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Office of the Minister of Finance

Office of the Minister of Revenue

Chair, Cabinet

ENSURING EVERYONE PAYS THEIR FAIR SHARE BY INCREASING THE TRUSTEE TAX RATE TO 39%

Proposal

1. This paper seeks Cabinet's agreement to align the trustee tax rate with the top personal tax rate at 39% for the 2024–25 and later income years (beginning 1 April 2024 for most trusts).

2. If approved, we propose including the necessary legislative amendments in a bill to be introduced on Budget night.

Relation to Government priorities

3. This proposal relates to the Government's Fiscal Strategy, in particular the Government's stated long-term revenue objective, which is to "ensure a progressive taxation system that is fair, balanced and promotes the long-term sustainability of the economy, consistent with the debt and operating balance objectives".

4. The Government currently raises revenue from three main tax bases: personal income tax, company tax, and goods and services tax (GST). The personal income tax base is a key tax base, raising around 50% of total tax revenue. The system of personal tax rates and thresholds is designed to reflect the Government's view on how progressive the tax system should be.

5. When the Government put in place the new 39% top personal income tax rate in 2021, Inland Revenue and Treasury recommended also increasing the trustee rate to 39%. Ministers made clear that if analysis indicated high income earners were circumventing the top personal rate through greater use of trusts, that the government would move to address this issue. Analysis of historical trust income data indicates that having lower tax rates on income earned through certain structures, such as trusts, means that those earning income through these lower-tax structures would likely not have been fully subject to the increase in the top personal tax rate.

6. Aligning the trustee and top personal tax rates at 39% will help improve the progressivity of the tax system, and make the tax system fairer, by reducing opportunities for high-income taxpayers to circumvent the top personal tax rate. The Minister of Revenue notes that he would prefer this proposal to be part of a broader tax switch package rather than a stand-alone increase.

Executive summary

7. Trustee income increased from $11.4 billion in the 2020 financial year to $17.1 billion in the 2021 financial year (a $5.7 billion increase). This was the result of companies paying higher-than-usual dividends so that trusts or individual shareholders would earn the dividends before the 39% personal tax rate took effect.

8. Analysis by Inland Revenue shows that 5% of trusts with assessable income (9,000 out of 177,000) accounted for 78% of trustee income ($13.3 billion out of $17.1 billion) in the 2021 financial year.

9. The proposal is to increase the trustee rate to 39% to reduce opportunities for people to avoid paying their fair share of personal tax. This would strengthen the sense of fairness in the tax system by ensuring that trusts cannot be used to shelter income from the top personal tax rate. Other countries align their trustee tax rate with the top personal tax rate.

10. To buttress the 39% rate, we recommend taxing certain beneficiary income allocations to corporate beneficiaries at the 39% trustee tax rate. This will ensure that trustees are not able to circumvent a 39% rate by sheltering income in a company as a beneficiary.

11. In making this change, we need to balance ensuring taxpayers cannot avoid the top tax rate, with not over-taxing lower-rate beneficiaries of trusts.

12. To ensure lower-rate beneficiaries are not over-taxed, current law allows income of a trust to be taxed at a beneficiary's personal tax rate if the income is paid or allocated to the beneficiary as "beneficiary income". This is an important mechanism that allows lower-rate settlors and beneficiaries to mitigate over-taxation.

13. There are situations where income cannot be allocated to beneficiaries. This includes where it is unclear who the beneficiaries are, and where the trustees do not yet know which beneficiaries to allocate income to. For example, estates (which are taxed as trusts) may be unable to allocate income to beneficiaries because the deceased's affairs are still being settled. We therefore recommend introducing special rules for estates that would allow income to be taxed at the deceased person's marginal tax rate for 12 months.

14. We also recommend introducing special rules for trusts settled for the care of disabled people to ensure they are not over-taxed. The special rules would enable trustee income of qualifying trusts to be taxed at the disabled beneficiary's marginal tax rate. This is broadly consistent with the approaches taken in Canada, Australia, the US, and the UK.

15. There may be other situations where a 39% trustee tax rate could result in over-taxation. Any such situations will be considered further as part of the select committee process for the Bill implementing a 39% trustee tax rate.

16. The proposals would apply for the 2024–25 and later income years (beginning 1 April 2024 for most trusts). The reforms are estimated to raise $350 million per year ($1.123 billion over the forecast period). However, the estimated revenue gain is highly uncertain and heavily dependent on the behavioural response by trusts. The additional

tax revenue will have an estimated consequential impact of $4.300 million on impairment of debt and debt write-off expenditure.

17. The proposed changes would be included in a bill to be introduced on Budget night, going through the normal select committee process, and enacted by 31 March 2024.

18. This initiative will require up to $11 million of operating and capital funding. Inland Revenue will self-fund the departmental capital and operating cost of this initiative.

Background

19. When the Government put in place the new 39% top personal income tax rate in 2021, Inland Revenue and Treasury recommended also increasing the trustee rate to 39%. Ministers made clear that if analysis indicated high income earners were circumventing the rate through greater use of trusts, that the government would move to address this issue. Misalignment between the 33% trustee rate and the 39% top personal rate allows taxpayers to circumvent the top personal rate and reduces the progressivity and fairness of the income tax system.

20. "Beneficiary income" is all income earned by a trust in an income year that has been paid or allocated to the beneficiaries of the trust before it files its tax return. Provided the trustees cannot change their mind about the allocation (i.e., the income is vested absolutely in the beneficiary), the income is considered beneficiary income and is taxed at the beneficiary's marginal rate.

Table 1: Types of beneficiary income with examples

Types of beneficiary income	Simplified examples
Income allocated and distributed, or paid, to or on behalf of a beneficiary.	Cash transferred to the beneficiary.
Income allocated to a beneficiary by crediting the beneficiary's current account with the trust (i.e., the cash is still with the trust but can be called upon by the beneficiary).	Allocated amounts are available in a bank account for the beneficiary to draw upon at any time.
Income that is allocated to a beneficiary for them to possess at a future date or event.	Allocated amounts are held in a bank account which the beneficiary cannot access until they reach the age of 21.

21. "Trustee income" is all taxable income earned by a trust in an income year that is not beneficiary income. Trustee income is taxed at the flat trustee tax rate. Once income has been taxed as trustee income, later distribution of that income to beneficiaries is tax-free. That is, trustee income is subject to a final tax imposed in the year the income is derived by a trust.

International comparisons

22. Australia, Canada, the UK, and the US all have broadly similar tax regimes and trust laws to New Zealand. However, in those countries, most trustee income is subject to tax at the top personal rate. New Zealand's current misaligned tax treatment of trustee income is an outlier. This is illustrated in Table 2.

Table 2: International comparison of the taxation of trustee income

	NZ	Australia	Canada	UK	US
Top personal tax rate	**39%**	45%[1]	33%	45%	37%
Top personal income threshold *(2023 tax year)*	$180,000 NZD	$180,000 AUS	$235,675 CAD	£150,000 GBP	$578,125 USD
Tax rate on trustee income	**33%**	45%	33%	45%	37%[2]

Tax planning using a trust

23. Trusts are often used to split income within a family unit so that tax is paid at low rates under a progressive tax scale. Trustees can allocate beneficiary income as they choose to beneficiaries on lower personal tax rates. To ensure trusts cannot be used to split income with minors (under 16 years of age), the minor beneficiary rule applies to tax beneficiary income derived by minors at the trustee tax rate (rather than the beneficiary's marginal rate).

24. Trusts can also be used to shelter income from high personal tax rates. If a trust has a 39% rate beneficiary (who could also be a settlor of the trust), income may be accumulated in the trust and taxed at the 33% trustee rate; there is no further tax when the income is later distributed to the beneficiary.

25. Trusts can offer non-tax advantages for those who use them. Settlors can use trusts for family succession planning, to protect assets from creditors and relationship property claims, and to circumvent rules that aim to target government assistance to lower-income people.

26. A settlor can retain enjoyment of trust property by being a beneficiary or having close family members who are beneficiaries. Trusts, therefore, may allow settlors to retain the benefits associated with owning property that has been transferred to a trust while avoiding the burdens and risks of ownership.

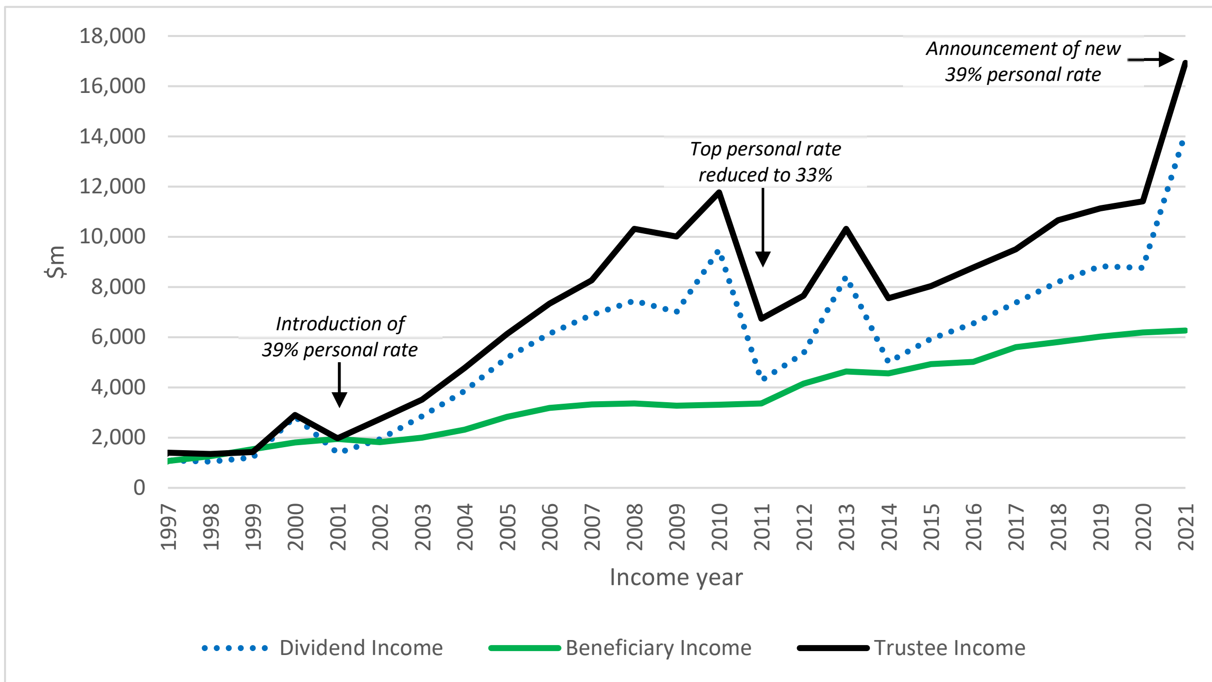
Misalignment in the 2000s

27. Since the introduction of the current tax regime for trusts in 1989, the trustee tax rate has been 33%. This rate was chosen intentionally to achieve alignment with the top personal rate, and it has only fallen out of alignment during the two periods since 2000 when the top personal rate was 39%.

[1] Excludes a Medicare levy of 2%, which applies to both personal income and trustee income.

[2] The 37% rate applies to trustee income over $13,450 derived by non-grantor trusts. Trustee income derived by grantor trusts, which are trusts effectively controlled by the settlor, is taxed at the personal tax rate of the settlor.

Figure 1: Income reported by trusts (1997 – 2021)



28. Figure 1 shows how significant amounts of income were diverted into trusts and taxed as trustee income when the personal tax rate was raised to 39% in 2000 but the trustee rate remained at 33%. Much of the growth of trustee income was in the form of dividends. From 2022, the top personal tax rate has again been higher than the trustee rate. In advance of the 39% rate taking effect, companies paid out higher than usual dividends so that trusts or individual shareholders would earn the dividends before the 39% personal tax rate took effect.

29. Approximately 180,000 domestic trusts report assessable income. In the 2021 financial year, total income derived by domestic trusts (including estates) was $23,300m. This was split between $6,300m beneficiary income (27%) and $17,100m trustee income (73%).

Table 3: Proportion of beneficiary and trustee income

	FY2020	FY2021
Number of trusts *(excluding trusts with nil income)*	182,000[3]	177,000[4]
Beneficiary income	$6,200m (35%)	$6,300m (27%)
Trustee income	$11,400m (65%)	$17,100m (73%)
Total income	$17,600m	$23,300m

30. Most trustee income is concentrated in a relatively small number of trusts. Table 4 shows that, in the 2021 financial year, 177,000 trusts reported assessable income (i.e.,

[3] Including approximately 19,000 estates and 400 foreign trusts.
[4] Including approximately 17,000 estates and 300 foreign trusts.

either beneficiary income or trustee income). Of these trusts, only 5% (9,000 out of 177,000) accounted for 78% of trustee income ($13.3 billion out of $17.1 billion).

Table 4: Trustee income reported by trusts with assessable income

	FY2020		FY2021	
Trustee income per trust	*Number of trusts*	*Aggregate amount of trustee income*	*Number of trusts*	*Aggregate amount of trustee income*
Nil	47,000 (27%)	Nil	43,000 (24%)	Nil
Up to $180,000	123,500 (66%)	$2,500m (22%)	120,000 (68%)	$2,500m (14%)
Over $180,000	11,500 (6%)	$8,900m (78%)	**14,000** (**8%**)	**$14,600m** (**86%**)
Total	182,000	$11,400m	**177,000**	**$17,100m**

31. Inferences on whether trusts have 39% rate settlors and/or beneficiaries should not be drawn from the breakdown of trusts (by trustee income) in Table 4. The breakdown does not take into account the number of settlors or beneficiaries of a trust, nor does it consider their personal income. However, the data does show that most trustee income is derived by a small proportion of trusts, and that a large proportion of trusts derive comparatively small amounts of trustee income.

Under-taxation of trustee income

32. Aligning the trustee tax rate with the top personal tax rate at 39% would be the most effective way of addressing the under-taxation of trustee income within the existing regime for trusts.

33. A small proportion of trusts would pay most of the additional tax. For trusts with assessable income in the 2021 financial year:

- *Trustee income is concentrated in a small number of trusts:* The top 5% of trusts in terms of trustee income (9,000 out of 177,000) accounted for 78% of trustee income ($13.3 billion out of $17.1 billion).

- *Most trusts have relatively small amounts of trustee income:* The lower 75% of trusts in terms of trustee income (133,000 out of 177,000) accounted for only 2.5% of trustee income ($0.4 billion out of $17.1 billion). This includes the lower 24% of trusts with assessable income (43,000) that reported only beneficiary income (i.e., they had no trustee income), so would not be impacted by a change in the trustee rate.

34. Even if the trustee rate is aligned with the top personal rate at 39%, there will continue to be opportunities to circumvent that rate by substituting trusts with companies or portfolio investment entities (PIEs). Companies and PIEs both have lower tax rates than the top personal tax rate and face similar misalignment issues.

35. However, trusts are a completely different legal structure from companies and PIEs, and they are not complete substitutes. This reduced level of substitutability means changes to the trust taxation rules, even without changes to the PIE and company taxation rules, would be a worthwhile step forward in addressing misalignment in the

tax system. Raising the trustee rate to 39% would still raise revenue in a relatively low-cost way, while better meeting the Government's distributional objectives.

Income allocations to corporate beneficiaries

36. To buttress a 39% trustee tax rate, we also recommend taxing certain beneficiary income allocations to companies at the 39% trustee tax rate. Affected allocations would be those where a settlor of a trust has natural love and affection[5] for a (direct or indirect) shareholder of a close company.[6] This is to ensure the proposed rule is targeted towards family trusts and would not affect the commercial use of trusts in large corporate groups.

37. The objective of this rule would be to prevent trustees circumventing a 39% rate by sheltering income in corporate beneficiaries. Under current law, income allocated to a company as a beneficiary of a trust is beneficiary income and is taxed at 28%. Using corporate beneficiaries to prevent the trustee tax rate applying is a major issue in Australia, where there is a large difference between the trustee and corporate tax rates. It is particularly appropriate to apply a 39% trustee tax rate where the trust is also directly or indirectly the shareholder of the corporate beneficiary, because the income effectively remains in the trust despite the allocation.

Over-taxation of trustee income

38. Some trusts with lower-rate settlors and beneficiaries may be over-taxed if the trustee rate is increased to 39%. However, we expect that any over-taxation that could arise with a 39% trustee rate can be mitigated by existing rules in most cases.

39. Existing rules allow income of a trust to be taxed at a beneficiary's marginal rate if the income is paid or allocated to the beneficiary as beneficiary income (see paragraph 20 above). Our recommended approach to mitigating over-taxation relies on this existing mechanism.

40. Allocating income as beneficiary income seems to be well understood by trusts; in the 2021 financial year, 79,000 trusts disclosed beneficiary current account net balances of $20 billion in aggregate. These are amounts of income that trustees have allocated as beneficiary income but have not yet paid out to beneficiaries.

41. It will be important to explain how taxpayers can use this mechanism to mitigate any over-taxation that could arise with a 39% rate when these proposals are introduced.

Impacts of allocating income as beneficiary income

42. There will be instances where allocating income to beneficiaries is problematic or costly for trusts. For example, the trustees may lack information on beneficiaries'

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[5] "Natural love and affection" is an existing concept in tax law. It relates to an action by a person where the motive is induced not by a promise or something in return, but by the natural love and affection the person has for another. Natural love and affection is generally considered to subsist between relatives, whether by blood, marriage, a non-spousal domestic relationship, or adoption. It can be present between close friends as well, although not ordinary acquaintances or colleagues.

[6] A "close company" is a company where five or fewer natural persons or trustees hold more than 50% of the voting interests (treating associated persons as one person).

personal tax rates, or they may have not yet determined which beneficiaries to allocate income to.

43. Beneficiary income impacts on beneficiaries' social policy obligations and entitlements, such as Working for Families and Child Support, so trustees will also need to consider potential social policy impacts when deciding whether to allocate income derived by a trust as beneficiary income. This could result in trustees incurring increased compliance costs in determining whether to allocate income as beneficiary income, although this decision already needs to be made under current law.

44. Due to there not being advance public consultation, there may be other barriers to mitigating over-taxation that we have not yet identified, which can be addressed during the Select Committee process.

Specific modifications to mitigate over-taxation

45. We recommend including modifications for estates (which are taxed as trusts) and trusts for disabled people to help ensure they are not over-taxed as a result of the proposed 39% trustee tax rate.

Estates

46. An estate may not be able to use existing rules to mitigate over-taxation if the affairs of the deceased person are still being worked through, particularly if it takes an extended period to determine who the beneficiaries of the estate are. It is likely that some estates are already overtaxed under a 33% trustee tax rate, and this over-taxation would be exacerbated with a 39% rate.

47. For income received by an estate within 12 months of a person's death, we recommend allowing the estate to choose to have the income taxed at the deceased person's marginal tax rate.[7] While 12 months may not be long enough for more complicated estates, there is a risk that a longer period may incentivise estates to retain income rather than distributing it to beneficiaries. Engagement with stakeholders once the proposals are announced would help refine how long this modification should apply for.

Trusts for disabled people

48. Some trusts are established to provide for disabled people ("disability trusts"), and there may be non-tax reasons why these trusts cannot allocate all their income as beneficiary income to mitigate over-taxation. However, we have limited data on how, and the extent to which, trusts are used to support disabled people.

49. To ensure disability trusts are not over-taxed, we recommend a modification that would allow trustee income of disability trusts to be taxed at a disabled beneficiary's marginal tax rate in the year income is derived by a trust. No further tax would be payable on the income when it is later distributed to the disabled beneficiary. This is broadly

[7] Where the 12-month period spans multiple income years, the deceased's marginal tax rate would apply in the income year in which the person died, and the personal tax scale would apply to trustee income received in the income year after the person's death.

consistent with the approach taken in other countries (such as Canada, Australia, the US, and the UK), which also have regimes specifically for these trusts.

50. The modification would have the following key design features:

Table 5: Recommended design features for disability trusts

Recommended design feature	**Explanation**
To qualify for the modification, a disability trust would be required to have only one beneficiary, who must – at any point during the relevant income year – either receive the Supported Living Payment on the ground of restricted work capacity or be a person (under 18 years of age) for whom the Child Disability Allowance is paid.	This feature would ensure the modification is targeted to disabled people, by linking eligibility for the modification to receipt of support payments for disabled people from the Government. Requiring these trusts to only have one beneficiary ensures it is clear whose marginal tax rate should apply to trustee income.
To qualify for this modification, a disability trust's deed must not allow any additional beneficiaries, apart from "residual beneficiaries", to be added to the trust. A "residual beneficiary" is a beneficiary who can only receive property from a disability trust after the disabled beneficiary has died. If a disability trust is wound up while the disabled beneficiary is still alive, any remaining trust property at that time must go to the disabled beneficiary.	Not allowing further beneficiaries to be added to the trust helps ensure the modification only benefits the disabled beneficiary of a disability trust. Allowing these trusts to have residual beneficiaries recognises that when a disabled beneficiary dies, any remaining trust property will need to be distributed. It seems appropriate to allow any remaining property to go to other people if the disabled beneficiary has died, even if those people are not disabled and/or are on different marginal rates.
There would be no restrictions on: • the number of trusts that can be settled for a disabled person, • who can settle property on these trusts, or • what property can be settled.	Regimes in other jurisdictions place additional restrictions on disability trusts, likely because the primary objective of those regimes seems to be providing social assistance (rather than mitigating over-taxation). Given the objective of the proposed modification is to mitigate over-taxation for disability trusts, we do not recommend any further restrictions.

Cases where over-taxation may arise but we do not recommend modifications

51. A 39% trustee tax rate may result in over-taxation for widely-held trusts, energy consumer trusts, or superannuation funds that are subject to the trustee tax rate. However, we do not recommend any further modifications at this stage.

Widely-held trusts

52. "Widely-held trusts" are trusts that have a large number of beneficiaries (e.g., more than 100). Simply because a trust has a large number of beneficiaries should not be a reason in itself for an exclusion from the 39% trustee rate. Generally, existing mechanisms should be sufficient to address risks of over-taxation for these trusts.

Energy consumer trusts

53. Energy consumer trusts (ECTs) hold the shares of electricity distribution companies on behalf of electricity consumers, who are the beneficiaries of these trusts. Without further consultation it is difficult to identify any specific constraints or barriers for ECTs. We recommend applying the 39% rate to these trusts until officials can engage with this sector to inform further advice on whether special rules should apply.

54. While it is likely that many beneficiaries of ECTs would have marginal tax rates below 39%, we expect that ECTs, like other trusts, would be able to allocate income as beneficiary income to mitigate over-taxation. By value, most income of ECTs is beneficiary income (87% in 2021). It is difficult to determine at this stage why some smaller ECTs retain all their income as trustee income.

Superannuation funds that are taxed as trusts

55. We do not recommend introducing special rules for the small number of superannuation funds that are taxed as trusts (the large majority of superannuation funds, like KiwiSaver, are taxed separately under the portfolio investment entity (PIE) rules). Although superannuation funds cannot use the beneficiary income allocation mechanism, we do not recommend a modification as most of these funds are likely to have 39% rate beneficiaries. An estimated 275 superannuation funds are taxed as trusts. 239 of these are single-person superannuation schemes, of which 211 were set up by judges, coroners, and Members of Parliament.

Financial implications

56. Increasing the trustee rate to 39% for the 2024–25 and later income years (beginning 1 April 2024 for most trusts) is estimated to raise approximately $350 million per annum ($1,133 million over the forecast period). However, this estimate is highly uncertain and heavily dependent on the behavioural response by trusts. The timing lag relates to information flows: the first year of affected tax returns needs to be filed before the additional income tax is recognised, and the second tax year and part of the third tax year is simultaneously accrued on the basis of that new information.

57. Providing a modification for estates is expected to have a fiscal cost of $5 million per annum for the 2025/26 and later fiscal years. The modification for disability trusts has no fiscal impact.

Table 6: Financial implications of the proposal

	$ million – increase/(decrease)					
Vote Revenue	2022/23	2023/24	2024/25	2025/26	2026/27 & outyears	Total
Crown revenue and receipts:						
Tax revenue						
39% trustee rate	-	-	13.000	770.000	350.000	1,133.000
Estates modification	-	-	-	(5.000)	(5.000)	(10.000)
Total revenue	**-**	**-**	**13.000**	**765.000**	**345.000**	**1,123.000**
Total operating	**-**	**-**	**(13.000)**	**(765.000)**	**(345.000)**	**(1,123.000)**

58. Increasing the trustee rate will have a consequential impact on the impairment of debt and debt write-off expenditure with a corresponding increase on the operating balance and net debt.

Table 7: Financial implications of the proposal – impairment of debt and debt write-off

	$ million – increase/(decrease)					
Vote Revenue	2022/23	2023/24	2024/25	2025/26	2026/27 & outyears	Total
Non-departmental other expenses:						
Impairment of debt and debt write-off	-	-	0.100	2.900	1.300	4.300
Total operating	**-**	**-**	**0.100**	**2.900**	**1.300**	**4.300**

Administrative implications

59. Implementation and ongoing administrative costs are as follows:

Table 8: Administrative implications of the proposal

	$ million – increase/(decrease)					
Vote Revenue	2022/23	2023/24	2024/25	2025/26	2026/27 & outyears	Total
One-off build costs	-	0.700	-	-	-	0.700
Ongoing admin costs	-	0.800	3.300	2.700	0.600	7.400
Total operating	**-**	**1.500**	**3.300**	**2.700**	**0.600**	**8.100**
Capital expenditure	-	2.900	-	-	-	2.900
Total capital	**-**	**2.900**	**-**	**-**	**-**	**2.900**
Total	**-**	**4.400**	**3.300**	**2.700**	**0.600**	**11.000**

60. The operating costs for this initiative include additional resource capacity, one-off implementation costs, depreciation, and capital charge. The resource impact of this initiative is six FTEs in 2023/24, 25 FTEs in 2024/25 and 19 FTEs in 2025/26. This predominantly relates to responding to customer queries (both about the changes and around the auto-calculation period), enquiries from tax agents, and compliance activity for return filing and non-compliant trusts. From 2026/27 these activities will reduce and be absorbed within business-as-usual activities, with no additional funding required. The ongoing funding impact from 2026/27 is for depreciation and capital charge.

61. Inland Revenue will self-fund the departmental capital and operating cost of this initiative.

Legislative implications

62. We recommend including the proposals in this paper in a bill to be introduced on Budget night, 18 May 2023. This Bill will go through the normal select committee process and be enacted by 31 March 2024.

Impact analysis

Regulatory Impact Assessment

63. A Regulatory Impact Statement has been completed and is attached to this paper.

64. The Quality Assurance reviewers at Inland Revenue have reviewed the Regulatory Impact Statement: *The Taxation of Trustee Income* prepared by Inland Revenue, and consider that the information and analysis summarised in the Regulatory Impact Statement **partially meets** the quality assurance criteria. This is because, as disclosed in the Limitations and Constraints on Analysis section, the affected stakeholders (trustees, settlors and beneficiaries of trusts) have not had an opportunity to submit on how they would be affected by the options, and there has been no publicity about the proposal to generate any public comment. Accordingly, the analysis of how these stakeholders would be affected is limited and uncertain.

Climate Implications of Policy Assessment

65. The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that the CIPA requirements do not apply to this proposal as the threshold for significance is not met.

Population implications

66. The available data is limited, and additional implications are likely to become apparent once the proposals become public. As shown in Table 4, in the 2021 financial year there were 177,000 trusts that reported assessable income.

    - The top 5% of trusts with assessable income (9,000 out of 177,000) accounted for 78% of trustee income ($13.3 billion out of $17.1 billion). These trusts would pay most of the additional tax.

    - The lower 75% of trusts with assessable income (133,000) accounted for only 2.5% of trustee income ($0.4 billion). This includes the lower 24% of trusts with assessable income (43,000) that had only beneficiary income and would not be impacted by a change in the trustee rate.

Māori

67. We are aware that trusts, like companies, are a convenient vehicle for Māori to transact with the Crown. A number of these commercial structures are subject to specific regulations and statutory constraints. The tax system recognises these constraints and provides a specific set of rules (the Māori authority tax rules) for entities that manage and own Māori communal assets.

68. Māori organisations that are eligible to apply these rules are called Māori authorities and are taxed at 17.5%. We expect most trusts used by Māori for communal ownership purposes would be eligible to be taxed as Māori authorities. We have undertaken limited consultation with Te Tumu Paeroa – The Office of the Māori Trustee regarding the reasons why a trust may choose not to elect to be a Māori authority. Very few trusts handled by Te Tumu Paeroa are not Māori authorities. We expect that an increase in the trustee rate is, in principle, unlikely to impact Māori development outcomes or present a barrier to sustainable prosperity and resilience for whānau Māori and future generations.

Disabled people

69. Some trusts are settled to support disabled people and could be affected by a 39% trustee tax rate. To ensure these trusts are not over-taxed, we recommend a modification that would allow trustee income of these trusts to be taxed at the disabled beneficiary's marginal tax rate in the year income is derived by a trust.

70. Some trusts settled for disabled people may not qualify for this modification because of the proposed eligibility criteria. We expect the qualification criteria for the modification to be refined further as part of the select committee process. To the extent a trust settled for a disabled person does not qualify for the modification, there could potentially be over-taxation if the trust retains income as trustee income. However, like other trusts, we expect these trusts should also be able to allocate income as

beneficiary income to mitigate over-taxation (so that the income is taxed at the beneficiary's marginal rate).

71. We expect the proposed modification and the availability of existing rules to mitigate over-taxation should help ensure this group is not adversely affected by the proposals.

Human rights

72. The proposals comply with the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Consultation

73. Inland Revenue and The Treasury worked closely together in the development of the proposed reform. The Department of the Prime Minister and Cabinet was consulted on this paper.

74. During the development of these proposals, officials undertook limited consultation with the Financial Markets Authority – Te Mana Tātai Hokohoko, the Public Trust of New Zealand, Te Tumu Paeroa – The Office of the Māori Trustee, Whaikaha – Ministry of Disabled People, the Ministry of Justice – Te Tāhū o te Ture, and the Australian Tax Office. The objective of this consultation was to further understand how trusts are currently used to help identify whether modifications to a 39% trustee rate might be required to mitigate over-taxation. Due to the Budget sensitive nature of this work, officials did not explicitly seek feedback on the proposals.

Communications

75. The proposals will be announced as part of Budget 2023. A detailed commentary on the proposals will be released when the Bill is introduced on Budget night. Inland Revenue will include details of the new legislation in a *Tax Information Bulletin* after the Bill is enacted.

76. Tax practitioners will raise concerns that information from the recent trust disclosure rules was not available in time to influence decisions regarding the trustee rate.

Proactive release

77. The Treasury coordinates a proactive release of Budget documents following Budget Day. This release is to improve transparency of the Budget decision-making process. The proactive release of documents will include this paper, and related advice from the Treasury and Inland Revenue.

78. We propose to proactively release the Regulatory Impact Statement, with appropriate redactions, on the introduction of the Bill on Budget night.

Recommendations

The Ministers of Finance and Revenue recommend that Cabinet:

1. **note** that when the Government put in place the new 39% top personal income tax rate in 2021, Inland Revenue and Treasury recommended also increasing the trustee

rate to 39%. Ministers made clear that if analysis indicated high income earners were circumventing the rate through greater use of trusts, that the government would move to address this issue;

2. **note** that analysis of taxpayer activities before the 39% top personal income tax rate came into force, as well as historical analysis, indicates that high income earners using trust structures would likely not have been fully subject to the increase in the top personal tax rate;

3. **agree** to increase the trustee tax rate to 39% for the 2024–25 and later income years (beginning 1 April 2024 for most trusts);

4. **agree** to tax beneficiary income that is paid or allocated to a corporate beneficiary at the 39% trustee tax rate, where the corporate beneficiary is a close company and a settlor of the trust has natural love and affection for a direct or indirect shareholder of the corporate beneficiary;

5. **agree** to allow income derived by an estate within 12 months of the deceased person's date of death to be taxed at the deceased's marginal tax rate;

6. **agree** to include a modification for trusts for disabled people, which would allow trustee income of an eligible trust to be taxed at the marginal tax rate of the trust's disabled beneficiary;

7. **authorise** the Minister of Finance and Minister of Revenue to make additional joint decisions on policy and drafting issues arising for these proposals;

Financial implications

8. **note** the following estimated increase in tax revenue, totalling $1,123.000 million over the forecast period, as a result of the decisions at recommendations 3 to 7, with a corresponding impact on the operating balance and net debt:

	$ million – increase/(decrease)					
Vote Revenue	2022/23	2023/24	2024/25	2025/26	2026/27 & outyears	Total
Crown revenue and receipts:						
Tax revenue	-	-	13.000	765.000	345.000	1,123.000
Total revenue	**-**	**-**	**13.000**	**765.000**	**345.000**	**1,123.000**
Total operating	**-**	**-**	**(13.000)**	**(765.000)**	**(345.000)**	**(1,123.000)**

9. **approve** the following consequential impact of $4.300 million on the impairment of debt and debt write-off appropriation, resulting from the additional tax revenue, with a corresponding impact on the operating balance and net debt;

	$ million – increase/(decrease)					
Vote Revenue	2022/23	2023/24	2024/25	2025/26	2026/27 & outyears	Total
Non-departmental other expenses:						
Impairment of debt and debt write-off	-	-	0.100	2.900	1.300	4.300
Total operating	**-**	**-**	**0.100**	**2.900**	**1.300**	**4.300**

10. **agree** that the impacts outlined above in recommendations 8 and 9 will be managed against the Budget 2023 operating allowance;

Administration implications

11. **note** that the estimated costs of the up-front build and on-going administration of the proposal is up to $11 million, being $2.900 million capital and $8.100 million operating over the forecast period (2022/23 to 2026/27);

12. **agree** that the departmental capital and operating costs of this initiative referred to in recommendation 11 will be self-funded by Inland Revenue;

13. **delegate** authority to the Minister of Finance and Minister of Revenue to agree the detailed appropriation-level recommendations necessary to give effect to recommendations 3 to 12 above, for Budget 2023;

Legislative implications

14. **authorise** the Minister of Revenue to introduce a Bill containing the measures referred to in recommendations 3 to 7; and

15. **note** that the Bill referred to in recommendation 14 is scheduled to be introduced on Budget night, 18 May 2023, will go through the normal select committee process, and be enacted by 31 March 2024.

Authorised for lodgement

Hon Grant Robertson
Minister of Finance

Hon David Parker
Minister of Revenue