Hon David Parker, Minister of Revenue

Information Release

Tax Administration (Financial Statements—Domestic Trusts) Order 2022

April 2022

Availability

This information release is available on Inland Revenue's tax policy website at https://taxpolicy.ird.govt.nz/publications/2022/2022-ir-cab-dev-22-sub-0016

Documents in this information release

#	Reference	Type	Title	Date
1	IR-2022-002	Tax policy report	Order in Council: minimum standards for financial statements prepared by domestic trusts	21 January 2022
2	DEV-22-SUB-0016	Cabinet paper	Tax Administration (Financial Statements—Domestic Trusts) Order 2022	2 March 2022
3	DEV-22-MIN-0016	Minute	Tax Administration (Financial Statements—Domestic Trusts) Order 2022	2 March 2022

Additional information

The Cabinet paper was considered by the Cabinet Economic Development Committee on 2 March 2022 and confirmed by Cabinet on 7 March 2022.

Two attachments to the Cabinet paper are not included in this information release as it is publicly available:

- Tax Administration (Financial Statements—Domestic Trusts) Order 2022
- Regulatory impact statement – Minimum standards for financial statements prepared by domestic trusts

Information withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act). Where this is the case, the relevant sections of the Act that would apply are identified. Where information is withheld, no public interest was identified that would outweigh the reasons for withholding it.

Sections of the Act under which information was withheld:

9(2)(a) to protect the privacy of natural persons, including deceased people

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POLICY AND REGULATORY STEWARDSHIP

Tax policy report: Order in Council: minimum standards for financial statements prepared by domestic trusts

Date:	21 January 2022	**Priority:**	High
Security level:	In Confidence	**Report number:**	IR2022/002

Action sought

	Action sought	Deadline
Minister of Revenue	**Agree** to recommendations	28 January 2022
	Authorise the lodgement of the attached Cabinet paper	10 am Thursday 24 February 2022

Contact for telephone discussion (if required)

Name	Position	Telephone
Stewart Donaldson	Principal Policy Advisor	s 9(2)(a)
Carl Harris	Policy Advisor	s 9(2)(a)

21 January 2022

Minister of Revenue

Order in Council: minimum standards for financial statements prepared by domestic trusts

Executive summary

Purpose

1. In September 2021 you gave approval for officials to consult on minimum financial reporting standards for domestic trusts (BN2021/319). Consultation is now complete. This report seeks your agreement to set the minimum standards by Order in Council (OIC).

Background

2. The Taxation (Income Tax Rate and Other Amendments) Act 2020 introduced increased disclosure requirements for trusts to 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.

3. The new rules require trustees of a trust that derives assessable income, and does not fall within a specific exclusion category, to prepare financial statements. This is in addition to requirements to disclose settlors, settlements, distributions and appointer details.

4. An OIC will set minimum standards for the financial statements. This will provide certainty regarding the level of detail to which the statements must be prepared and will impact on the quality of data collected.

Consultation

5. Policy officials undertook targeted and public consultation on the content of the OIC from June to December 2021. Officials also consulted on operational guidance to address practical matters for trustees, which is planned to be issued in an operational statement in March 2022.

6. The main themes arising from the OIC consultation involved a concern about high compliance costs, a preference for a one-year deferral of all disclosure requirements, general support for the OIC, recommendations concerning the definition and extent of relief for small trusts, and suggestions concerning various technical matters including related legislative amendments.

Analysis

7. Officials acknowledge that the trust disclosure rules will result in increased compliance costs. This was addressed in the 2020 Regulatory Impact Assessment (RIA) "Introducing a new top personal income tax rate". The RIA included the recommendation to conduct a post-implementation review of the new disclosure rules. An appropriate time would be in 2023, after trustees using agents have filed

their first returns under the new rules (these trustees have until 31 March 2023 to file their returns for the 2021-22 year).

8. Throughout the OIC consultation process in 2021, policy officials attempted to strike a balance between ensuring the OIC does not generate unnecessary compliance costs and ensuring the Commissioner will have sufficient financial information to meet the objectives of the disclosure rules. We believe the proposed OIC content will achieve this.

9. The proposed key features of the OIC are:

   9.1 **Date of application:** Officials propose that the OIC will apply for the 2021-22 and future income years.

   9.2 **OIC requirements:** Officials propose that the OIC specifies core requirements for financial statements that must be met by all trusts and additional requirements that must be met for trusts that are not small trusts.

   9.3 **Limited relief for small trusts:** Officials propose limited relief in the OIC for small trusts. This would simplify their reporting obligations and significantly reduce compliance costs. However, all trusts will provide the same financial information in forms prescribed by the Commissioner to ensure the Commissioner has sufficient financial information to meet the objectives of the disclosure rules.

   Small trusts would be defined as having less than $100,000 assessable income, $100,000 tax deductions, and $5 million total assets in the relevant income year. The income and deduction thresholds would exclude income and expenditure relating to the residential property bright-line rules. Officials estimate that these thresholds will provide limited relief for approximately 75% or 135,000 out of 180,000 trusts subject to the new disclosure rules.

   9.4 **Asset valuation**: Valuations will be market value, cost or tax adjusted value, at the discretion of the trustees.

   9.5 **Associated person disclosures:** Associated person transactions must be disclosed in the financial statements if not disclosed in prescribed forms. Disclosures will not be required for transactions at market value. The definition of associated person will be the general definition to be consistent with prescribed forms, however the Commissioner's operational statement will accept a best endeavours approach to reporting all associated persons transactions in the first year if information is not available.

10. Officials have recommended three legislative amendments to the trust disclosure rules in the separate policy report for including amendments to the Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill at the Finance and Expenditure Committee stage (IR2022/017 refers).

Timing

11. Officials recommend that the OIC come into force by 31 March 2022. Subject to Cabinet Committee and Cabinet meeting dates, this will require a waiver of the 28-day rule.

12. Officials have been liaising with the Parliamentary Counsel Office (PCO) regarding the drafting of this OIC. Due to the compressed timeframes, there is not sufficient time to obtain Cabinet approval to provide drafting instructions to PCO, and then separately obtain Cabinet Legislation Committee approval to submit the OIC to Executive Council. Officials recommend seeking policy and legislative approval for the OIC in the same Cabinet paper. PCO will begin drafting the OIC following your agreement to the minimum standards set out in this paper.

13. A regulatory impact assessment of the proposed minimum standards will be provided to you before the attached Cabinet paper is lodged with the Cabinet Office.

Recommended action

We recommend that you:

a. **agree** that the minimum standards for financial statements as set out in Appendix A to this report, which will apply to domestic trusts that are subject to the disclosure rules in section 59BA of the Tax Administration Act 1994, should be set by Order in Council.

Agreed/Not agreed

b. **agree** that the Order in Council will apply for income years ending from the date the Order is made.

Agreed/Not agreed

c. **direct** officials to provide drafting instructions to the Parliamentary Counsel Office.

Directed/Not directed

d. **agree** to seek a waiver of the 28-day rule to allow the Order in Council to come into force by 31 March 2022.

Agreed/Not agreed

e. **authorise** the lodgement of the attached Cabinet paper with the Cabinet Office by 10 am Thursday 24 February 2022 for consideration at the Cabinet Economic Development Committee meeting on 2 March 2022.

Authorised/Not authorised

f. **note** that a regulatory impact assessment will be provided to you before the attached Cabinet paper is lodged with the Cabinet Office.

Noted

g. **agree** to the release of the attached Cabinet paper, associated minutes, and key advice papers, within 30 days of Cabinet making decisions, subject to minor redactions under the Official Information Act 1982.

Agreed/Not agreed

s 9(2)(a)

Stewart Donaldson
Principal Policy Advisor
Policy and Regulatory Stewardship

Hon David Parker
Minister of Revenue
/ /2022

Background

14. The Taxation (Income Tax Rate and Other Amendments) Act 2020 introduced increased disclosure requirements for trusts to 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. Amendments to reduce compliance costs for some trusts were subsequently enacted in March 2021 in the Taxation (Annual Rates for 2020-21, Feasibility Expenditure, and Remedial Matters) Act 2021.

15. The increased disclosure requirements apply to trustees of trusts that derive assessable income and are not subject to specific exclusions. These new rules apply for the 2021–22 and later income years and require trustees to include with their annual return:

    15.1 A statement of profit or loss and a statement of financial position

    15.2 The amount and nature of settlements received

    15.3 Settlor details, including details of previous settlors if not previously supplied to the Commissioner

    15.4 The amount of distributions made and details of beneficiaries who received the distributions

    15.5 Appointer details.

16. Officials propose setting minimum standards for the financial statements by an Order in Council made under section 21C of the Tax Administration Act 1994 (TAA). In the absence of minimum standards, there would be uncertainty regarding the level of detail the statements must be prepared to. This would affect the quality of data collected.

17. Two similar Orders have been made under the same section in the past:

    17.1 The Tax Administration (Financial Statements) Order 2014 sets out the minimum standards for financial statements of companies, and

    17.2 The Tax Administration (Financial Statements—Foreign Trusts) Order 2017 sets out the minimum standards for financial statements of foreign trusts.

Impact

18. The total volume of New Zealand trusts has been estimated to be up to 500,000. 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. The financial statement disclosure requirements will primarily affect approximately 55,000 of these domestic trusts. These are trusts that report assessable income to Inland Revenue but do not currently report business income or file any financial statements.

Objectives

19. Officials proposed minimum standards that are consistent with the following objectives:

    - **Minimise compliance costs while supporting policy objectives.** The minimum standards will strike a balance between minimising unnecessary compliance costs and ensuring the Commissioner will have sufficient financial information to meet the objectives of the disclosure rules.

- **Improve the quality of data.** The minimum standards will positively impact on the quality of data collected.

- **Ensure consistency with existing frameworks.** The minimum standards will be consistent with previous minimum standards set for companies and foreign trusts and they will align with accounting principles where appropriate.

- **Follow the proportionality principle.** The minimum standards will be tailored to the size of the trust. Small trusts will not be required to meet all of the minimum standards set for large trusts.

Consultation

20. Policy officials undertook targeted and public consultation on the content of the OIC from June to December 2021. Officials also consulted on operational guidance to address practical matters for trustees. The main themes arising from the OIC consultation were:

    20.1 **High compliance costs.** The new disclosure rules will result in some trusts incurring significant compliance costs. Submitters suggested this could be addressed by legislating a one-year deferral of all of the trust disclosure rules, to allow trustees to structure out of the rules or give them more time to prepare for implementation of the rules. In addition, legislative amendments could provide small trusts an exemption from all of the trust disclosure rules.

    20.2 **Support for OIC.** The proposal to enact an OIC to set minimum financial reporting standards was supported, as it would provide guidance for trustees.

    20.3 **OIC 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.

    20.4 **Technical matters.** Submitters engaged on a range of technical matters that should be required in the OIC, the most significant relating to valuation, associated person disclosures, and disclosures relating to beneficiary accounts.

Analysis

21. The proposed key features of the OIC content, largely supported by submitters and outlined below and in detail in Appendices A and B, are:

    21.1 **Date of application:** Officials propose that the OIC will apply for the 2021-22 and future income years. There are several areas where compliance for the first year (2021-22) could be on a 'best endeavours' basis and these will be addressed in the Commissioner's operational statement. For example, the calculation of opening balances and the reporting of transactions with associated persons. Compliance with the OIC will not impact on the financial information the Commissioner will collect in prescribed forms.

    21.2 **OIC requirements:** Officials propose that the OIC specifies core requirements for financial statements that must be met by all trusts and additional requirements that must be met for trusts that are not small trusts.

    21.3 **Limited relief for small trusts:** Officials propose limited relief in the OIC for small trusts which would be defined using income, expense and asset thresholds. The proposal is to set these thresholds at $100,000 assessable income, $100,000 tax deductions, and $5 million total assets. The income and deduction thresholds would exclude income and expenditure relating to the residential property bright-line rules. Officials estimate that these thresholds will result in 75% (135,000 out of 180,000) of trusts will be classified as small trusts for the purpose of OIC relief. This means small trusts 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 (information to be collected in prescribed forms is summarised in Appendix A).

21.4 **Asset valuation**: Valuations will be market value, cost or tax adjusted value, at the discretion of the trustees. The valuation method for certain assets must be disclosed.

21.5 **Associated person disclosures:** Associated person transactions must be disclosed in the financial statements if not disclosed in prescribed forms. Disclosures will not be required for transactions at market value. The general definition of associated persons will be applied, however for practical purposes the Commissioner's operational statement will accept a best endeavours approach to reporting associated persons transactions in the first year if information is not available to trustees.

21.6 **Beneficiary account movements:** Beneficiary account movement details will not be set out in the OIC but movements disclosed in prescribed forms would, at a minimum, be part of the materials supporting the financial statements.

22. Officials have recommended three legislative amendments to the trust disclosure rules in the separate policy report for including amendments in the Taxation (Annual Rates for 2021-22, GST, and Remedial Matters) Bill at the Finance and Expenditure Committee stage (IR2022/017 refers). These proposed changes will:

22.1 Exclude non-cash distributions that are minor services incidental to the operation of the trust from the disclosure requirements.

22.2 Clarify that the new rules require trusts to disclose the nature of each distribution made by the trustee of the trust.

22.3 Exempt all foreign trusts from the new domestic disclosure rules.

Administrative implications

23. Implementation and on-going administration costs will be met through baseline funding.

Appendix A – Summary of proposed minimum requirements for the preparation of financial statements by domestic trusts subject to section 59BA of the Tax Administration Act

25. The OIC will contain minimum requirements for the preparation of financial statements by trusts subject to section 59BA of the Tax Administration Act 1994 (TAA), as summarised below. For the purpose of the OIC, the term "financial statements" includes any notes and other supporting materials forming part of the financial statements.

Tier 1: Core requirements – for all trusts subject to s 59BA

i. Prepare a statement of financial position and a profit and loss statement.
ii. Apply the double-entry method of recording financial transactions.
iii. Use the prescribed valuation principles and disclose the valuation method adopted for shares/ownership interests, land and buildings.
iv. Financial statements must contain all relevant amounts that any forms prescribed by the Commissioner of Inland Revenue under section 35 of the TAA require to be copied from the company's financial statements (for example, the IR10 Financial Statements Summary and the financial statement disclosure section in the IR6 income tax return and the IR6B movement in beneficiary accounts).

Tier 2: Additional requirements for trusts that are not "small trusts"

v. Apply the principles of accrual accounting.
vi. Provide a statement of accounting policies.
vii. Disclose comparable figures for the previous income year to the extent that the trustee has that information.
viii. Disclose several specific items:
  - A reconciliation between the profit or loss in the statement of profit and 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.
ix. Disclose associated persons transaction details. For the purposes of the disclosure rules:
  - The disclosure should include 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 trustee;
  - Transaction details include names of the associated persons, the nature of the association, the nature of the transactions and the amounts involved;
  - Disclosures are not required if transactions are at a market rate;
  - If associated person disclosures have been made separately in any forms prescribed by the Commissioner of Inland Revenue, this information does not need to be duplicated in the financial statements.
  - Associated persons are as defined in subpart YB of the Income Tax Act 2007.

26. Officials note that from the 2021-22 and later years, the following financial information will be collected by the Commissioner in prescribed forms for all domestic trusts subject to section 59BA:

Income Tax Return for trusts

i. Total accounting profit before tax
ii. Tax adjustments to reconcile accounting income with assessable income in tax return
iii. Untaxed realised gains
iv. Total assets
v. Associated persons financial arrangements
vi. Shares/ownership Interests
vii. Land
viii. Buildings
ix. Total liabilities
x. Associated persons financial arrangements
xi. Total equity
xii. Drawings
xiii. Closing current account balances

Trust beneficiary form

Beneficiary account movements
i. Opening balance
+ Distributions
ii. Accounting income and other distributions
iii. Corpus
iv. Capital
v. Use of trust property for less than market value
vi. Distribution of trust assets
vii. Forgiveness of debt
- Withdrawals
viii. Amounts withdrawn from the trust during the income year
ix. Closing balance

Appendix B – Summary of policy recommendations

27. The policy recommendations following discussions with stakeholders are summarised below.

28. **Minimum standards:** Officials propose the OIC will state it contains 'minimum' standards for trustees of trusts required to comply with the disclosure requirements set out in section 59BA of the TAA. Financial statements may be prepared to any level above the minimum specified by the OIC. These minimum standards will not directly affect other disclosures required under section 59BA(2), which include details of settlements, settlors, distributions and appointers.

29. **Date of application:** Officials propose the OIC be enacted by 31 March 2022 and apply it to the 2021-22 income year for balance dates ending 31 March or later. There are several areas where compliance for the first year (2021-22) could be on a 'best endeavours' basis and these will be addressed in the Commissioner's operational statement rather than the OIC. Changes proposed as a result of consultation remove significant compliance costs so there is no advantage in deferring its application. Making the OIC before 31 March 2022 and applying it for the 2021-22 year onwards will provide useful guidance for trustees. Setting out in an operational statement where the Commissioner will accept a 'best endeavours' approach for the first year will reduce transition costs for many trusts. Early balance-date trusts will not be required to follow the OIC (approximately 400 out of 180,000 trusts with assessable income are early balance date trusts and about half will be able to access the OIC small trust concessions).

30. **Financial statement notes and supporting materials:** Officials propose the domestic trust OIC will clarify that, for the purposes of the OIC, the term 'financial statements' includes any notes and other supporting materials. Section 59BA(2)(a) requires trusts to provide "a statement of profit or loss and a statement of financial position". Where the OIC refers to financial statements it will align with the companies OIC which states that the term *financial statements* "includes any notes and other supporting materials forming part of the financial statements". This is an important compliance cost savings measure – making it clear that items required in the OIC can simply be supporting materials rather than in the actual financial statements.

31. **Non-standard balance date reporting:** Officials propose that 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 Commissioner approval for non-standard balance date reporting. This concession will relieve passive investment trusts from having to re-state their financial statements to the 31 March tax year if they have non-standard balance dates for accounting purposes.

32. **Small trust thresholds:** Officials propose that small trust relief thresholds be as follows:

    i. To qualify as a small trust, a trustee must report, for the relevant income year:

    - less than $100,000 assessable income (before allocation); and
    - less than $100,000 deductible expenditure; and
    - total assets (including assets that are not in the tax base) valued at less than $5m as at balance date.

    ii. The $100,000 assessable income and deductible expenditure figures used for the purpose of determining whether a trust is small will not include income assessed under the bright-line rules or related deductible expenditure.

iii. Assets will be valued using the valuation principles in the OIC and must be consistent with financial statements.

33. Officials estimate that raising these thresholds will provide relief for approximately 75% or 135,000 out of 180,000 trusts subject to the new disclosure rules. Threshold increases remove significant compliance costs but allow IR to continue to collect sufficient information in prescribed forms.

34. Officials considered suggestions from submitters to minimise trusts 'flipping' in and out of the disclosure rules if they have one-off transactions which would put them above the thresholds. Officials recommend the approach suggested by some submitters that the calculation be limited to assessable income (and deductible expenditure) in the current year but that assessable income derived from the bright-line residential property sale rules (and related deductible expenditure) be excluded to avoid anomalies involving residential property sales.

35. **Small trust scope of relief:** Officials propose the scope of relief for small trusts will mean only four minimum standards will apply to small trusts:

i. Prepare a statement of financial position and a profit and loss statement.

ii. Apply the double-entry method of recording financial transactions.

iii. Use the prescribed valuation principles and disclose the valuation method adopted for shares/ownership interests, land and buildings.

iv. Financial statements must contain all relevant amounts that any forms prescribed by the Commissioner of Inland Revenue under section 35 of the TAA require to be copied from the company's financial statements (for example, the IR10 Financial Statements Summary and the financial statement disclosure section in the IR6 income tax return and the IR6B movement in beneficiary accounts). These increases in the scope of the relief for small trusts remove significant compliance costs but allow the Commissioner to continue to collect sufficient information in prescribed forms.

36. **Valuations:** Officials propose the valuation method will be left to the judgement of the trustees.

37. The OIC will clarify that for the purposes of calculating market value of properties, the use of rating valuations is an acceptable proxy.

38. In order to prevent inappropriate use of a 'tax value' option, this option will be restricted to assets and liabilities that are in the tax base.

39. **Associated person disclosures:** Officials propose:

i. Trustees must disclose associated persons transaction details, with the exception of trustees of small trusts who must only disclose associated person transactions when required to do so in prescribed forms.

ii. Transaction details include names of the associated persons, the nature of the association, the nature of the transactions and the amounts involved.

iii. Associated persons are defined in subpart YB of the Income Tax Act 2007.

iv. The disclosure should include 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 trustee.

v. Disclosures are not required if transactions are at a market rate.

vi. If associated person disclosures have been made separately in any forms prescribed by the Commissioner of Inland Revenue, this information does not need to be duplicated in the financial statements.

40. The approach will reduce duplication with disclosures in prescribed forms, provide more clarity as to what disclosure is required, and reduce the extent of disclosures required (for example, by excluding minor and incidental transactions).

41. **Beneficiary account movements:** Officials propose there will be no requirement in the OIC to provide a line-by-line reconciliation in beneficiary accounts. Instead, the OIC will clarify that financial statements must contain all relevant amounts that any forms prescribed by the Commissioner of Inland Revenue including the IR6B movement in beneficiary accounts. The beneficiary account movements disclosed in the prescribed form will be sufficient for the purpose of the OIC. This will save compliance costs.

42. **Gross-up options:** Officials propose the OIC will not prescribe dividend gross-up for imputation credits and interest/dividend gross-up for RWT. The gross-up option will be left to the judgement of the trustees.

43. **Trusts Act 2019:** Officials propose the OIC will explicitly note that there are requirements for trustees to keep records under section 45 of the Trusts Act 2019. Section 45 of the Trusts Act 2019 requires each trustee of a trust to keep, so far as is reasonable, records of the trust property that identify the assets, liabilities, income, and expenses of the trust and that are appropriate to the value and complexity of the trust property.

44. This requirement differs from the OIC as it does not explicitly require trustees to compile financial statements and it allows the trustee to exercise judgement as to what is reasonable and appropriate in respect of record keeping. However, it is a legislative provision that could be usefully referenced in the OIC, while clarifying that the minimum reporting standards in the OIC are more prescriptive and in some cases apply income tax concepts (for example, the use of tax valuations).

45. **Fixed asset schedule:** Officials propose the financial statements will include an appropriately detailed schedule of the trust's fixed assets and depreciable property used for tax purposes. Fixed assets with a tax value are typically tracked through a tax fixed assets register. For the purpose of the OIC it will only be required to be included in financial statements as supporting materials.

In Confidence

Office of the Minister Revenue

Chair, Cabinet Economic Development Committee

TAX ADMINISTRATION (FINANCIAL STATEMENTS—DOMESTIC TRUSTS) ORDER 2022

Proposal

1. In 2020, Cabinet agreed to increase the disclosure requirements for trusts, including the requirement to prepare financial statements for the 2021–22 and later income years (CAB-20-MIN-0484 refers). This paper seeks Cabinet's approval of the minimum level of detail required in those financial statements. Approval is also sought for the Order in Council required to bring the minimum standards into law, and for authority to submit the Order directly to the Executive Council.

Relation to Government Priorities

2. The Taxation (Income Tax Rate and Other Amendments) Act 2020 introduced a new top personal income tax rate of 39% on income exceeding $180,000 for the 2021–22 and later income years. The introduction of a 39% tax rate formed part of the Labour Party's manifesto for the 2020 General Election. Labour campaigned explicitly that we would not increase the trustee income tax rate but would monitor behaviour around avoidance and the success of enforcement measures.

3. The Act also introduced additional information reporting and disclosure obligations for trustees for the 2021–22 and later income years. The objective of these obligations is related to the integrity of the tax system. The disclosure rules will help evaluate the effectiveness of the new 39% rate and gain insight into the use of structures and entities by trustees in New Zealand.

Executive Summary

4. The increased trust disclosure requirements include a requirement to prepare a statement of profit or loss and a statement of financial position. This requirement does not specify what level of detail the statements must be prepared to.

5. I propose to set, by Order in Council, minimum requirements for financial statements prepared by trusts subject to the new disclosure rules. This will provide increased certainty for trustees regarding their reporting obligations, support compliance with the disclosure rules and will improve the quality of data collected. The proposed Order would apply for the 2021–22 and later income years for most trusts.

6. Inland Revenue officials undertook targeted and public consultation on the proposed content of the Order in 2021. Submitters supported setting minimum standards by Order in Council, as it would provide certainty regarding trustees' reporting obligations and help mitigate the compliance costs imposed by the disclosure rules.

7. The proposed Order has been designed based on feedback received in consultation and is aimed at striking a balance between supporting the Government's objectives for the disclosure rules and minimising compliance costs for trusts. The proposed minimum standards provide simplified reporting requirements for certain trusts.

Background

8. On 23 November 2020, 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 39% top personal income tax rate. Cabinet agreed to collect information from trustees to test compliance and effective operation of the new 39% rate and provide better information to understand and monitor the use of structures and entities by trustees (CAB-21-MIN-0484 refers).

9. The Taxation (Income Tax Rate and Other Amendments) Act 2020 was enacted on 7 December 2020 and introduced increased disclosure requirements for trusts that derive assessable income. The rules apply for the 2021–22 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 to the Commissioner of Inland Revenue:

    9.1 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);

    9.2 settlor details, including details of previous settlors if not previously supplied to the Commissioner of Inland Revenue;

    9.3 the amount of distributions made and details of beneficiaries who received the distributions; and

    9.4 appointer details.

10. Certain trusts are excluded from these rules. These 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.

11. The total volume of trusts in New Zealand has been estimated to be over 400,000. 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. The financial statement disclosure requirements will primarily affect approximately 55,000 of these domestic trusts. These are trusts that report assessable income to Inland Revenue but do not currently report business income or file any financial statements.

12. 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 rules.

13. Section 21C of the Tax Administration Act 1994 (TAA) provides that the Governor-General can prescribe minimum requirements for financial reporting. Before

recommending the making of an Order under this section, the Minister of Revenue must consult with professional accounting bodies. This requirement has been satisfied by consultation undertaken by officials in 2021, as detailed below.

Objectives

14. The minimum standards should be consistent with the following objectives:

    14.1 **Minimising compliance costs:** The minimum standards should strike a balance between ensuring the Commissioner of Inland Revenue will have sufficient financial information to meet the objectives of the disclosure rules and minimising unnecessary compliance costs.

    14.2 **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.

    14.3 **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.

    14.4 **Proportionality:** The minimum standards should be tailored to the size of the trust. Smaller trusts should have simplified reporting requirements.

Consultation

15. Inland Revenue officials undertook targeted and public consultation on the proposed minimum standards in 2021. Officials also consulted on operational guidance for the disclosure rules to address practical matters for trustees. The main themes arising from consultation were:

    15.1 **High compliance costs:** The new disclosure rules will result in some trusts incurring significant compliance costs. Submitters suggested this could be addressed by legislating a one-year deferral of all the trust disclosure rules, to allow trustees to restructure out of the rules or give them more time to prepare for implementation of the rules. In addition, legislative amendments could provide smaller trusts an exemption from all the disclosure requirements.

    15.2 **Support for Order in Council:** The proposal to set minimum financial reporting standards by Order in Council was supported, as it would increase certainty for trustees regarding reporting obligations.

    15.3 **Relief for small trusts:** Submitters engaged on how small trusts should be defined for the purposes of the Order in Council relief and the scope of that relief.

    15.4 **Technical matters:** Submitters engaged on a range of technical matters that should be covered by the Order in Council, the most significant relating to valuation methods, associated person disclosures, and disclosures relating to beneficiary accounts.

16. In addition to consulting with members of the tax and accounting community, the External Reporting Board, the Department of Internal Affairs, the Ministry of Business, Innovation and Employment, the Ministry of Justice, the Office of the Privacy Commissioner, Statistics NZ and the Treasury were consulted during the development of the proposed minimum standards.

Minimum standards

17. The key features of the proposed Order are set out below. These features have been developed based on feedback received in consultation and the objectives set out above. The annex contains further detail on the proposed minimum requirements.

Application date

18. A small number of trusts have an early balance date and will have already filed their annual return before the Order is proposed to come into force. Inland Revenue data indicates approximately 0.2% (400 out of 180,000) of trusts subject to these rules are in this situation.

19. To prevent retrospectively imposing requirements on these trusts, I propose that the minimum standards apply for income years that end after the Order comes into force. This will be 2021–22 and future income years for the large majority of trusts that do not have an early balance date.

20. There are several areas where compliance for the first year (2021–22) could be on a 'best endeavours' basis and these are expected be addressed in the Commissioner's Operational Statement on the disclosure rules. For example, this could include the calculation of opening balances in the first year and the reporting of transactions with associated persons.

Simplified reporting requirements for certain trusts

21. The proposed Order provides simplified reporting requirements for certain trusts. A trust with less than $100,000 assessable income, less than $100,000 tax deductions and less than $5 million total assets in an income year will have simplified reporting requirements. These thresholds would exclude income and expenditure relating to the residential property brightline rules to reduce the risk of trusts not qualifying for the simplified reporting requirements due to large one-off transactions.

22. Officials estimate that these thresholds will result in 75% (135,000 out of 180,000) of trusts qualifying for simplified reporting requirements.

23. While these trusts will have to meet fewer requirements for their financial statements, all trusts will provide the same financial information in forms prescribed by the Commissioner of Inland Revenue. This helps reduce compliance costs for a significant number of trusts, while continuing to support the objectives of the disclosure rules of evaluating the effectiveness if the new 39% rate and gaining insight into the use of structures and entities by trustees in New Zealand.

Asset valuation

24. Assets will be valued at either market value, cost or tax adjusted value, at the discretion of the trustees. For the purposes of calculating the market value of properties, the use of rating valuations will be an acceptable proxy. This helps ensure trustees are not forced to re-value assets, or engage valuers, to comply with the disclosure rules.

25. The valuation method for certain assets must be disclosed. This helps support the quality of the data collected.

Associated person disclosures

26. Trustees must disclose associated persons transaction details, except for trustees of “simplified reporting trusts” who only need to disclose associated person transactions when required to do so in prescribed forms.

27. Disclosures will not be required for transactions at market value. Disclosure of transactions with associated persons not at market value is important to assess compliance with the 39% personal income tax rate.

Financial Implications

28. This proposal has no financial implications.

Timing and 28-Day Rule

29. The proposed Order will come into force on 31 March 2022, the end of the 2021–22 income year for trustees with standard balance dates. The minimum standards set by the Order will apply for income years ending on or after the Order comes into force. That is, the Order will not retrospectively impose requirements on trustees with balance dates prior to the Order coming into force.

30. A waiver of the 28-day rule is sought to allow the Order to come into force by 31 March 2022 on the grounds that the Order needs to be in force before the end of the 2021–22 income year for trustees with standard balance dates, to provide increased certainty regarding reporting obligations for the 2021–22 and later income years.

Compliance

31. The Order in Council complies with:

    31.1 the principles of the Treaty of Waitangi;

    31.2 the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993;

    31.3 the principles and guidelines set out in the Privacy Act 2020;

    31.4 relevant international standards and obligations;

    31.5 the Legislation Guidelines (2021 edition), which are maintained by the Legislation Design and Advisory Committee.

Regulations Review Committee

Application date

32. The short time between the proposed making of this Order and the application date of the minimum standards may be a basis for the Regulations Review Committee to draw the Order to the attention of the House of Representatives under Standing Order 327. Officials consider this risk to be low and that the application date is appropriate for the following reasons:

    32.1 The disclosure rules were enacted in December 2020. Trustees have had a reasonable amount of notice regarding the requirements in the disclosure rules in section 59BA of the TAA.

    32.2 Trustees will have until 7 July 2022 to file returns for the 2021–22 income year. Trustees with tax agents (the large majority) will be able to file returns as late as 31 March 2023.

    32.3 During consultation in 2021, submitters broadly supported applying the minimum standards for the 2021–22 income year. Submitters considered that this would provide increased certainty regarding trustees' reporting obligations. Deferring the application of the Order to a later date would provide no relief from the requirement in section 59BA to prepare financial statements for the 2021–22 income year.

    32.4 Inland Revenue has been engaged with tax agents, accountants and software providers regarding the implementation of the disclosure requirements.

Sub-delegation issue

33. Clause 1(e) of the Schedule to the Order requires that the financial statements must include all relevant amounts that are required to be copied from financial statements into a form prescribed by the Commissioner of Inland Revenue (for example, the IR10 form – *financial statements summary)*.

34. There is a low risk that this clause may be a basis for the Regulations Review Committee to draw the Order to the attention of the House of Representatives under Standing Order 327. This is because there is a risk that the Order could be seen to sub-delegate to the Commissioner the legislative power to set requirements for financial statements for domestic trusts.

35. Taxpayers that derive business income are required to either file an IR10 form or provide a set of financial statements to Inland Revenue. Clause 1(e) of the Schedule is an important integrity measure to ensure that taxpayers cannot avoid the requirements in the IR10 form by filing a set of financial statements prepared to a lower standard. This clause ensures that the financial statements are an appropriate proxy for the IR10 form. This approach follows the precedent set by the minimum standards for financial reporting for companies.[1]

36. Clause 1(e) of the Schedule to the Order only relates to forms that the Commissioner is already authorised to prescribe under section 35 of the TAA. To ensure the

[1] Clause 1(e) of the Schedule to Tax Administration (Financial Statements) Order 2014.

financial statement requirements are workable, it is important that they interface with these forms. In these circumstances, officials are satisfied that this approach is within the scope of the regulation making power contemplated by Parliament.

Certification by Parliamentary Counsel

37. The Order in Council has been certified by the Parliamentary Counsel Office as being in order for submission to Cabinet.

Impact Analysis

Regulatory Impact Statement

38. A Regulatory Impact Statement has been completed and is attached.

39. 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.

Climate Implications of Policy Assessment

40. 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

41. There are no population implications arising from these proposals.

Human Rights

42. The proposals do not give rise to any human rights implications.

Communications

43. I will publish a press statement regarding the minimum standards for financial statements prepared by domestic trusts before the end of the 2021–22 income year.

44. The Order will be published in the *Gazette* and Inland Revenue will include details of the new minimum standards in a *Tax Information Bulletin* after the Order is made.

45. To date a number of submitters and media articles have focused on the increased compliance costs for trustees as a result of the new domestic trust disclosure rules. They have noted these rules go further than reporting requirements under the Trusts Act 2019 and suggested that because the disclosure rules were enacted in December 2020 with no consultation it would be preferrable to defer their application for a year. While the proposed Order goes some way to reducing compliance costs based on submitter feedback, it is likely that concerns about the timing and the amount of information being collected will continue to be raised.

Proactive Release

46. I propose to proactively release this Cabinet paper, associated minutes, and key advice papers with appropriate redactions within 30 working days of Cabinet making final decisions.

Recommendations

The Minister of Revenue recommends that the Committee:

1. **note** that the Taxation (Income Tax Rate and Other Amendments) Act 2020 introduced increased disclosure requirements for certain trusts, including the requirement to prepare financial statements for the 2021–22 and later income years.

2. **note** that section 21C of the Tax Administration Act 1994 allows the Governor-General to prescribe, by Order in Council, minimum requirements for preparing financial statements for certain classes of taxpayers.

3. **note** that before recommending the making of an Order in Council under section 21C of the Tax Administration Act 1994, the Minister of Revenue must consult with professional accounting bodies. Targeted and public consultation undertaken by officials in 2021 satisfies this requirement.

4. **agree** to the minimum financial reporting requirements as set out in the attached Order, Tax Administration (Financial Statements—Domestic Trusts) Order 2022.

5. **agree** that the proposed Order should apply to all trusts subject to the disclosure rules introduced by the Taxation (Income Tax Rate and Other Amendments) Act 2020.

6. **agree** that the proposed Order should apply for income years that end on or after 31 March 2022.

7. **authorise** the submission to the Executive Council of the Tax Administration (Financial Statements—Domestic Trusts) Order 2022.

8. **note** that the Tax Administration (Financial Statements—Domestic Trusts) Order 2022 will come into force on 31 March 2022, the end of the 2021–22 income year for trusts with standard balance dates.

9. **note** that a waiver of the 28-day rule is sought so that the Order in Council can come into force by 31 March 2022 on the ground it needs to be in force before the end of the 2021–22 income year.

10. **agree** to waive the 28-day rule so that the Order in Council can come into force by 31 March 2022.

Authorised for lodgement

Hon David Parker
Minister of Revenue

Annex – 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 of Inland Revenue 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 reported 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.

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

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.
    - Disclose 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.

Cabinet Economic Development Committee

Minute of Decision

Tax Administration (Financial Statements — Domestic Trusts) Order 2022

Portfolio **Revenue**

On 2 March 2022, the Cabinet Economic Development Committee:

1 **noted** that the Taxation (Income Tax Rate and Other Amendments) Act 2020 introduced increased disclosure requirements for certain trusts, including the requirement to prepare financial statements for the 2021–22 and later income years;

2 **noted** that section 21C of the Tax Administration Act 1994 allows the Governor-General to prescribe, by Order in Council, minimum requirements for preparing financial statements for certain classes of taxpayers;

3 **noted** that:

3.1 before recommending the making of an Order in Council under section 21C of the Tax Administration Act 1994, the Minister of Revenue must consult with professional accounting bodies;

3.2 targeted and public consultation undertaken by officials in 2021 satisfies this requirement;

4 **agreed** to the minimum financial reporting requirements as set out in the Tax Administration (Financial Statements – Domestic Trusts) Order 2022 (the Order);

5 **agreed** that the Order should apply to all trusts subject to the disclosure rules introduced by the Taxation (Income Tax Rate and Other Amendments) Act 2020;

6 **agreed** that the Order should apply for income years that end on or after 31 March 2022;

7 **noted** that the Order will come into force on 31 March 2022, which is the end of the 2021–22 income year for trusts with standard balance dates;

8 **noted** that a waiver of the 28-day rule is sought:

8.1 on the grounds that the Order needs to be in force before the end of the 2021–22 income year;

8.2 so that the Order can come into force by 31 March 2022;

9 **agreed** to waive the 28-day rule so that the Order can come into force by 31 March 2022;

10 **authorised** the submission to the Executive Council of the Tax Administration (Financial Statements—Domestic Trusts) Order 2022 [PCO 24469/4.0].

Janine Harvey
Committee Secretary

Present:
Hon Grant Robertson (Chair)
Hon Carmel Sepuloni
Hon David Parker
Hon Poto Williams
Hon Stuart Nash
Hon Kris Faafoi
Hon Willie Jackson
Hon Michael Wood
Hon Dr David Clark
Hon Dr Ayesha Verrall
Hon Meka Whaitiri
Hon Phil Twyford
Dr Deborah Russell MP

Officials present from:
Office of the Prime Minister
Officials Committee for DEV