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## Abolition of Gift Duty

Gift Duty has been abolished in respect of all gifts made on or after 1 October 2011.

Gift Duty has been in existence since 1885 and has traditionally been in existence as a "buttress" to the estate duty regime to ensure that individuals do not escape estate duty by gifting off assets prior to death. When the estate duty regime was abolished Gift Duty was retained as a hedge against tax avoidance, creditor avoidance, and eligibility for social assistance. However the government now considers that there is other legislation in place to adequately deal with these issues. Furthermore over 225,000 gift statements are being filed each year with only approximately $2M of total Gift Duty being collected. This added to the costs to tax payers having to complete and file gifting documentation has resulted in the government's decision to abolish the Gift Duty regime.

### Implications of Repeal of Gift Duty

1. **Income Tax**

1.1 The implications in respect of income tax are essentially nil. This is because even if an income earning asset was not fully gifted off when it was transferred into a Trust (or other entity) the Trust has always been entitled to return all income/expenses associated with the asset as from the date the asset was transferred into the Trust. Furthermore, the top personal tax rate and the current trust tax rate have now been aligned (33%) and accordingly the incentive to transfer income earning assets into a Trust to gain a tax advantage between the trustee rate of income and the top personal rate has already been removed.

1.2 Please note however that the "financial arrangements" rules continue to apply to existing (and future) **forgivenesses of debt**. The "financial arrangements" rules in short provide that a Forgiveness of Debt will give rise to taxable **income** (to the Trust) **unless** the Trust has been established mainly to benefit natural persons for whom the creditors (i.e. the Settlors of the Trust) have natural love and affection **and** distributions from the Trust have been to those persons. If debts that have been "forgiven" (i.e. gifted) by the Settlors are then distributed (by the Trust) to beneficiaries other than persons for whom the settlor has natural love and affection then the distribution will become taxable as income in the hands of the Trust.

1.3 However if assets are now gifted directly to the Trust then there is no resulting "debt back" and the "financial arrangements" rules are unlikely to apply. This would mean that there is potential to subsequently distribute those gifted assets to a wider range of beneficiaries (not necessarily being persons for whom the Settlors have natural love and affection).

1.4 The existing tax considerations when transferring assets (primarily income earning assets) into a Trust (or other entity) continue to apply e.g. GST/losses retention/imputation credits/depreciation.

## 2. Creditor Protection – Claw back

2.1 The principal legislation that is relevant is the Property Law Act 2007 ("the PLA") and the Insolvency Act 2006 ("the IA"). The existing provisions in both of these acts continue to apply unamended despite the repeal of Gift Duty. Both of these acts are concerned with the "claw back" of gifts/transfer of property made by a person ("debtor") who is subsequently bankrupted or is being challenged by a creditor for alienating property which the creditor wishes to recover.

2.2 The PLA applies to;

A. Dispositions with intent to prejudice a creditor; or

B. A gift; or

C. Dispositions where you do not receive equivalent value.

Furthermore;

(a) The debtor must be insolvent at the time or became insolvent as a result making the disposition; or

(b) The debtor has engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small; or

(c) The debtor intended to incur or should have believed that the debtor would incur debts beyond the debtor's ability to pay.

As to (a) above a debtor is **insolvent** if they are unable to pay debts as they fall due from their assets other than the property disposed of.

2.3 The IA is similar to the PLA but;

(a) Provides that a gift made within **two years** of bankruptcy is automatically cancelled (the debtor is automatically assumed to be insolvent and can not rebut this).

(b) Gifts made between 2-5 years prior to bankruptcy are also presumed to be cancelled but it is open to the debtor to rebut this i.e. prove that he/she was not insolvent at the time the gift was made.

(c) The IA also enables the official assignee to set aside any "insolvent transactions" within two years of bankruptcy.

"Insolvent transactions" (previously known as "voidable preferences") are transactions made within two years of bankruptcy and at a time when the bankrupt was unable to pay his/her debts and which enable a creditor to receive more towards the satisfaction of their debt than they would otherwise have received in bankruptcy. Transactions within six months of a person being becoming bankrupt are presumed (unless the contrary is proved) to be made at a time when the bankrupt was unable to pay his/her debts.

2.4 Accordingly both the PLA and the IA rely heavily on whether or not the debtor was **insolvent** at the time a gift/transfer of property is made. Whether or not a person is insolvent at any point in time is very difficult to define (leading cases illustrate different approaches by several judges).

2.5 Therefore if you gift off assets of significant value then your solvency is likely to be much more closely looked at in the event that you subsequently become bankrupt and/or are subject to a claim by creditors. It is therefore advisable to have a "solvency test" completed by your accountants for significant dispositions of property/gifts particularly where certain risk elements are present e.g. you are running a high risk business.

2.6 Another significant area of uncertainty with respect to ascertaining solvency at the time of making a gift/disposition is the effect of any **guarantees** that have been given by the debtor. Again this will depend on each set of circumstances but in general terms the effect of having given a Guarantee on solvency will depend on how likely a debtor can reasonably expect the guarantee to be called upon.

## 3. Relationship Property

3.1 Section 44 of the Property Relationship Act 1976 ("the PRA") (previously the Matrimonial Property Act 1976) provides that dispositions of property may be set aside if they were made "in order to defeat the claim or rights of any person" under the PRA. This provision has not been used much as it is difficult to prove.

3.2 Section 44C of the PRA allows a court to order compensation to a spouse/partner where that spouse/partner's rights have been defeated by a transfer of relationship property to a Trust. This provision does not however allow the court to have recourse to the assets in the Trust.

3.3 Section 182 of the Family Proceedings Act allows a court to vary the terms of a Trust in certain circumstances – but this only applies where the parties are married and the relevant Trust has been settled on both parties.

3.4 The repeal of Gift Duty will make it easier in the first instance for a spouse/partner to put property beyond the reach of the other spouse/partner. Although the spouse/partner will continue to have the rights as set out above each of these rights has various limitations.

## 4. **Residential Care Subsidy**

4.1 The Social Security Act 1964 (and associated regulations) ("the SSA") provides for an asset assessment to determine whether a person qualifies for a Residential Care Subsidy ("RCS"). The threshold used to be low but was significantly increased by labour in 2005 and now stands at $210,000.00 and will continue to increase by $10,000.00 each year up to $350,000.00 in 2026.

4.2 There is also an alternative test (option B) where a person claiming a RCS has a partner/spouse who is not receiving a RCS which has a lower threshold ($115,000.00 plus a house and car).

4.3 The "claw back" or "add back" provision under the SSA are wide ranging and the Ministry of Social Development ("MSD") have signalled they will be looking very closely at any significant gifts made to trusts. There is no time limit on how far back the MSD can go in looking at gifts/dispositions of property to Trusts (or other entities) by persons now claiming a RCS. The gifting limits set out in the SSA are not affected by the repeal of Gift Duty.

4.4 In summary the MSD can claw back;

(a) Any gifts above $6,000.00 per annum or $30,000.00 in total in respect of the 5 year period prior to the application for a RCS.

(b) Any "deprivation of Property" which can include;

- Gifts made (potentially by **both** spouses) more than 5 years from application for a RCS which total in excess of $27,000.00 per annum.
- Transfers of property at less than market value or for no consideration at all.
- The failure to exercise any right of entitlement to demand a payment.
- An investment in non-income earning assets.

4.5 It therefore appears that if you are particularly concerned about income testing in respect of application for a RCS then the conservative approach is to continue gifting a maximum $27,000.00 each year (**per couple** (if applicable) not just per individual) in order to stay outside the stated deprivation of property test. If however you wish to make large one off gifts (which will not now attract any Gift Duty) then it is preferable to complete this sooner rather than later as the nearer this is to an application for an RCS the more likely it is to be "clawed back" by the MSD.

## 5. **Summary**

5.1 No gift duty is payable in respect of any gifts made on or after 1 October 2011.



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5.2 No Gift Statements are required to be completed or filed in respect of any gifts made on or after 1 October 2011.

5.3 Documentation will still generally need to be prepared and signed to effect a gift/transfer of property – this will not occur automatically.

5.4 Annual meetings of trustees should still continue to occur incorporating the annual review of the Trust's affairs. At that time any gifting/transfer of property can also be documented. This is also a good time to update/review any associated estate planning documentation (e.g. Wills/Memorandum of Wishes/Enduring Powers of Attorney).

5.5 In general terms if you have set up a Trust and have embarked on an estate planning process of divesting personal assets into your Trust then it is preferable to continue gifting remaining assets into the Trust. The continued gifting of assets to your existing Trust will build upon the existing benefits of your Trust/estate planning structure e.g.

- Creditor protection
- Protection against relationship property claims
- Taxation advantages in certain circumstances
- A possible hedge against means/assets/income testing
- Minimisation of assets in your personal estate therefore counteracting any challenges to your Will – and possibly avoiding necessity for Probate to be obtained
- Flexibility in distributions from the Trust after you pass away.

5.6 By contrast in certain circumstances gifting of all or significant assets to the Trust may not be advisable for the following reasons;

(a) Loss of ability to legally claim back sums owed to you by the Trust. This outstanding debt is technically the only claim that you personally have against the Trust and once it is completely gifted off then you are reliant on the Trustees distributing assets/income out of the Trust to you (as beneficiaries) as you require. In most circumstances the ability to appoint and remove trustees resides in the settlors and accordingly this should not be a significant concern. However each family has its own set of circumstances and these should be discussed before any significant gifting transactions are undertaken; or

(b) Would remove ability to claim back any uneven sums loaned to the trust by the settlors; or

(c) You may lose the ability to apply the "Option B" asset Limit when applying for a RCS; or



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(d) Larger gifts/transfers of property may be clawed back by the MSD if you apply for a RCS; or

(e) Gifts/transfers of property may be clawed back by creditors utilising the PLA or the IA; or

(f) It may helpful in the future to preserve the ability of the Trust to pay sums to you as "loan repayments" as opposed to "distributions" of capital or income out of the Trust.

Please contact us if you would like to complete a further gifting exercise and we will discuss your individual circumstances and requirements.

Yours faithfully
**Schnauer and Co Limited**

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