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Increase in the trustee tax rate to 39%

The Government announced the 2023 Budget on 18 May 2023 and there is one key take-home point for trustees of income earning trusts : the trustee tax rate will be increased to a flat rate of 39% from 1 April 2024.

As a result of IRD monitoring trusts and discovering that since the individual tax rate went to 39% for income over $180,000, there has been a 50% spike in trust income, the trust tax rate is to increase from 33% to 39% for every dollar of Trust income for the 2025 year.

So, what does that mean for trustees of income earning trusts?
One helpful point is that IRD have confirmed that distributing income to beneficiaries on lower tax rates isn't going to be viewed as tax avoidance. So, for Trusts and beneficiaries with income on the lower end of the scale, the 39% may not cut too deep. However, it's good to keep in mind that Trusts aren't just a tax reduction tool. They are a legal vehicle used to protect assets from potential creditors or relationship property claims against pre relationship assets. They are also often a method of ensuring the assets of a person are passed on to certain family members or used in a particular fashion different from a Will after that persons death. Distributing income to sidestep tax needs to be balanced with the purpose of the Trust.

Trustees should first and foremost be considering the purpose of the trust and the overall benefits it holds for its beneficiaries. While there are various reasons for holding assets in trust, some key reasons include succession and estate planning, providing controlled financial support for specific people, and family asset protection from potential claims (including those resulting from director liability).

For Trusts owning the majority of shares in companies with retained earnings, in anticipation of the 39% tax rate for the 2025 income year, consideration will need to be given to declaring any dividends and what needs to be considered when determining how much to distribute to beneficiaries.

Why the change?
The current trustee tax rate of 33% has been in place since 1989, which was deliberately aligned with the top personal tax rate at that time. But in 2020, a new top tax rate of 39% for personal income over $180,000 was introduced. The trustee tax rate was not adjusted at that time. Since the trustee tax rate is a final tax, some individuals can obtain a tax advantage by earning income through a trust, because this allows them to get around the 39% personal tax rate. The Government is aligning the trustee and top personal tax rates at 39% with the objective of ensuring that trusts cannot be used to pay less than the top personal tax rate.

Mitigating over-taxation
Current law however, allows settlors and beneficiaries on lower personal tax rates to mitigate over taxation. The income of a trust can be taxed at a beneficiary's personal tax rate if the income is paid or allocated to the beneficiary as beneficiary income.

Deceased estates
In the situation where a deceased person's affairs are still being settled, the estate (which is taxed as a trust) may be unable to allocate income to beneficiaries as beneficiary income. Special rules for estates are proposed to allow trustee income to be taxed at the deceased's personal tax rates for 12 months to help address this.

UPCOMING TAX DATES

21 August 2023
July 2023 PAYE Due

28 August 2023
Provisional Tax Payments Due

28 August 2023
GST Payments for the Period Ending 31 July Due

20 September 2023
August 2023 PAYE Due

28 September 2023
GST Payments for the Period Ending 31 August Due

Deductibility of holding costs for land

Inland Revenue has issued a draft interpretation statement on the deductibility of holding costs for land i.e., interest, rates, and property insurance expenses.

The deductibility of holding costs has been an area of uncertainty since the bright-line test was introduced in 2015.

Inland Revenue's view is that holding costs incurred on land that is not revenue account property and is not rented out — but is taxed on sale — are not deductible.

Livestock — Explaining the Valuation Methods

Herd Scheme

The theory underlying the herd scheme is that the livestock (Herd) are a capital asset. It therefore follows that the movement in livestock values should not be assessable income. Changes in numbers and classes of livestock only are assessable.

Around the end of May each year Inland Revenue announces the Herd Values (National Average Market Values) for each class of livestock. These values are calculated from a survey of livestock values throughout the country as at the 30th of April each year.

This year we have seen a mixed bag with sheep and female dairy values falling, but most other values rising on strong demand for commodities. The fall in values for female dairy cattle can be explained by the prohibition of the export of livestock by sea from 30 April 2023 which impacts dairy cattle more than other livestock classes. This has seen the Herd Value for R1 heifer drop below the NSC value, which has not happened before. Contrast the fortunes of R1 heifers with R1 Steers & Bulls which increased by 21.6%. A mixed age dairy cow is now valued at $1,628. Sheep values whilst falling back are still among the highest values that they have ever been.

The Herd Scheme allows you to value both your opening and closing livestock at the same value per head. This is done by making a 'tax free' adjustment (increase or decrease) to the opening livestock. The adjustment is made to the livestock on hand at the opening day of the financial year and therefore removes any taxable income due to changes in values of livestock.

The theory behind the Herd scheme means that there should not be a huge tax liability created upon the sale of the herd. However, because the Herd livestock adjustment affects next year's opening livestock values it is important that your accountant knows what your thoughts or plans are regarding your livestock ownership.

Once you elect to enter the Herd Scheme there are very limited circumstances where you can exit. This was a move introduced by Inland Revenue to stop people moving back and forth between the various schemes. You do still have the option of using an alternative valuation method for any increases in numbers.

National Standard Cost Scheme

The NSC Scheme is a cost of production-based system. NSC values are determined by Inland Revenue after looking at and analysing the cost of production for all types of livestock. Values are released for the Breeding, Rearing and Growing (BRG) cost to get an animal to where it is a Rising One year. A further value is then applied for Rearing and Growing (RG) the animal for a further year to a Rising Two year. At that point it is classed as a mature animal. No further increases in value apply from that point onwards.

NSC values are released at the end of February and are based on farm input cost information collected by industry bodies. The nature of the data collection means that there is a lag in NSC values compared to the costs actually being incurred on farm.

A farmer applies the NSC values to homebred stock while all purchased stock is valued at purchase price. The average of these costs is applied to year-end stock on hand to obtain a closing value.

Because the NSC scheme is a 'cost based' scheme a farmer will typically have a lower cost per animal recorded in the financial statements. This means that when stock is sold there may be assessable income created - i.e. the difference between market value and book value. If you are using the NSC valuation option and you sell all or part of your herd, there may be a considerable tax liability created. NSC can be used in conjunction with the Herd Scheme. For this reason, it is quite common for farmers to place additional livestock in the NSC Scheme, particularly when Herd Scheme Values are perceived to be quite high.

Our recommendation

There are also other less common valuation methods available to be used. The decision as to which valuation option to take is an important one. Livestock valuation is a complex area, and it requires an individual approach - each farmer's circumstances will be different from those of another.

We will discuss your livestock valuation choices with you and make some recommendations. It is important you understand your options and the pros and cons of each scheme.