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Private Wealth 2021

New Zealand
Trends & Developments
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Trends and Developments

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Introduction

In 2020, private wealth professionals in New Zealand had to grapple with the immediate practicalities of working within the confines of a COVID-19 environment. A number of new laws were passed to enable business to continue while finance was uncertain and in-person meetings could not be held.

In New Zealand, the health outcome has to date been relatively successful, due in part to the country's elimination strategy. This has resulted in New Zealand enjoying freedom of movement within the country with relatively few periods of lockdown. As New Zealanders have returned to a more normal way of living, other factors have overtaken the immediate issues raised by COVID-19.

Trust Act 2019

The Trusts Act 2019 has been in force since January 2021. New Zealanders are getting used to the change in language that the new legislation has introduced. Cases relying on the Trusts Act 2019 (Act) are now beginning to be decided in the courts.

In a recent case in the High Court of New Zealand, Michael Anthony Talijancich & Ors v Lorraine Marise Talijancich & Ors [2021] NZHC 753, the trustees of a family trust for a high-profile New Zealand family sought several variations to the Trust Deed under the Act. The Court considered the application of Sections 121–125 of the Act, enabling it to vary the terms of a trust where there were beneficiaries who were not able to act on their own behalf. Although the considerations were relatively procedural it is helpful to practitioners for these sections to start to be

considered by the courts and for the common law to start to develop under the Act.

Housing Crisis and Taxation Changes

The unprecedented levels of world-wide fiscal stimulus and the low interest rate environment continue to have an effect on issues which were present in the New Zealand landscape prior to COVID-19. There is a well-documented housing shortage in New Zealand, and it continues to a very high level of unaffordability, particularly for buyers of first homes in urban areas.

This is an issue which the current Labour government is trying to address through a number of policy levers, including taxation. In line with global moves towards greater transparency due to concerns over equality of taxation, trusts are also coming under increasing scrutiny in New Zealand. As real estate and trusts are inextricably linked in the New Zealand investment landscape, changes which affect one inevitably have an impact on the other.

New Tax Administration Act 1994 Provisions *New requirements*

The most recent of these changes to come into force (from 1 April 2021) are changes which require active trusts to file detailed financial information with their tax return to the Inland Revenue Department (IRD).

From the 2022 tax year (1 April 2021 to 31 March 2022), trustees will need to file the following.

- Financial accounting information, including profit and loss statements, balance sheet items and other information to be specified by the Commissioner (of the IRD).

- Information on distributions and settlements made during the income year.
- In respect of settlements in prior income years, there may be an obligation to disclose, as Section 59BA (2)(c) reads “or whose details have not previously been supplied to the Commissioner”.
- The information required for trust settlements will include identifying information for the settlor such as their name, country of tax residence, IRD or tax number and date of birth.
- The information required for trust distributions will include identifying information for beneficiaries such as their name, country of tax residence, IRD or tax number and date of birth.
- Identifying information (country of tax residence, IRD or tax number and date of birth) 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.

There is also a wide catch-all provision in Section 59BA(2)(f) – “the other information required by the Commissioner”. As at the date of publication (August 2021) the final IRD form has not been set, so there may be other reporting requirements.

Collection of information

Section 59BAB further provides that the Commissioner may request information relating to periods from 1 April 2014. This obligation only applies to trusts to which the Section 59BA reporting requirements apply. The information also has to be in the knowledge, possession or control of the trustee. Therefore, if the Commissioner is requesting information in relation to a distribution to a beneficiary prior to the 2022 tax year, the trustees may be able to respond that the necessary information was not collected at the time of the distribution.

If documenting any settlement or distribution from 1 April 2021, practitioners are well advised to collect the necessary information directly from the settlor or beneficiary at the time of the transaction. This is because chasing the information later when tax returns are due may prove difficult. There is also likely to be increased documentation around settlements and distributions because the person disclosing the information to the IRD will be the trustees. It will therefore be prudent to have the settlor or beneficiary provide the information in writing, confirm the information is true and correct and also acknowledge that the information will be disclosed to the tax authority.

There may also be an obligation to collect this information under the OECD’s Common Reporting Standard (CRS) and if so, such disclosures should also be acknowledged.

Increasing awareness of the source of trust equity

The changes to the Tax Administration Act 1994 will necessitate a change to how trust accounts in New Zealand are prepared. The source of trust equity is no exception. Trust equity in most New Zealand trust balance sheets is presented as a one or two-line item. This alone tells the trustees very little about the source of trust equity.

Practitioners in New Zealand who have been involved with a trust making distributions to an offshore beneficiary will know that it is important to understand what is being distributed. Is it surplus income? Capital gains? Corpus settled on the trust?

The changes to the rules represent an opportunity to better reflect the source of trust equity, which should be separated into the following five key components:

- initial settlement sum;

- further settlements received;
- revaluation reserve (to reflect increases in valuation of assets);
- capital reserve (realised accumulated capital gains); and
- retained earnings (accumulated revenue after taxation).

Both trustees and professional advisors to New Zealand trusts will be able to make more informed decisions relating to distributions and other trust matters when the source of trust equity is clearly presented and tracked. Distributions to beneficiaries that are foreign tax residents can benefit from clear division of trust equity components. This information is also extremely useful if there is an analysis of the trust in respect of claims under the Property (Relationships) Act 1976 for the purposes of a separation. What assets have been settled on the trust and when did that occur?

Non-active trusts

These reporting requirements will not apply to non-active trusts. So, if a trust only holds the family home, which does not generate any income, the reporting is not required. The requirements also do not apply to foreign trusts, charitable trusts and Māori Authorities. Of course, foreign trusts have a separate reporting requirement, and it may well be that the form is similar to that for a foreign trust annual return.

New 39% Tax Rate for Individuals

The anticipated consequence from the extensive borrowing required to support the country's economy during COVID-19 was an increase in the personal tax rate. This has been confirmed and from 1 April 2021 individuals who earn over NZD180,000 are required to pay income tax on the amount exceeding that sum at a rate of 39%.

This leaves a gap between the trustee tax rate of 33% and the individual top tax rate of 39%.

The government has warned that it will be looking carefully at behaviour resulting in the exploitation of that difference and that the general anti-avoidance provisions will apply. The reporting requirements for active trusts under the Tax Administration Act are one of the “integrity measures” that the IRD has adopted. The government has left it open to increase the trust tax rate to 39% as well if it considers that trusts are being used to divert funds towards trust income rather than individual income. Some of the work around these measures has not yet been concluded as the government also announced further reform in the taxation of capital gains resulting from residential housing in April 2021 which is designed to further dampen down speculation in the housing market.

Extension of the Bright-Line Test

The “bright-line” rules apply to the buying and selling of residential property in New Zealand. Any uplift in value on the transfer of residential property is taxable where the property has been acquired in one of three periods.

The first period is between 1 October 2015 and 28 March 2018, where the property is sold within the two-year bright-line period. The second period is between 29 March 2018 and 26 March 2021, where the property is sold within the five-year bright-line period.

From 27 March 2021, property which is acquired and sold within a ten-year bright-line period will be captured, subject to certain exemptions. The government has indicated that one of those exemptions will be if the property is a “new build”. In that case the applicable bright-line period will still be five years. However, the definition of a “new build” has not yet been finalised and is currently under consultation. Generally, it is proposed that residential property would be considered a new build if it is a self-contained dwelling (ie, with its own kitchen and bathroom,

and one that has received a code compliance certificate).

The bright-line rules impact on residential property held through a trust because a transfer from one trust to another (or to an individual) generally resets the bright-line period. The change from five to ten years has given trustees more pause for thought when considering whether to restructure trusts which hold residential property that is not the main home of the settlor. In New Zealand, many people hold second or third homes through a trust which would not qualify as a main home.

A home property held in trust may qualify for the main home exemption, but only if the persons residing in the property are also the main settlors of the trust. These rules are therefore affecting how families choose to fund and provide housing for their family members.

Removal of Interest Deductibility

At the same time as it announced the extension of the bright-line period, the government also proposed that interest deductibility on a mortgage on a residential investment property (acquired before 27 March 2021) will be gradually phased out (as to 25% each year) between 1 October 2021 and 31 March 2025. Given the historic leverage that was available to property investors this will have a significant impact on non-professional investors who have used borrowings to acquire their residential investment property.

The new rules are proposed to apply to the following taxpayers using loans to acquire residential property:

- trusts, partnerships and limited partnerships;
- close companies (where five or fewer people own more than 50% of the company), including look-through companies; and
- any company where residential property makes up more than 50% of its assets and individuals.

The change to the interest deductibility rules is currently under consultation.

Conclusion

The impact of COVID-19 and the changes to government policy to try and ensure a stable domestic economy continue to have an effect on trends and developments in private wealth in New Zealand. The heavy reliance in New Zealand on residential real estate as an asset class for investment and the preponderance of trusts among property owners ensures that any policy adjustments affecting property owners will have an outsize impact on how trusts are considered and used.

Contributed by: Mary Joy Simpson, John Kirkwood and Emma Tonkin, Hesketh Henry

Hesketh Henry is a commercial law firm based in Auckland, New Zealand, with a sector-led focus. The Private Wealth Team comprises three partners, one senior associate and three solicitors. They advise clients on a wide range of services, with a focus on trusts and estates; establishing, administering and restructuring trusts and advising on trust structures; opinions on complex trust issues for existing clients of the firm and referrals from other law firms; preparing and advising on relationship property agreements and help in assisting in the resolution of

relationship property issues; wills and advice on issues that arise relating to wills and estate planning; enduring powers of attorney; administering estates; trust disputes and advice on the establishment and operation of charitable trusts; and establishing family office structures and advice in managing these through the generations. The firm also has a significant practice acting for individuals and families dealing with a wide range of issues that affect their personal, property and business interests.

AUTHORS



Mary Joy Simpson leads Hesketh Henry's Private Wealth Team. Her principal areas of practice are estate planning, trusts, relationship property and estate management. A specialist

in trust law, Mary Joy regularly reviews and provides advice on personal asset management. Mary Joy is often asked to speak at seminars and is a member of the Society of Trust and Estate Planning Professionals. Relationships are important to Mary Joy and she has developed strong and trusting relationships with her clients. Mary Joy also regularly advises charitable organisations on legal and structuring issues.



John Kirkwood is a partner of Hesketh Henry and a highly experienced commercial and trust lawyer with more than 30 years in private practice. He operates at the intersection of

commercial and private wealth law. John's particular expertise is in small to medium enterprise businesses and the business, personal and wealth planning requirements of the people who own and operate them. He has experience across the wide range of legal issues affecting these individuals, with a particular interest in business and trust structuring, succession planning for individuals and exit and transition planning for the businesses they own. John also oversees the estate administration practice.



Emma Tonkin is a partner in Hesketh Henry's Private Wealth Team. She specialises in private wealth, real estate and overseas investment. Emma regularly advises on trust structures, both

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