required, or opting, to prepare general purpose financial reports (GPFRs). Trusts do not generally come under XRB's reporting standards unless they are charitable trusts which are also registered charities. These trusts are required under the Charities Act 2005 to comply with XRB's Public Benefit Entity standards. Registered charities are specifically excluded from the trust disclosure rules.
31. In issuing its standards, XRB focuses on the user's needs for information in GPFRs, that is, information intended to meet the needs of users who are not able to require an entity to prepare reports tailored to their particular needs. In contrast, the Government is able to legislatively request information from users as Special Purpose Financial Reports (SPFRs).

32. Adopting XRB standards for financial statements prepared by domestic trusts subject to section 59BA is inconsistent with the approach to the financial reporting requirements for companies and foreign trusts. The Financial Reporting Act 2013 removed the obligation for a large number of companies to prepare GPFRs. The Government at the time decided that these companies should continue to prepare financial reports for tax purposes, but to a lesser and minimum special-purpose level. These requirements for companies were set by OIC under section 21C of the TAA.
33. Officials consider that it would be appropriate to tailor specific reporting requirements for SPFRs for domestic trusts rather than adopt existing standards for GPFRs. This would lessen unnecessary compliance costs on trusts. XRB were consulted during the development of the proposals and did not object to minimum standards for SPFRs prepared by domestic trusts being set by OIC.

Option Three – Using secondary legislation to set minimum standards for financial statements prepared by domestic trusts

34. This option involves making an OIC under section 21C of the TAA to set minimum standards for financial statements prepared by domestic trusts. Two OICs have been previously made under section 21C to set minimum standards for companies and foreign trusts. Using a similar approach for domestic trusts would supplement the disclosure rules by providing increased certainty for trusts regarding their reporting obligations. This would also ensure consistency in the legislation for different entity types (companies, foreign trusts, and domestic trusts).
35. This approach also enhances the transparency of the standards and subjects them to review by the Minister of Revenue and the consent of the Executive Council, thereby assuring taxpayers that appropriate processes have been undertaken. Throughout multiple rounds of consultation in 2021, submitters broadly supported setting minimum standards by OIC.

Option Four – Using primary legislation to set minimum standards for financial statements prepared by domestic trusts

36. Section 59BA of the TAA could be amended to explicitly specify the minimum standards for financial statements prepared by domestic trusts. Similar to Option Three, this approach would provide increased certainty for trusts regarding their reporting obligations.
37. Placing the minimum standards alongside the requirement to prepare financial statements in the TAA may make it easier for trusts to find their reporting obligations. This is not expected to be a significant benefit for trustees due to Inland Revenue's planned extensive communications for the disclosure rules and minimum standards.
38. Setting minimum standards in primary legislation is inconsistent with the approach for companies and foreign trusts and would limit the flexibility of the Government to amend the minimum requirements if necessary.

Timing of OIC

Option One – Set minimum standards by OIC for the 2021–22 and later income years

39. This option would align the application of the minimum standards with the application date of the increased disclosure rules introduced in section 59BA. Aligning the application dates would ensure that the OIC provides increased certainty from the first year.
40. This would provide limited notice for trustees to prepare financial statements for the 2021–22 income year.
41. According to Inland Revenue records, out of the approximately 180,000 trusts that are expected to be affected by the disclosure rules, only approximately 400 (or 0.2%) have early balance dates (October to February). For trusts with an early balance date, the 2021–22 income year will be complete before the proposed minimum standards come into force. To ensure that the minimum standards do not retrospectively impose reporting obligations on trustees that have already filed returns, this option would prospectively apply to trusts with a standard or late balance date for the 2021–22 income year, and all domestic trusts subject to section 59BA for later income years.

Option Two – Defer the application of minimum standards by OIC until the 2022–23 and later income years

42. Some submitters indicated that requiring trusts to prepare financial statements beginning in the 2021–22 income year will be challenging and provides little time to prepare. Some proposed that the minimum standards be deferred until the 2022–23 and later income years.
43. The timing of the disclosure rules in section 59BA is crucial to the integrity of the new top 39% rate. 2021–22 is an essential year to understanding and identifying avoidance of the new rate, as it is the first year the new rate applies. The timing of the new rate and the disclosure rules in section 59BA is outside the scope of this RIS. Deferring the application of the minimum standards risks undermining the Government’s objectives for the disclosure rules.
44. With this context, there was broad consensus from submitters that deferring the application of the OIC for one year without delaying the disclosure rules in section 59BA would provide minimal benefit. This option would only result in a lack of guidance and clarity in the first year of the requirement for domestic trusts to prepare financial statements. This would risk undermining the quality of data disclosed to Inland Revenue and could possibly lead to non-compliance with the disclosure rules.

Option Three – Set minimum standards by OIC for the 2021–22 and later income years. Apply “best efforts” approach to the first year in the OIC.

45. Some submitters recommended that an OIC should provide “best efforts” relief from the minimum standards for the 2021–22 income year. Some trusts may not have prepared financial statements before or may not have sufficient information to be able to prepare the statements. Submitters considered that providing “best efforts” relief in the OIC would ensure certainty for trustees regarding their reporting obligations for the 2021–22 and later income years, while providing relief for trustees that may find complying with the new requirements difficult.
46. Officials consider that it is not appropriate for details of what constitutes “best efforts” to be included in an OIC. This is an interpretative matter for the Commissioner. Inland

Revenue undertook public consultation on a draft Operational Statement in 2021 regarding the Commissioner's approach to applying the increased disclosure rules in section 59BA. This included interpretative matters relating to complying with the disclosure rules in the first income year. Officials consider it is appropriate for the Operational Statement to cover the Commissioner's approach to the first year of the disclosure rules (including whether to take a "best efforts" approach operationally and what would constitute "best efforts"). The finalised Operational Statement is expected to be published in March 2022.

Simplified reporting requirements for certain trusts

47. This section covers the level of partial relief that should be provided to certain trusts subject to section 59BA. Options for determining which trusts qualify for these simplified reporting requirements is considered in the subsequent section.

Option One – Provide no relief

48. This option would align the minimum standards for domestic trusts with the minimum standards for all resident foreign trusts who must provide a return to the Commissioner under section 59D of the TAA. Financial statements prepared by these foreign trusts must be prepared to the same minimum level, regardless of the size of the trust.
49. This option would provide increased clarity regarding reporting obligations. Setting one level of minimum standards involves a trade-off between reducing compliance costs for smaller trusts and prescribing sufficient minimum standards to support the quality of data collected by Inland Revenue. As the disclosure rules in section 59BA are a Government priority, it is essential that the minimum standards do not undermine the quality of data collected by Inland Revenue or the objectives of the disclosure rules. Hence, this option would likely result in unnecessary compliance costs for smaller trusts.

Option Two – Provide partial relief

50. The minimum standards for financial statements prepared by companies fully exempts "small" companies from the minimum requirements. Officials consider that an OIC made under section 21C cannot fully exempt a class of trusts from the requirements of section 59BA. A full exemption would require amending section 59BA itself. Amendments to section 59BA are outside the scope of this RIS. The proposed OIC must supplement, rather than override, the disclosure obligations in section 59BA.
51. Officials undertook public consultation in October and November 2021 on proposed minimum standards for financial statements prepared by domestic trusts.¹² One of the proposals was that certain trusts would be exempt from:
- a. applying the principles of accrual accounting;
 - b. providing a statement of accounting policies; and
 - c. disclosing comparable figures for the previous income year.
52. Submitters broadly considered that the scope of relief should be increased due to the significant compliance costs for smaller trusts. Submitters were of the view that smaller trusts should not be required to provide a fixed asset schedule. It was also noted that the

¹² Officials' issues paper: *Reporting requirements for domestic trusts*, Inland Revenue, October 2021. <https://taxpolicy.ird.govt.nz/publications/2021/2021-ip-reporting-requirements-domestic-trusts>

associated persons disclosures can be very complex, particularly for trusts. Officials agreed with submitters that the level of relief should be expanded to help minimise compliance costs.

Option Three – Provide broad relief

53. Based on feedback received in public consultation regarding partial relief for certain trusts, officials developed a proposal for broader relief. In addition to the partial relief outlined in Option Two above, trusts that qualify for relief would not need to disclose:
- a. associated person transactions;
 - b. reconciliations between the profit and loss in the statement of profit and loss to taxable income;
 - c. a schedule of the trust's fixed assets and depreciable property used for tax purposes; and
 - d. certain matters relating to trusts with forestry and livestock businesses.
54. This means that a trust qualifying for relief will have to meet fewer minimum requirements for their financial statements set out in the OIC, but the information they provide to the Commissioner in prescribed forms will remain the same for all trusts. This would reduce compliance costs for a significant number of trusts while ensuring that the Commissioner has sufficient information to meet the Government's disclosure rules objectives. The information that is required to be disclosed in the IR6 form (income tax return for estates and trusts) includes:
- a. Total accounting before profit before tax**
 - b. Tax adjustments to reconcile accounting income with assessable
 - c. Untaxed realised gains
 - d. Total assets**
 - e. Associated persons financial arrangements
 - f. Shares/ownership interests*
 - g. Land*
 - h. Buildings*
 - i. Total liabilities**
 - j. Associated person financial arrangements
 - k. Total equity**
 - l. Drawings
 - m. Closing current account balances.

** Trustees will disclose the valuation method adopted for these assets*

55. Officials tested the broader simplified reporting requirements with submitters in late 2021. Submitters broadly supported this level of relief and considered that this approach would ease a lot of their concerns regarding compliance costs.

Trusts eligible for simplified reporting requirements

Option One – Adopt the “small” company thresholds combined with an asset threshold

56. The minimum standards for financial statements prepared by companies fully exempts small companies from the minimum requirements. A company is considered “small” for an income year if:
- a. the company is not part of a group of companies; and

- b. the company has not derived income in excess of \$30,000, and has not incurred expenditure in excess of \$30,000, during the income year.
- 57. Based on IR6 data, approximately 44% of domestic trusts subject to 59BA would fall below a \$30,000 assessable income and \$30,000 deductible expenditure threshold.
- 58. Officials consider that an asset threshold test should be introduced and apply to all assets (not just assets within the tax base) to support the Government's objective of gaining a better understanding of the use of New Zealand domestic trusts. IR6 and IR10 data indicates that adding a \$2 million asset threshold would result in approximately 38% of domestic trusts falling below both thresholds (i.e. both the \$2 million asset and \$30,000 income/expenditure threshold).
- 59. One of the proposals that officials publicly consulted on in 2021 was for a trust to be considered "small" for an income year if:
 - a. the trustee had not derived more than \$30,000 assessable income and had not incurred more than \$30,000 deductible expenditure; and
 - b. the total value of trust assets did not exceed \$2,000,000.
- 60. Submitters considered that the proposed thresholds for qualifying for partial relief should be increased to reflect income more likely to be shielded from the new personal income tax rate and to reflect that it is easy to incur \$30,000 maintenance expenses in one financial year on a primary home. Submitters suggested a range of possible income and expenditure thresholds, ranging from \$50,000 to \$150,000. Officials agree that there is merit in raising the income and expenditure thresholds to help reduce trustee compliance costs.
- 61. Several submitters suggested that the asset threshold be increased to ensure it excludes trusts that own a family home or holiday home. Suggestions for an asset threshold ranged from \$3 million to \$20 million. The \$20 million proposal aligned with the wealth level above which taxpayers have been selected for Inland Revenue's wealth research project. It would also align with the requirements for an overseas large company under the Financial Reporting Act 2013 and Companies Act 1993.
- 62. Some submitters were comfortable with the proposed asset threshold if non-income earning assets are excluded. One submitter's first preference was to remove the asset test completely in order to be consistent with the equivalent approach for companies. They noted that there is no wealth tax in New Zealand, so it is not valid for the Commissioner to collect data about wealth accumulation. One of the Government's objectives for the disclosure rules is to gain an understanding of the use of structures and entities by trustees. Officials consider that understanding how assets are used by trustees is essential to achieving the Government's disclosure rules objectives.
- 63. As noted above, both options two and three for the level of simplified reporting include relief from providing comparable figures for the previous year. One submitter considered that this would mean that the issue of trusts flipping in and out of the disclosure rules is not significant.

Option Two – Broad definition of a “simplified reporting trust”

64. Based on feedback received in public consultation regarding the proposed thresholds for qualifying for partial relief, officials undertook further analysis and developed an expanded definition. The broader definition of a “simplified reporting trust” is a trust that, for an income year:
 - a. the trustee derives less than \$100,000 assessable income (before allocation to beneficiaries) and incurs less than \$100,000 deductible expenditure; and
 - b. the trust has total assets (whether or not held on revenue account) valued at less than \$5,000,000.
65. Submitters raised concerns that trusts may move in and out of the simplified reporting requirements each year. A large one-off transaction, such as the sale of property under the residential property brightline rules, could result in a trust having to comply with the full minimum standards for that year. Submitters considered that applying the thresholds to income, expenditure and assets held in the previous one or two years would help mitigate the risks of flipping in and out of the simplified reporting requirements.
66. To alleviate the problem of trusts exceeding the thresholds due to large one-off transactions, officials proposed excluding income assessed under the brightline rules and related deductible expenditure from the asset and expenditure thresholds. This specific exclusion will help reduce the likelihood of trusts falling out of the simplified reporting trust definition due to large one-off fluctuations in assessable income or deductible expenditure. Officials consider that the threshold test should be based on metrics relating to the relevant income year.
67. IR6 and IR10 data indicates that this option would result in approximately 75% (135,000 out of 180,000) trusts subject to the disclosure rules qualifying as a simplified reporting trust.
68. Officials undertook further engagement with submitters to test whether the expanded simplified reporting trust definition is reasonable. Submitters considered that the expanded thresholds are sensible and help ensure that only “meaningful trusts” need to meet all of the OIC requirements.
69. There is some risk that trustees may sell assets to fall within the simplified reporting requirements. Officials consider this risk to be low, as selling a significant amount of assets may trigger the assessable income threshold. Officials will be evaluating compliance with the trust disclosure rules in real-time and will undertake a post-implementation review in 2023. Officials will consider whether any remedial amendments are required to support the disclosure rules and whether changes can be made to reduce compliance costs for trustees.

How do the options compare to the status quo/counterfactual?

70. The following pages analyse the above options against:

- a. Minimising compliance costs
- b. Achieving the Government's objectives
- c. Ensuring consistency with existing frameworks
- d. Proportionality

Key

++	much better than doing nothing/the status quo/counterfactual
+	better than doing nothing/the status quo/counterfactual
0	about the same as doing nothing/the status quo/counterfactual
-	worse than doing nothing/the status quo/counterfactual
--	much worse than doing nothing/the status quo/counterfactual

Setting minimum standards

	Option One – status quo (no minimum standards)	Option Two – adopting XRB standards	Option Three – setting standards by OIC	Option Four – setting standards by primary legislation
Compliance costs	n/a Unknown.	n/a Unknown.	n/a Unknown.	n/a Unknown.
Achieving the Government's objectives	-- Lack of certainty for taxpayers could lead to non-compliance with the trust disclosure rules. Would impact quality of data collected by Inland Revenue.	+ Some certainty for taxpayers, XRB standards would be optional. Would likely positively impact on compliance with the trust disclosure rules relative to there being no standards.	++ Certainty for taxpayers regarding their reporting obligations supports compliance with the trust disclosure rules and the quality of data collected by Inland Revenue.	++ Certainty for taxpayers regarding their reporting obligations supports compliance with the trust disclosure rules and the quality of data collected by Inland Revenue.
Consistency with existing frameworks	- Inconsistent for legislation to require the preparation of financial statements without minimum standards.	0 Some consistency with existing accounting standards. Inconsistent with approach for companies and foreign trusts.	++ Consistent with approach for companies and foreign trusts.	- Inconsistent with approach for companies and foreign trusts.
Proportionality	n/a	n/a	n/a	n/a
Overall assessment	-- Risks undermining the Government's trust disclosure rules objectives.	+ Supports the Government's trust disclosure rules objectives. Inconsistent with other entity types.	++ Supports the Government's trust disclosure rules objectives and creates consistency with other entity types.	+ Supports the Government's trust disclosure rules objectives. Inconsistent with other entity types. Limited flexibility to adapt standards.

Timing of OIC

	Option One – 2021–22 and later income years	Option Two – 2022–23 and later income years	Option Three – 2021–22 and later income years. “Best efforts” approach to first year in OIC.
Compliance costs	n/a Unlikely to impact on compliance costs.	n/a Unlikely to impact on compliance costs.	n/a Unlikely to impact on compliance costs.
Achieving the Government’s objectives	++ Certainty for taxpayers regarding their reporting obligations supports compliance with the trust disclosure rules and the quality of data collected by Inland Revenue.	-- Risks negatively impacting on voluntary compliance with s 59BA and the quality of data by Inland Revenue. Risks negatively impacting Inland Revenue’s ability to evaluate compliance with the new 39% rate.	++ Certainty for taxpayers regarding their reporting obligations supports compliance with the trust disclosure rules and the quality of data collected by Inland Revenue.
Consistency with existing frameworks	+ Aligns timing of minimum standards with the trust disclosure rules.	-- Not aligned with the trust disclosure rules.	- Aligns timing of OIC with the trust disclosure rules. Setting out “best efforts” in an OIC is inconsistent with previous approaches.
Proportionality	0 All trusts subject to the disclosure rules would be treated the same.	0 All trusts subject to the disclosure rules would be treated the same.	0 All trusts subject to the disclosure rules would be treated the same.
Overall assessment	+ Supports the Government’s trust disclosure rules objectives and aligns timing of OIC and disclosure rules.	-- Risks undermining the Government’s trust disclosure rules objectives. Inconsistent with the timing of the disclosure rules.	0 Supports the Government’s trust disclosure rules objectives for the disclosure rules. Defining “best efforts” is an interpretative matter for the Commissioner, not secondary legislation.

Simplified reporting requirements for certain trusts

	Option One – No relief	Option Two – Partial relief	Option Three – Broad relief
Minimise compliance costs	-- Would impose significant compliance costs on smaller trusts.	+ Partial reduction in compliance costs for trusts that qualify for relief.	++ Greater reduction in compliance costs for trusts that qualify for relief.
Achieving the Government's objectives	++ All trusts will be required to provide certain information in prescribed forms to support the Government's trust disclosure rules objectives and the quality of data collected.	++ All trusts will be required to provide certain information in prescribed forms to support the Government's trust disclosure rules objectives and the quality of data collected.	++ All trusts will be required to provide certain information in prescribed forms to support the Government's trust disclosure rules objectives and the quality of data collected.
Consistency with existing frameworks	- Consistent with reporting requirements for foreign trusts in treating all trusts the same. However, providing no relief for smaller trusts is inconsistent with reporting requirements for companies and accounting standards set by XRB.	0 Mixed. Inconsistent with foreign trusts (no relief) and companies (full relief for small companies). Some elements are consistent with XRB accounting standards (allowing smaller entities to apply cash accounting).	-- The broad scope of relief is not based on existing frameworks but is tailored to the specific circumstances for domestic trusts, the disclosure rules and feedback from submitters.
Proportionality	0 No proportionality. All trusts subject to the disclosure rules would be treated the same.	+ Provides some relief for certain trusts.	++ Provides greater relief for certain trusts.
Overall assessment	- Supports the Government's trust disclosure rules objectives but imposes significant compliance costs for smaller trusts.	+ Supports the Government's trust disclosure rules objectives and provides a partial reduction in compliance costs for certain trusts.	++ Supports the Government's trust disclosure rules objectives and provides a significant reduction in compliance costs for certain trusts.

Trusts eligible for simplified reporting requirements

	Option One – Adopt similar definition to a “small” company	Option Two – Broader definition of a “simplified reporting trust”
Minimise compliance costs	+	++
	Assuming option 2 or 3 is adopted for the simplified reporting requirements for certain trusts, this option results in reduced compliance costs for an estimated 38% of trusts.	Assuming option 2 or 3 is adopted for the simplified reporting requirements for certain trusts, this option results in reduced compliance costs for an estimated 75% of trusts.
Achieving the Government’s objectives	0	0
	No impact on the Government’s trust disclosure rules objectives. (All options for partial relief support the Government’s objectives, regardless of the size of trusts that qualify for such relief).	No impact on the Government’s trust disclosure rules objectives. (All options for partial relief support the Government’s objectives, regardless of the size of trusts that qualify for such relief).
Consistency with existing frameworks	+	-
	Same income and expenditure thresholds as the “small” companies definition.	Thresholds based on feedback from submitters rather than existing frameworks.
Proportionality	+	++
	An estimated 38% of trusts subject to the disclosure rules will meet this definition.	An estimated 75% of trusts subject to the disclosure rules will meet this definition.
Overall assessment	+	++
	Provides a reduction in compliance costs for an estimated 38% of trusts.	Provides a reduction in compliance costs for an estimated 75% of trusts.

What options are likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

71. Based on the above analysis, officials consider that the best options are:
 - a. to set minimum standards by OIC (Setting minimum standards, Option Three);
 - b. for the minimum standards to apply for the 2021–22 and later income years (Timing of OIC, Option One);
 - c. to provide broad relief for certain trusts (Simplified reporting requirements for certain trusts, Option Three); and
 - d. to adopt the broader definition of a “simplified reporting trust” (Trusts eligible for simplified reporting requirements, Option Two).
72. These options will ensure that the minimum standards support the Government’s objectives for the disclosure rules, help reduce compliance costs for trusts and provide certainty regarding reporting obligations for trustees.
73. Further detail regarding technical differences between the proposed minimum standards for domestic trusts and the minimum reporting requirements for companies is covered in Appendix A. Appendix B contains a detailed summary of the proposed minimum standards for financial statements prepared by domestic trusts.

What are the marginal costs and benefits of the option?

Affected groups	Comment <i>nature of cost or benefit (eg, ongoing, one-off), evidence and assumption (eg, compliance rates), risks.</i>	Impact <i>\$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts.</i>	Evidence Certainty <i>High, medium, or low, and explain reasoning in comment column.</i>
Additional costs of the preferred options compared to taking no action			
<u>Regulated parties</u> : trusts subject to section 59BA	Inland Revenue has a limited understanding of the compliance costs imposed by the new disclosure rules or the proposed minimum standards. The minimum standards may result in accountants and software providers passing on additional costs to trustees.	Unknown monetised impact	Low
<u>Regulator</u> : Inland Revenue	Proposed minimum standards will have minimal implementation costs for Inland Revenue.	Negligible monetised impact	High
Wider Government	n/a	n/a	n/a
<u>Other parties</u> : Tax agents, accountants, software providers, and preparers of financial statements	Any person required to make technical/software changes to accommodate the introduction of minimum standards for the preparation of financial statements could face some costs, to the extent they cannot recover these costs.	Low non-monetised impact	Medium
Total monetised costs		Unknown total monetised impact	Low
Non-monetised costs		Low total non-monetised impact	Medium

74. As noted in the November 2020 regulatory impact assessment (RIA) prepared for the new 39% rate, Inland Revenue has a limited understanding of the compliance costs that trusts will face with the increased disclosure requirements and how large the costs will be.¹³ This has constrained the ability of officials to accurately determine the compliance costs of the proposed minimum standards.

¹³ Page 9, *Regulatory Impact Statement – Introducing a new top personal tax rate*, <https://taxpolicy.ird.govt.nz/publications/2020/2020-ria-top-personal-income-tax-rate>

Affected groups	Comment <i>nature of cost or benefit (eg, ongoing, one-off), evidence and assumption (eg, compliance rates), risks.</i>	Impact <i>\$m present value where appropriate, for monetised impacts; high, medium or low for non-monetised impacts.</i>	Evidence Certainty <i>High, medium, or low, and explain reasoning in comment column.</i>
Additional benefits of the preferred options compared to taking no action			
<u>Regulated parties:</u> trusts subject to section 59BA	Increased certainty regarding reporting obligations. Significantly reduced compliance costs for an estimated 75% of affected trusts.	Low non-monetised impact	Medium
<u>Regulator:</u> Inland Revenue	Setting minimum standards will improve the quality of data collected by the Commissioner and help support the Government's trust disclosure rules objectives.	Medium non-monetised impact	High
Wider Government	Setting minimum standards will help support the Government's trust disclosure rules objectives – to evaluate the effectiveness of the new 39% rate and gain insight into the use of structures and entities by trustees in New Zealand	Medium non-monetised impact	High
<u>Other parties:</u> Tax agents, accountants and preparers of financial statements	Increased certainty regarding reporting obligations for domestic trusts.	Low non-monetised impact	Medium
Total monetised benefits		Nil total monetised impact	Medium
Non-monetised benefits		Medium total non-monetised impact	Medium

Section 3: Delivering an option

How will the new arrangements be implemented?

75. The proposed minimum standards will be set by an OIC made under section 21C of the TAA. After the OIC is made, it will be published in the *Gazette* and officials will include details of the new minimum standards in a *Tax Information Bulletin*.
76. It is proposed that the OIC will come into force on 31 March 2022, applying for all income years that end on or after 31 March 2022. For trusts with an early balance date, the 2021–22 income year will be complete before the proposed minimum standards come into force. The proposed application date will ensure that the minimum standards do not retrospectively impose reporting obligations on trustees that have already filed returns. That is, the OIC will apply to trusts with a standard or late balance date for the 2021–22 income year and will apply to *all* domestic trusts subject to section 59BA for the 2022–23 and later income years.
77. Inland Revenue undertook public consultation on a draft Operational Statement in 2021 covering how the Commissioner will apply the new disclosure requirements in section 59BA of the TAA. The Operational Statement will provide guidance to assist trustees with their reporting obligations under section 59BA, including the minimum standards set by OIC. The finalised Operational Statement is expected to be published in March 2022.
78. Inland Revenue is undertaking a comprehensive communications approach to the new disclosure requirements. This includes presentations for relevant stakeholders and sharing key information and promoting resources via newsletters and email communications.
79. Inland Revenue has been working with stakeholders and software providers on the implementation of the new disclosure rules. The proposed minimum standards to be set by OIC will have minimal implementation or systems implications for Inland Revenue.

How will the new arrangements be monitored, evaluated, and reviewed?

80. The November 2020 RIA for the new 39% rate referred to a post-implementation review of the increased trust disclosure rules in 2021.¹⁴ Officials consider that a comprehensive post-implementation review would not be feasible until after the first full year of income tax returns are filed under the new legislation. Trustees with tax agents have until 31 March 2023 to file their returns for the 2021–22 income year.
81. Officials will undertake a post-implementation review of the disclosure rules in section 59BA of the TAA, and the minimum standards set by OIC, in 2023. This will allow officials to consider the impact of the increased disclosure rules and minimum standards based on a full year of returns. This review will consider how compliance costs can be reduced and whether the benefits of the increased information disclosure rules justify the compliance costs imposed on trustees.

¹⁴ Page 9, *Regulatory Impact Statement – Introducing a new top personal tax rate*, Inland Revenue, November 2020. <https://taxpolicy.ird.govt.nz/publications/2020/2020-ria-top-personal-income-tax-rate>

Appendix A: Summary of further technical issues

82. This appendix contains analysis of further technical issues with the proposed minimum standards not covered in the RIS. The summaries below outline the original proposals, feedback from submissions and officials' analysis. This analysis has been included for transparency and completeness.

Valuations

83. Officials originally considered adopting the valuation approach for financial statements prepared by companies, where a hierarchy of valuation methods is prescribed (the first being tax values, the second being historical cost and the third being market values if it gives a better basis of valuation).
84. Some submitters recommended removing the hierarchy and aligning with the approach for foreign trusts – which allows foreign trusts to choose, without restriction, whether to use tax values, historical cost or market values. Officials agree with submitters that it is appropriate to align the valuation approach for domestic trusts and foreign trusts and not prescribe a hierarchy.

Associated person disclosures

85. During public consultation in 2021 officials proposed that all trusts subject to the disclosure rules must show associated persons transactions in their financial statements unless the transaction is minor and incidental. It was proposed that for each disclosed transaction, certain matters must be disclosed, including:
- the name of the associated person and a description of the association,
 - information about interest expenses, loans, the cost of services, expenses incurred for rentals and intangible property, and
 - a reconciliation of movements in trust corpus, capital and loans or current accounts to and from beneficiaries, associated persons and appointers.
86. Submitters in public consultation noted that the proposed breakdown was extensive and wide ranging and providing it would be time consuming and costly. Officials thus considered whether the definition of associated persons for the proposed minimum standards should be narrower than the general definition in the Income Tax Act 2007 (ITA).
87. For example, the definition could be limited to sections YB 3 (company and 25% voting interest holder / 25% market value interest holder), YB 6 (trustee and beneficiary), YB 8 (trustee and settlor) and YB 9 (settlor and beneficiary) of the ITA. Alternatively, it could be aligned with the narrower definition in the land provisions. Officials note that for the purposes of the prescribed forms, the “associated person” amounts rely on the general definition in the ITA and this is explained in existing Inland Revenue guidance.¹⁵
88. Officials consider that applying inconsistent definitions in the prescribed forms and the OIC would potentially result in confusion for trustees and would reduce the Commissioner’s ability to identify tax issues involving associated persons. Officials recommend that the general definition of associated persons should be applied in the OIC for trusts that are not “simplified reporting trusts”. Inland Revenue is finalising an Operational Statement covering the Commissioner’s approach to the disclosure rules.

¹⁵ See the IR6G reference to associated persons and the attribution rule (question 16 Business or rental income); the IR10G reference to associated persons’ remuneration (question 21) and the IR620 Associated persons definitions for income tax purposes.

This is expected to cover a “best efforts” approach to the first year, including issues relating to trustees not having the necessary information to be able to comply with the associated persons transaction disclosure requirements. The finalised Operational Statement is expected to be published in March 2022.

Beneficiary account movements

89. Officials proposed in public consultation in 2021 for the minimum standards to require “a reconciliation of movements from opening to closing balances, on a line-by-line basis, of all beneficiary accounts, including loans.”¹⁶ This is similar to the minimum standards for foreign trusts. The officials’ issues paper also proposed “a reconciliation of movements in trust corpus, trust capital and loans or current accounts to, and from, the beneficiaries or other persons with powers of appointment of the trust and associated persons of the trust.”
90. Some submitters said this detail should not be required to be disclosed as it would create compliance costs. One submitter noted that the requirement to reconcile movements in trust corpus added unnecessary complexity and compliance costs given that the definition of trust corpus for income tax purposes could be different to the concept of corpus for accounting purposes.
91. Based on submissions, officials do not propose including this requirement in the minimum standards. Alternatively, officials propose that the minimum standards include a requirement that financial statements must contain all relevant amounts in any forms prescribed by the Commissioner. This includes the IR6B form which will collect information about the movement in beneficiary accounts.

Gross-up options

92. During public consultation in 2021, officials proposed adopting the same approach for taxable dividends as contained in the minimum standards for companies. Under that approach, taxable dividends are shown in the financial statements grossed up for imputation credits if the credits are available to satisfy the trust’s income tax liability for the income year.
93. Similar to the minimum standards for companies, the issues paper also proposed a requirement that interest and dividends received by trusts be shown in the financial statements grossed up for resident withholding tax (RWT).
94. Submitters noted that it is acceptable from an accounting point of view to show dividends either gross or net of imputation credits. Another pointed out that the treatment of a fully-imputed distribution from a listed Portfolio Investment Entity is optional,¹⁷ so such a distribution would be grossed up only if the trustees choose to treat the distribution as being taxable income.
95. Officials agreed with submissions that trustees should be able to show dividends either gross or net of imputation credits, and interest and dividends can be either gross or net of RWT, provided the financial statements disclose which approach is being taken.

¹⁶ Pages 3-4, Officials’ issues paper: *Reporting requirements for domestic trusts*, October 2021. <https://taxpolicy.ird.govt.nz/publications/2021/2021-ip-reporting-requirements-domestic-trusts>

¹⁷ Section CX 56C of the Income Tax Act 2007.

Appendix B: Proposed minimum standards for financial statements prepared by domestic trusts

For the purposes of the Order in Council, the term “financial statements” includes any notes and other supporting materials forming part of the financial statements.

The standards set out below are “minimum” standards. Financial statements may be prepared to any level above these minimum requirements.

Financial statements may be prepared to a non-standard balance date (i.e., a balance date that is not 31 March) used for accounting purposes, provided the trust does not derive business income (which would require approval from the Commissioner for non-standard balance date reporting – section 38 of the Tax Administration Act 1994 (TAA)).

Valuation

Valuation of assets and liabilities can be either at market value, cost or tax adjusted value, at the discretion of the trustee. The use of ‘tax value’ will be limited to assets and liabilities that are in the tax base (i.e., assets and liabilities that are used in the production of assessable income).

Simplified reporting trusts

A trust is a “simplified reporting trust” for a relevant income year if the trustee reports:

- less than \$100,000 assessable income, AND
- less than \$100,000 deductible expenditure, AND
- total assets in the statement of financial position (including both private and income producing assets) valued at less than \$5 million as at balance date.

The \$100,000 assessable income and deductible expenditure thresholds used in this test do not include income assessed under the brightline rules or related deductible expenditure. Assets will be valued using the valuation principles set out above and must be consistent with the prepared financial statements.

Core requirements for all trusts

The following minimum standards apply to all trusts subject to the disclosure rules.

The financial statements must consist of:

- a statement of financial position setting out the assets, liabilities, and net assets of the trust as at the end of the return year; and
- a statement of profit or loss statement showing income derived, and expenditure incurred, by the trust during the return year.

Financial statements must be prepared using the double-entry method of recording financial transactions.

Financial statements must use the prescribed valuation principles (set out above) and disclose the valuation method adopted for land, buildings, and shares/ownership interests. A trustee can choose to adopt a different valuation method for each of these categories. If there are

multiple assets within one category (e.g., multiple buildings), each asset may be valued using a different method.¹⁸

Financial statements must contain all relevant amounts required to be copied from the trust's financial statements by any forms prescribed by the Commissioner under section 35 of the TAA.

Additional requirements for trusts that are not “simplified reporting trusts”

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

- Be prepared applying the principles of accrual accounting.
- Include a statement of accounting policies.
- Disclose comparable figures for the previous income year to the extent that the trustee has that information.
- Disclose several specific items:
 - a reconciliation between the profit or loss in the statement of profit or loss to taxable income;
 - an appropriately detailed schedule of the trust's fixed assets and depreciable property used for tax purposes;
 - matters relating to trusts with forestry and livestock businesses:
 - information about the cost of timber as at the end of the income year and a reconciliation of movements in the cost of timber during the income year;
 - if the trust is a specified livestock owner, details of livestock valuation methods, valuations, and calculations for tax purposes;
 - details of transactions between the trust and any associated person of the trustee, unless the transaction is minor and incidental to the activities of the trust.
 - Transaction details include the names of the associated persons, the nature of the association, the nature of the transactions and the amounts involved.
 - Disclosure is not required if the transaction is at a market rate.
 - If associated person disclosures have been made separately in any forms prescribed by the Commissioner, this information does not need to be duplicated in the financial statements.

¹⁸ This is consistent with the updated IR6 *income tax return for estates and trusts*. Trustees of trusts subject to the disclosure rules will be required to disclose each valuation method used for the asset classes: land, buildings, and shares/ownership interests. If there are multiple assets within an asset class, and more than one valuation method has been used, the method that reflects the largest proportion of assets in that class must be disclosed. Trustees will not be required to adopt the same valuation method as the previous year.