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Public Consultation
Inland Revenue
Wellington 6140

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PUB00347: GST treatment of short-stay accommodation (interpretation statement)

PUB00346: If property held in a trust is rented out by a beneficiary of the trust for short-stay accommodation, who should declare the income, and what deductions can be claimed? (QWBA – Beneficiaries Renting)

PUB00346: If property held in a trust is rented out by the trustees for short-stay accommodation, who should declare the income, and what deductions can be claimed? (QWBA – Trustees Renting)

1. The New Zealand Law Society (Law Society) welcomes the opportunity to submit on the two Questions We've Been Asked: *PUB00346 – Beneficiaries Renting* and *– Trustees Renting* (QWBAs), and the draft Interpretation Statement: *PUB00347 – GST treatment of short stay accommodation* (draft IS).
2. Both of the QWBAs consider the questions of who should declare the income and what deductions can be claimed where property that is held in trust is rented out for short-stay accommodation. One of the QWBAs considers these questions in the context of a trustee who rents out the property for short-stay accommodation and the other considers the questions in the context of where a beneficiary who rents the property out for short term accommodation.

PUB00346 – QWBAs

3. Paragraphs 1 to 6 of both QWBAs provide an overview of the meaning of an “interest in land”.
4. Where it is only the trustees who have an interest in land (i.e. because the property is not being occupied by a beneficiary as that beneficiary’s home) and the trustees rent the property out as short-stay accommodation, then it is the trustees who derive the income. The trustees may resolve to distribute some or all of that income as beneficiary income, however any income that is not distributed as beneficiary income is taxable as trustee income.
5. Where the rental income is trustee income, the trustees are entitled to claim deductions for non-capital property related expenditure subject to any apportionments required.
6. Where it is the beneficiary who has an interest in the property (because the beneficiary has a right of possession of the property) and the beneficiary rents out the property for short-stay accommodation, then the income belongs to the beneficiary. The income however may

be exempt where either DET 19/02 is used or the mixed -use asset rules apply. The deductibility of expenditure in relation to property-related outgoings incurred by the beneficiary is to be determined in accordance with DET 19/02 or where DET 19/02 is not used, deductibility of expenditure will be subject to apportionment for private use.

7. We agree with the above analysis. However, we do not agree with the proposal under both QWBAs to treat as trustee income any expenditure incurred by the trustee that has been paid for by the beneficiary, but the trustees have not reimbursed that beneficiary for making the payment.
8. Where a trustee grants a beneficiary the right to occupy trust property as that beneficiary's home, provided that the beneficiary meets the outgoings in relation to the property (being costs that would otherwise be incurred by the trustees) but otherwise rent-free, the payment of those outgoings would not generally be treated as rental income to the trustees under section CC 1.
9. In our view, a beneficiary meeting an expense as a condition of use of a property does not automatically give rise to a landlord/tenant relationship.
10. The right for a beneficiary to occupy trust property as their home on a rent-free basis is clearly distinguishable from a situation contemplated in paragraphs 35 to 39 QWBA (Beneficiary Renting) where a property is leased by the trustees to a beneficiary and the beneficiary uses the property to derive income. In the latter case, the Commissioner has indicated that section GC 5 ITA would not apply to deem adequate rent to be paid by the lessee (the beneficiary) to the lessor (the trustees).
11. There may be times during a beneficiary's period of occupation of trust property as their home that they may rent the property out as short-term accommodation. In such cases DET 19/02 would apply, or if it did not apply then the mixed asset use rules would apply.
12. We consider that in the context where income is derived from the property by the beneficiary, the proposal to treat the payment of expenditure by a beneficiary as trustee income has the potential to result in numerous trusts having to reconsider whether or not they should be filing a non-active trust declaration. This conclusion is based on what it appears the QWBA is stating, namely that in situations where a beneficiary derives income from using the property for short-stay accommodation and that beneficiary meets certain expenses for which they are not reimbursed, the payment of those expenses (for which they are not reimbursed) would be considered to be trustee income.
13. A trust is a non-active trust if it has not derived (or deemed to derive) any income for the year and does not have any deductions.
14. We do not agree that the trust would continue to meet the definition of a non-active trust if the trustees are deemed to have derived rental income and claim a corresponding deduction. Despite the fact the deduction would offset the income, it is not possible to claim a deduction without filing a tax return. Section 43B(3) of the Tax Administration Act 1994 provides the payment of insurance, rates and other expenditure incidental to the occupation of the dwelling owned by the trust, but incurred by the beneficiary, are not taken into account in determining whether a trust is "non-active". This does not reconcile with the proposed treatment to deem the payment of outgoings by a beneficiary as trustee income and allow the trustee to claim a corresponding deduction, as in order to claim the deduction the trustees would need to file a tax return.

15. In the cases where the property is used by the beneficiary, and the beneficiary meets certain expenses but is not reimbursed for those expenses by the trustee, we consider the preferable treatment would be to treat these payments as advances or settlements on the trust by the beneficiary rather than treat them as rental income of the trustees.
16. We recommend minor changes to example 2 of PUB00346 (Trustees Renting) to make it clear who “they” are. We therefore suggest that the second and third sentences read as follows:

“The Browns use the holiday house for 45 nights during the tax year. The trustees of the Fab Five Family Trust rent it out to friends of the Browns for 15 nights in the year for “mate’s rates” of \$50 a night and the trustees rent it out to others for 80 nights in the year for \$200 a night”.

PUB00347: GST treatment of short-stay accommodation (IS)

17. Our principal comment on the draft IS is the need to clarify whether the use of trust property by a beneficiary without payment would constitute a “taxable activity” in respect of the property. (The section in the draft IS [paragraphs 48 to 52] does not consider whether the use of property by a beneficiary of a trust without payment will constitute a “taxable activity” in respect of the property.)
18. Paragraph 51 provides that for there to a “taxable activity” under section 6(1)(a):
 - a. There must be an activity;
 - b. Which is carried on continuously or regularly by a person; and
 - c. That involves or is intended to involve, supplies made to another person for *a consideration*.
19. The valuation rules in section 10 (including the “open market value” rule in s 10(3)) clearly apply to determine whether someone who is carrying on a “taxable activity” is required to GST register and, if so, what obligations they will have in respect of making a supply to an associated person. However, it is not clear whether these valuation rules would also operate to deem the supply of the use of the property to a beneficiary to be for “consideration” in determining whether a “taxable activity” is being carried on in the first place.
20. That is, it is not clear from the draft IS whether trustees who are not already carrying on a taxable activity would be deemed to be carrying on a taxable activity simply by making accommodation owned by the trustees available to the beneficiaries from time to time.
21. Clearly the long-term use of a residential property by a beneficiary as the beneficiary’s home would be an exempt supply. However, where the trustees own a holiday home which was not rented out to third parties, but is made available to the beneficiaries of the trust from time to time, it is unclear whether this would constitute a taxable supply (notwithstanding the supply is made for no consideration but the value of that supply is determined in accordance with section 10).
22. As noted at paragraph 87 of the draft IS even if the use of the property by a beneficiary from time to time would constitute a supply, it is unlikely the value of those supplies would exceed the registration threshold.
23. It would be helpful if officials could clarify whether the use of property by a beneficiary of a trust without payment will constitute a taxable activity in respect of the property where the

trustees are not already GST registered.

Further assistance

24. We trust Inland Revenue will find these comments helpful. If you wish to discuss the comments, please do not hesitate to contact the Tax Law Committee convenor Neil Russ, through the Law Society's Law Reform Adviser, Emily Sutton (Emily.Sutton@lawsociety.org.nz).

Yours faithfully

A handwritten signature in black ink, appearing to read 'Herman Visagie', written in a cursive style.

Herman Visagie
Vice President