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14 July 2023

Dear Sir/Madam,

Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill

Thank you for the opportunity to comment on the **Taxation (Annual Rates for 2023-24, Multinational Tax, and Remedial Matters) Bill** (the Bill).

CPA Australia represents the diverse interests of more than 173,000 members, including over 2,700 members in New Zealand, working in over 100 countries and regions supported by 19 offices around the world. We make this submission on behalf of our members and in the broader public interest.

Perceived tax avoidance

In the Bill, one of the measures proposes to align the trustee tax rate, currently at 33 per cent with the top personal tax rate of 39 per cent for the 2024–25 and later income years. The Government's **position** that "There is evidence that high-income earners have shifted their income to trusts to avoid the top personal rate."

By increasing the personal and now trustee tax rates from 33 per cent to 39 per cent, the Government is undermining the broad base low rate (BBLR) approach that has been the basis of the New Zealand tax system for the past four decades. The limited historical differential in tax rates reduced the incentives for tax arbitrage but the recent increases have driven changes in taxpayer behaviour. In consequence, this initiated the various complex tax measures introduced in this Bill to combat the perceived avoidance due to the arbitrage between the company tax rate of 28 per cent and proposed trustee rate increases from 33 per cent to 39 per cent to align with the top personal tax rate. If the Government's aim is to stamp out income shifting to avoid the top tax rate, we submit there is less incentive to do this at the 33 per cent tax rate than at the 39 per cent tax rate. If the concern is distorted tax outcomes resulting from arbitrage opportunities, then we recommend a more refined approach to better target the tax avoidance behaviour.

Trust disclosure reconsideration

The trust disclosure requirements introduced in 2021-22 should be reconsidered to ascertain whether the legislation should be amended to make compliance simpler or whether it can be cancelled instead, given the alignment of the trustee tax rate with the highest marginal tax rate. The additional trust disclosures have created a significant compliance burden on both advisors and taxpayers. The concerns and justification for the Government and the Inland Revenue for additional trust disclosures no longer exist when the top personal and trustee tax rates are the same.

Issues relating to the risk of over-taxation of beneficiaries

Does the ability for trustees to allocate income as beneficiary income (taxed at the beneficiary's personal tax rate) sufficiently mitigate over-taxation? In what circumstances is this method not sufficient?

There will be instances where the objective in setting up a discretionary trust is for the purposes of wealth generation, accumulation, and asset protection, including where one of the spouses has a high risk of being sued due to his or her occupation. As such, these trusts will not be distributing or allocating the trust's net income to

beneficiaries. Instead, the net income is accumulated and re-invested in the trust. Any tax measure must target the tax avoidance behaviour such as where the distribution is allocated but not physically paid, as opposed to adversely affecting taxpayers who are using trusts for legitimate non-tax reasons.

A simpler and more practical approach to minimise over-taxation is to re-align the highest personal marginal tax rate and the trustee rate back to 33 per cent. This would overcome the over-taxation concerns we are currently facing and reinforce the BBLR tax system in New Zealand.

Are there potential policy responses that could supplement this ability? For example: de minimis/tiered tax rate for trustee income?

If multi-tiered tax rate thresholds are allowed, we recommend that the thresholds are indexed (e.g., Consumer Price Index) to avoid bracket creep over time.

Corporate beneficiaries

In what situations are companies used as beneficiaries of trusts?

A corporate beneficiary of a trust is used to hold on to distributions until some point in the future when it can be distributed to individuals. In Australia, the legitimate advantages of distributing trust income to corporate beneficiaries lie in the facts that:

1. Companies pay a flat rate of tax on income which can be more or less than the applicable individual tax rate.
2. Corporate beneficiary is an effective asset protection vehicle to quarantine wealth from creditors and other claimants.
3. Using loans to related corporate beneficiary to purchase and hold assets and in a tax efficient manner.
4. Corporate beneficiary is an efficient structure to accumulate wealth and asset succession.
5. Whilst a trustee is compelled to distribute the income of the trust, a corporate beneficiary can hold those distributions and distribute the profit at a later point in time. If there are franking credits available, there might also not be a 'tax differential' to pay on those distributions.
6. It may also be possible for the corporate beneficiary to deduct expenses from the income it receives from the trust such as distributing to a company that has carried-over tax losses from previous financial years.
7. It makes commercial sense sometimes to transfer only the retained earnings out of a company. This involves transferring profit out of a company without paying cash. Examples include where the company has been using its profits to pay off debt. In these situations, the company will accumulate valuable franking credits and retained earnings and it makes sense in some circumstances to transfer these out of a company rather than leaving them there exposed to commercial and legal risk. The franking credits can be used for the distribution of income in the future.

Is the proposed corporate beneficiary rule sufficiently targeted to not affect the use of companies in corporate structures?

We do not believe the proposed corporate beneficiary rule is sufficiently well-targeted. The trustee should only be taxed where the beneficiary company never receives the distribution. This addresses the issue of unpaid distributions to the company being used by others such as the individual beneficiaries of the trust instead. In Australia, the **Division 7A** income tax provisions are tightly targeted at preventing profits or assets being provided to shareholders or their associates tax free.

The rule proposes that all trust distributions to closely held corporate beneficiaries will be taxed at the 39 per cent top trustee rate instead of the corporate tax rate of 28 per cent The rule does not differentiate between where the trust has physically paid the distribution to the corporate beneficiary against where an allocation to the corporate beneficiary was made but the distribution was not physically paid. We believe a distinction should be made between the two as is the case in Australia, where in the latter, the unpaid present entitlement is a financial accommodation that is subject to Division 7A of the *Income Tax Assessment Act 1936* (ITAA 1936).

Division 7A applies to certain payments, loans and debt forgiveness made by trustees to a shareholder or an associate of a shareholder of a private company, where the company is presently entitled to an amount from the net income of the trust estate and the whole of that amount has not been paid by year-end. Division 7A prevents company shareholders from receiving tax-free payments from private companies. If an arrangement between a private company and a shareholder is caught under Division 7A, the benefit will be considered a "deemed dividend"

and the shareholder will have to pay tax at their full marginal tax rate rather than merely a top-up tax, as deemed dividends are not usually franked.

Furthermore, the Australian Full Federal Court in **Guardian AIT Pty Ltd ATF Australian Investment Trust v Commissioner of Taxation [2021] FCA 1619** (Guardian case) recently held that the general anti-avoidance rules Part IVA of the ITAA 1936 can apply where the closely held corporate beneficiary was used for tax reasons. Instead of introducing legislation to stop all trust distributions received by closely held corporate beneficiaries being taxed at 28 per cent, any proposed law should focus on where these closely held corporate beneficiaries are used for tax reasons, including using the general anti-avoidance provisions BG1 and GA1 of the Income Tax Act 2007, like what the Inland Revenue did in **Ian David Penny and Gary John Hooper v Commissioner of Inland Revenue SC 62/2010 [2011] NZSC 95** (Penny and Hooper).

Deceased estates

How long does it normally take for an estate to settle the affairs of the deceased? Are there situations in which the proposed 12-month period would not be sufficient?

Australia has a three-year tax concession for deceased estates to be taxed at individual marginal tax rates. This is because it takes time for probate application to be granted and for deceased estate assets, beneficiaries to be ascertained and for assets to be distributed, especially where there are disputes and those died intestate. Even a three-year tax concessional period can be a real challenge for some deceased estates to be wound up in Australia. In view of the Australian experience, we suggest New Zealand expands the tax concession period from 12 months to at least three years instead.

Should the modification apply for a fixed amount of time (e.g., 12 months) or on an income year basis?

In Australia, the concessional rate will apply for the first three income years of the deceased estate. Using the income year instead of a fixed 12-month approach, the application of the complex formula method proposed under section HC 8B(2) is avoided.

Should the modification be opt-in or mandatory for estates?

Unless there are material changes to the estate's circumstances, the concessional tax rate applies automatically in Australia without the need for an election to opt-in. We suggest the modification should be automatic without the need to opt-in.

If you have any queries about this submission, contact Bill Leung, Tax Technical Advisor on +61 3 9606 9779 or **bill.leung@cpaaustralia.com.au**.

Yours sincerely,

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