

10 July 2023

Clerk of the Committee
Finance and Expenditure Select Committee
Parliament Buildings
WELLINGTON

Dear Sir / Madam

**FINANCE AND EXPENDITURE SELECT COMMITTEE
SUBMISSION ON THE TAXATION (ANNUAL RATES for 2023 – 24,
MULTINATIONAL TAX AND REMEDIAL MATTERS) BILL**

This submission is made by Entrust on the Taxation (Annual Rates for 2023 – 24, Multinational Tax and Remedial Matters) Bill.

Entrust wishes to have the opportunity to make an oral submission to the Committee on this submission.

The person to contact to arrange timing for the oral submission and in other matters relating to this submission is: Robin Oliver, Olivershaw Ltd, level 3, 120 Featherston Street, Wellington – phone 021-035-3380 – email robin@olivershaw.co.nz.

Summary

Our submission is on clause 62. This proposes to raise the income tax rate of trustee income from 33% to 39%.

We submit that Entrust (and other similar community trusts if identified) should have a similar exemption from the trustee rate increase as is proposed for disabled beneficiary trusts in clauses 39 and 59.

In the normal cause of events, Entrust (as required by its Deed of Trust) distributes all its income as beneficiary income. Entrust thus should have no trustee income on which the proposed 39% trustee rate would be paid. Nevertheless, Entrust could be exposed to the 39% rate on unclaimed payments that under the Deed of Trust revert to Entrust and are then distributed to other beneficiaries. We are seeking Inland Revenue confirmation that unclaimed payments do not give rise to trustee income. Unexpected administrative delays could also result in Entrust distributions being paid after the date required for treatment as beneficiary income.

Entrust is potentially affected by the proposed trustee rate increase because, despite being widely held (far more beneficiaries than any listed company has), its tax treatment is governed by rules designed for family trusts. The result is a tax regime not suited to Entrust circumstances. The rules are costly to operate, complex and confusing to beneficiaries. The main issue of concern is that current rules result in many lower income families and individuals being over-taxed on their Entrust distributions. We therefore submit that the Committee should amend the Bill to remove Entrust from the tax trust rules and instead make them subject to the PIE rules that are more specifically designed for widely held investment entities. No Entrust exemption from the proposed trustee rate increase would then be necessary.

About Entrust

Entrust grew out of the 1993 electricity industry reforms. A trust (called Auckland Energy Consumer Trust at that time) was set up to own the successor to the Auckland Electric Power Board and ensure that the power lines remained in control of the electricity consumers in the area that used to be served by the Board. In 2016 the Auckland Energy Consumer Trust was renamed Entrust.

Entrust is a private trust. It acts in the interests of its beneficiaries, over 356,000 households and businesses in central, east and south Auckland. Entrust's key asset is a 75.1% shareholding in Vector, the local lines company.

Generally speaking, Entrust does four things:

1. Receives dividends from its shareholding in Vector and distributes them to its beneficiaries. This annual Entrust distribution is a very useful annual supplement to the budgets of many low-income Auckland households and businesses.
2. Manages its majority ownership of Vector on behalf of beneficiaries.
3. Deals with government bodies on regulatory issues.
4. Provides strategic input to Vector at board level.

Submission that Entrust be Exempt the 39% Trustee rate

It is submitted that Entrust should be exempt from the proposed increase in the trustee rate. This would be on the same basis and for the same reason the Bill proposes that disabled beneficiary trusts be exempt (clause 39 proposed section HC 39). The reason given for proposing to increase the trustee rate from 33% to 39% is to prevent people from being able to shelter income that would otherwise be taxed at 39% so that it is taxed at the lower current trustee rate of 33%. Clearly Entrust cannot be used for this purpose. Only a very small number of Entrust beneficiaries would be earning over \$180,000 a year so as to be subject to a 39% marginal tax rate.

These points seem to have been accepted by the Regulatory Impact Statement (pages 48 to 49). However, officials stated that they expect Energy Consumer Trusts (such as Entrust) should not be subject to tax at 39% because they could distribute all income as beneficiary income (subject to tax at the beneficiary's individual marginal tax rate not the trustee rate). Officials concluded: "We think the 39% trustee tax rate should apply to ECTs until we engage with the sector to determine whether a modification is required".

Under its Deed of Trust Entrust is required to distribute all net income by the end of the next financial year and this has all been beneficiary income. Thus, in general, Entrust distributes all its income as beneficiary income and has no trustee income subject to the trustee rate of tax. That is in accordance with officials' expectation in the RIS. However, there are circumstances where this may not be the case and Entrust could derive trustee income.

It is therefore submitted that an exemption along the lines contemplated in the RIS should be provided.

The main issue is unclaimed payments - payments sent out to beneficiaries that are left unclaimed. This is a material sum. Under the Deed of Trust unclaimed payments revert to Entrust after 2 years and are then distributed to other beneficiaries. Entrust withholds tax on this at the 33% rate in the year of original distribution so, with the agreement of Inland Revenue, Entrust has been treating the distribution of unclaimed payments as a tax-paid payment and not as trustee income that under the proposal would be liable to

tax at a 39% rate. We have discussed this with Inland Revenue and are seeking their confirmation that they are still comfortable with this treatment. If Inland Revenue is comfortable with this past practice that would alleviate our main concern that a change to a 39% tax rate for trustee income could unfairly impose additional tax on Entrust's over 350,000 beneficiaries. At the time of writing discussions with Inland Revenue remain ongoing.

In addition to the unclaimed payments issue, Entrust is concerned that it could unfairly face a 39% tax rate on its Vector dividend if for administrative reasons those distributions were made by the end of the next financial year (as required by the Deed of Trust) but not within the statutory time required to treat the income as beneficiary income rather than trustee income (the earlier of six months after the end of the income year or the date the tax return is filed). Entrust has in the past ensured that distributions do qualify as beneficiary, and not trustee income, but this may not always be possible.

Submission that the Income Tax Act be amended so that Entrust is taxed as a PIE and not as a trust

Under current law Entrust is taxed under the rules applying to ordinary family trusts. The proposed increase in the trustee rate highlights how inappropriate these rules are for Entrust which has over 350,000 beneficiaries and holds a substantial asset for the benefit of the community.

Applying trust tax rules to such a large community investment entity results in rules that are costly to operate, complex and confusing to beneficiaries. Entrust submits that it should be taxed, not under the trust rules, but under the PIE rules (applying to KiwiSaver funds and similar investment entities). For administrative reasons (Entrust's inability to determine the individual tax rates of beneficiaries because direct initial and day to day contacts with those people are with the retailer not Entrust) we submit that the listed PIE rules are the most appropriate.

The main issue of concern with the trust rules is that they result in many lower income families and individuals being over-taxed on their Entrust distributions.


To describe the issue as simply as possible, current rules require Entrust to deduct tax from the Vector dividend at the rate of 33%. From national Inland Revenue data, we have calculated that some 86% of Entrust beneficiaries are on a tax rate lower than 33% and so they are overtaxed. Inland Revenue have undertaken a more detailed investigation which suggested that 70% are over-taxed. The amount of over-taxation can be refunded if beneficiaries file a tax return and include in that return their Entrust distribution together with the various tax credits they are entitled to. However, in practice the overwhelming majority of beneficiaries (especially low-income earners) do not do so. As such there is significant over-taxation.

The level of over-taxation is significant. We estimate, based on Inland Revenue data, that each year Aucklanders are over-taxed by some \$14 million on their Entrust distributions. For Aucklanders earning the least, that's up to \$90 a year of their dividend unfairly reduced by over-taxation.

The listed PIE rules would result in Entrust being taxed at a capped single rate (the listed PIE rate is 28% but given the high number of lower rate beneficiaries of Entrust, we submit that a 17.5% capped rate would be more appropriate. Those beneficiaries on a lower personal tax rate could still get a refund by filing a tax return (although in practice few are likely to do so).

The legislative change to achieve this listed PIE treatment is relatively simple in drafting terms. While there may be other drafting options, we annex our proposed drafting changes that would bring this into effect.

We thank the Committee for its consideration of our submission.



William Cairns
Chairman
Entrust

Annex - Proposed legislative changes

Amend the Income Tax Act to stop Entrust being taxed under the normal trust rules. Achieved by:

Insert in section HM 13(1) after paragraph (c) the words:

“but this section does not apply to a community energy trust resulting from the restructuring of electric power boards in 1993 (or any successor entity) that holds 75% of its assets or more by way of shares in a company listed on a recognised exchange in New Zealand.”

In section HM 23 insert a new sub-section (3) reading:

“Subsection 2 of section HM 14 and section HM 17 do not apply to a community energy trust resulting from the restructuring of electric power boards in 1993 (or any successor entity).”

Amend the Act to tax Entrust as a company Achieved by:

Insert after paragraph (b) of the definition of company in section YA 1 the following paragraph:

“(ba) a community energy trust resulting from the restructuring of electric power boards in 1993 (or any successor entity) that elects by writing to the Commissioner to be treated as a company.

Amend the Act to allow Entrust to be taxed under the existing listed PIE rules. Achieved by:

Insert in sub section 5 of section MB 1 paragraph (a) after the words “the portfolio investment entity is” the words “a Listed PIE that is a community energy trust resulting from the restructuring of electric power boards in 1993 (or any successor entity)”.

In the definition of Listed PIE in section YA 1 insert in paragraph (a) after “is listed on a recognised exchange in New Zealand”, the words “or is a community energy trust resulting from the restructuring of electric power boards in 1993 (or any successor entity) that holds 75% of its assets or more by way of shares in a company listed on a recognised exchange in New Zealand”.

Set the tax rate for Entrust as a listed PIE at 17.5% and not 28%. Achieved by:

In Schedule 1 Part A in paragraph 3 delete the word “or” and after 6 insert “or 12”.

In Schedule 1 Part A insert a new paragraph 12 reading:

“The basic rate of income tax for community energy trust resulting from the restructuring of electric power boards in 1993 (or any successor entity) that holds 75% of its assets or more by way of shares in a company listed on a recognised exchange in New Zealand and that elects to be a Listed PIE is 0.175.”