

Increasing the trustee tax rate to 39%

The Government is introducing a Bill to increase the trustee tax rate to 39%. This is proposed to take effect from 1 April 2024.

At a glance

The Government is proposing to align the trustee tax rate with the top personal tax rate of 39% for the 2024–25 and later income years (beginning 1 April 2024 for most trusts).

This is estimated to raise approximately \$350 million per year (\$1.1 billion over the forecast period).

The proposals will be included in a Bill to be introduced on 18 May 2023.

Who is affected

In the 2020–21 income year there were 177,000 trusts that reported assessable income.

Of those 177,000 trusts, only 9,000, (five percent) accounted for 78 percent of trustee income (\$13.3 billion out of \$17.1 billion) in the 2020–21 income year. These trusts would pay most of the additional tax.

The lower 75 percent of trusts in terms of trustee income (133,000) accounted for only 2.5 percent of trustee income (\$0.4 billion). This includes the lower 24 percent of trusts (43,000) that had only beneficiary income; they would not be affected by a change in the trustee tax rate.

About trusts

A trust is a relationship where a person (the trustee) holds property for the benefit of another person or persons (the beneficiaries). The settlor is the person who

creates the trust and is the source of trust property.

Income earned by a trust can be paid or allocated to the beneficiaries of the trust as “beneficiary income”, or it can be retained by the trustees and taxed as “trustee income”.

Beneficiary income is taxed at the personal tax rates of the recipient beneficiary. Trustee income is taxed at a flat tax rate, which is currently 33%. This means that the same tax rate applies from the first dollar of trustee income derived, unlike personal income which is taxed at an increasing tax rate as income rises.

Tax paid on trustee income is also final, which means that no further tax is paid when the income is later paid out to beneficiaries.

Why the change

The current trustee tax rate of 33% has been in place since 1989, which was deliberately aligned with the top personal tax rate at that time. But in 2020, a new top tax rate of 39% for personal income over \$180,000 was introduced. The trustee tax rate was not adjusted at that time.

Since the trustee tax rate is a final tax, some individuals can obtain a tax advantage by earning income through a trust, because this allows them to get around the 39% personal tax rate.

Aligning the trustee and top personal tax rates at 39% would help ensure that trusts cannot be used to pay less than the top

personal tax rate. This would improve the fairness and progressivity of the tax system, protect the revenue base from erosion, and improve the Government's ability to raise revenue.

Integrity measures

The Government currently raises revenue from three main tax bases: personal income tax, company tax, and GST. Government revenue gathered from personal income is important because it accounts for around 50

percent of total tax revenue. Maintaining the integrity of the personal income tax base is therefore a high Government priority.

To prevent trustees using companies as beneficiaries of a trust to shelter income from the new 39% trustee rate, beneficiary income derived by certain private companies will be taxed as trustee income. The proposed rule would not affect the commercial use of trusts in large corporate groups.

Mitigating over-taxation

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

Example 1: Lower-rate beneficiaries

Amy (an air traffic controller) and Anthony (a builder with his own company) have settled some income-generating assets on a discretionary family trust for the benefit of themselves, their children (both minors under the age of 16) and future grandchildren. Amy, Anthony, and their accountant are the trustees.

2024–25 income year

Anthony has personal income of \$70,000 and Amy has personal income of \$180,000. Their trust has income of \$40,000.

If the income is retained as trustee income, it will be taxed at the proposed 39% trustee tax rate. Any income allocated to their children as beneficiary income will also be taxed at 39% under the minor beneficiary rule.

However, by allocating the income to Anthony as beneficiary income it can be taxed at his personal tax rate. This amount can be credited to Anthony's current account, available to be called upon at any time, or he can settle it on the trust if he wishes to do so.

2025–26 income year

Bary, the older of Amy and Anthony's children, turns 16 so is no longer a minor. Bary has no personal income, Anthony again has personal income of \$70,000, Amy has personal income of \$180,000, while the trust has income of \$50,000.

Since Bary is no longer a minor, he is not subject to the minor beneficiary rule. Income can be allocated to Bary as beneficiary income and taxed at his personal tax rates (e.g., up to \$14,000 at 10.5%, over \$14,000 and up to \$48,000 at 17.5%).

If the trustees do not want to distribute this income to Bary, it can be credited to his current account, available to be called upon at any time, or a sub-trust arrangement can be set up so that Bary's interest in a portion of the trust assets is recognised and protected.

Deceased estates

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

Example 2: Special rules for deceased estates

Moana died on 31 May 2024. Before her death, she derived \$20,000 of employment income. In the 2024–25 income year, the trustee of her deceased estate derives a further \$100,000 of trustee income.

The trustee decides to apply the special rules for deceased estates to the trustee income. Applying the special rules, the trustee has an income tax liability of \$28,000.

- Combined tax liability on \$20,000 + \$100,000 at marginal tax rates = \$30,520
- Tax liability on Moana's \$20,000 at marginal tax rates = \$2,520
- Trustee's tax liability is \$30,520 less \$2,520 = \$28,000

The aggregate tax liability would have been the same had Moana earned the \$100,000 directly as personal income. If the proposed 39% trustee tax rate had applied instead, the trustee's tax liability would have been \$39,000.

2025–26 income year

Moana's deceased estate derives \$10,000 of trustee income in April 2025, and a further \$50,000 in December 2025.

The special rules for deceased estates apply to the \$10,000 derived in April, because this is within 12 months of Moana's death. Applying the personal tax scale (since Moana derived no income herself this year, as she died during the previous income year), the income tax liability is \$1,050. If the proposed 39% trustee tax rate had applied instead, the trustee's tax liability would have been \$3,900.

The remaining \$50,000 derived by the estate in December 2025 falls outside the 12-month period the special rules apply for. As a result, the \$50,000 is taxed at the proposed 39% trustee tax rate, and the income tax liability is \$19,500.

Disabled beneficiary trusts

Special rules are also proposed for certain trusts settled for disabled people to allow trustee income to be taxed at the disabled beneficiary's personal tax rate.

Example 3: Special rules for disabled beneficiary trusts

Matilda receives the supported living payment on the ground of restricted work capacity. She receives \$21,440 of taxable income each year.

Her parents decide to settle property on a trust to ensure she will continue to receive the same level of care in the future. Matilda's siblings, their lawyer, and their accountant are trustees of the trust. Matilda is the only beneficiary of the trust. Overall, the trust satisfies the requirements to be a disabled beneficiary trust.

The trustees derive \$50,000 of trustee income in the 2024-25 income year. Applying the special rules, the trustees have an income tax liability of \$11,723.20, which is the same net outcome as if the trustee income had been earned directly by Matilda.

- Combined tax liability on \$21,440 + \$50,000 at marginal tax rates = \$14,495.20
- Tax liability on Matilda's \$21,440 at marginal tax rates = \$2,772
- Trustees' tax liability is \$14,495.20 less \$2,772 = \$11,723.20

If the proposed 39% trustee tax rate had applied instead, the income tax liability would have been \$19,300.

If there are further situations that come to light through the Select Committee process, further rules aimed at mitigating over-taxation may be considered.

Inland Revenue will continue to monitor the use of structures to undermine the 39% personal tax rate.

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