

Tax Changes



FAMILY TRUSTS AND TRUSTEES ARE IN THE GOVERNMENTS SIGHTS

The Government is showing an increasingly anti-family trust sentiment, trustees believe. Lately there have been 5 proposals/ changes aimed at trusts.

1. The Inland Revenue, Treasury and MP's appear to be lining up trusts for a tax grab to balance ambitions to reduce the company rate to 30%. But potentially lifting the top trust tax rate from 33% to 36%.
2. When the government announced plans for a new capital gains tax on overseas shares, it said portfolios under \$50,000 would be exempted. But not trusts as the government feared people would set them up to hide overseas shares.
3. Also the Charities Act 2005 requires charitable trusts to register with the IRD by 1 July 2008 to keep their tax-free charitable status. Why - fear that commercial operations are posing as charitable foundations.
4. The Government has also proposed new foreign trust disclosure rules requiring NZ-based trustees to disclose financial details of overseas trusts they serve.

5. The implementation of a race based tax scheme giving tax concession exclusively to Maoris.

These are only one of a number of policy moves which indicate growing official hostility to trusts, New Zealand Trustees Association said

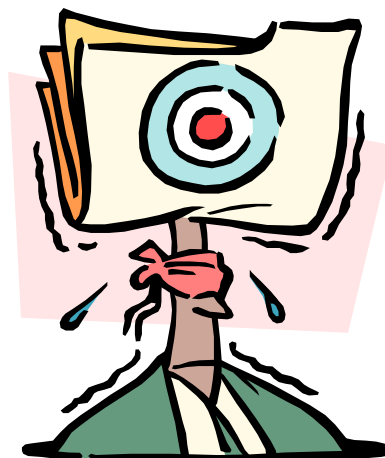
So why are trusts in the government's bad books?

Revenue Minister Peter Dunne told *Sunday Star-Times* that there is evidence trusts are being used as tax shelters by the rich.

Tax take from trusts has risen much faster than from top rate taxpayers, leading to a strong suspicion that income is being retained within trusts to lower tax. There's also a suspicious clustering of incomes around the \$60,000 threshold for the top tax rate, Dunne said.

Those findings came out of an IRD ministerial briefing, which has quietly inquired into the impact of the growth of family trusts on the tax-take.

However, lifting the trust tax rate from 33% to 36% while dropping the top personal rate from 39% to 36%, and the company tax from 33% to 30% would only lead to an increase in tax-planning activities.



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TRUSTEES CALLED TO ARMS AGAINST THE GOVERNMENT & IRD

Trustees of the Nation rise up and unite against Inland Revenue proposals to raise tax on trust income, or fail in your legal duties and obligations, the New Zealand Trustee Association is warning.

“We are telling trustees that they have a duty to oppose this tax,” said chief executive Errol Anderson, who is planning to run a series of newspaper adverts to persuade trustees of family trusts to contribute to a fighting fund to lobby against raising the top trust tax rate to 36% from 33%.

“They are responsible for protecting the income and capital in their trusts, and they must take action to oppose this income in tax,”

He said there were two options for trustees wanting to join the fight: make a one-off donations direct to the association by ringing its helpline, or paying the \$55.50 to become a family trust member of the association.

The association’s fears are based on this paragraph from the Business Tax Review, released in July:

“The government acknowledges that company tax rate changes may have implications for the design of the wider income tax system. For example, briefing papers to the Minister of Revenue discussed proposals which would combine a reduction in the company tax rate to 30% with a corresponding reduction of the top personal marginal tax rate to 36% and an increase on the trustee rate to 36%.”

Anderson believed a Labour government with a slim grasp on power would not be so foolhardy as to propose an increase in trust tax before the next election and risk alienating the massive number of New Zealand voters who are either a trustee or a settler of one of the nation’s approximately 244,000 family trusts, but it needed to be sent the message that New Zealand’s trustees were not a pushover.

TAX CHANGES UNFAIR AND IMPOSSIBLE TO POLICE

To stay under the \$50,000 threshold many trustees will need to sell their offshore investments leaving them with only New Zealand and Australia investments.

The concerns with this proposal is that:

- a) Trustees are required to maintain a balanced portfolio and many believe that only having New Zealand and Australia investments is not balanced.
- b) The complicated nature of the charges that arise from the calculation of the capital gain

portions. At present this is set at 85% of the change in value, and capped at 5% each year. The 5% cap is a concession to help smooth out the tax effect of volatile sharemarkets - but the result is to make calculating tax owed much more complex.

- c) The difficulty is the IRD policing this area - even professional accountants have said they struggle with the calculation so how will trustees cope?
- d) The tax on unrealised gains.

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TAX PROPOSALS PUT FAMILY TRUSTEES IN THE GUN

Being Prudent could get you sued

Warnings have emerged that the government's proposed changes to the investment tax regime could put trustees in the legal firing line from trust beneficiaries.

The tax changes would, if implemented, require a rebalancing of investment portfolios. This would include family trusts that hold shares.

Family trusts with investments would have to rebalance their portfolios - and if they failed to do so beneficiaries would be able to sue trustees as in the Trustee Act requires trustees to prudently look after trust assets.

The Act also includes an obligation on trustees to diversify investments and to have regard to tax liabilities.

If these tax changes - which include extending the offshore capital gains tax to all offshore investments except portfolio investments in Australia are passed - then that would require a large change for many trusts.

"You've got a regime coming along which is going to impact on the tax liabilities of the trusts and the trustees are going to have to take that into account."

If the changes went through as they stood. "It is likely to have the effect of pushing trustees out of global shares and into more local assets as New Zealand and Australian shares and rental properties."

However, this would be a difficult decision for trustees to make because as well as having to take into account tax liabilities they also have to be prudent investors - which means taking a reasonably diversified approach.

"It is to be hoped that the government will reconsider its proposals and that trustees who already shoulder significant responsibilities will not have life made anymore difficult for them," he said.

"Every trust has its own particular circumstances and reasons for making decisions one way or another. But the fact of the matter is trustees will have to do a lot of thinking about what is the most prudent approach to this and they will have to take the tax changes into account."

It is going to create a significant amount of activity and it will incur huge expenses for little or no benefit or value to the trustees.

What the law says (s13E Trustee Act)

A trustee exercising any power of investment may have regard to (among others):

- The desirability of diversifying trust investments.
- The nature of existing trust investments.
- The need to maintain the real value of the capital or income of the trust.
- The marketability of the proposed investment during, and on the termination of, the term of the proposed investment.
- The effect of the proposed investment in relation to the tax liability of the trust.

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CULLEN MUDDIES WATER WITH RACE-BASED TAXATION

Just when the Government thought it was safe to go back into troubled waters of tax policy, another feisty stingray has shown up to greet it.

The proposed capital gains tax on overseas investment has mobilised thousands of investors to fight back. Their tax revolt may soon be joined by hundreds of thousands of people with family trusts, if the New Zealand Trustees Association (NZTA) has its way.

The Labour-led government has had a fraught relationship with family trusts. Previous revenue minister Michael Cullen slapped the corporate tax rate of 33% on minors that were family trust beneficiaries. His reasoning at the time was couched in his usual bash-the-rich-tax-evaders rhetoric.

Moreover, and this is an issue the NZTA may wish to tackle in its anti-36% campaign, New Zealand must be one of the few countries in the world to impose a racist taxation regime. Not content with taxing children as corporates, Dr Cullen had the law changed so that beneficiaries of Maori tribal trusts could be taxed at their personal marginal rate.

The tax regime applicable to trust beneficiaries in this country is thus dependant on racial ancestry. A Maori trust beneficiary can be taxed at 19.5% on trust income, while everybody else pays 33% and soon 36% if the government gets its way.

The government has just announced its intention to create yet another exclusive break for Maori. Dr Cullen has undertaken to change the law next

year so that Maori trust beneficiaries can receive trust income without offsetting the impact on their social welfare benefit payments.

He told tribal trust representatives: "I want to assure you that work is under way to ensure [iwi trust distributions] will not be taken into account when assessing [Maori tribal] members eligibility for social assistance.

"In line with other reforms we are also mindful that these distributions should be subject to a final withholding tax based on the marginal tax rate of a member.

"The government is now considering generic legislation to be introduced next year to cover these issues and officials will work with you on the design of the new rules."

A campaign focused only on the 36% rate to be applied to trusts that do not get race based tax break deals with just half of the story. Any review of trust should be addressing why New Zealand needs a two-tiered system driven by race.

If the NZTA is correct that the government wants to fund a cut in corporate tax by sending the bill to family trusts, the question must be asked as to why beneficiaries of Maori trusts will not be making their fair share of contribution but instead will hitch a free ride.

Ideally, any trust tax campaign worth its salt will be demanding all trusts get the same treatment as Maori trusts.

ACKNOWLEDGEMENT

The above articles includes extracts from the following published articles:

Family Trust in firing line - Rob Hoskings/ National Business Review

Trustees called to arms - Rob Stock/ Sunday Star Times

Tax Proposals - Rob Stock/ Sunday Star Times

Cullen Muddies Water with Race Based Taxation - Michael Coote/ National Business Review

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