

ABOLITION OF GIFT DUTY



The Taxation (Tax Administration & Remedial Matters) Bill was passed by Parliament on the 17th August. One of the main features of the Bill was the abolition of gift duty. Gift duty will therefore be abolished from 1st October 2011.

We set out below some of the potential implications of the repeal of gift duty.

If gift duty is abolished - what does this mean for your trust?

The abolition of gift duty will be relevant to you if you have transferred property to your trust and a debt is still owed to you by the trust in connection with the transfer.

Currently, the debt owed to you by the trust can be forgiven, over time, at a rate of \$27,000 per annum. If gift duty is abolished, assets can be transferred to the trust without the need to enter into a lengthy gifting programme.

For those of you with existing gifting programmes, the balance debt owed to you by your trust can be forgiven in full.

I am due to make a gift before 1 October - should I still make it?

In many cases it may be appropriate to delay any further gifts by way of forgiveness of debt until after 1 October 2011. However there may be specific reasons in individual cases to complete gifts due before 1 October 2011, where making the gift is time critical for example you want to ensure your property is completely transferred to your trust prior to entering into a relationship or if there is a high possibility of needing rest home care and you want to ensure you have a period of time which is "gift free".

Each person's individual circumstances will be different therefore we recommend that you contact us prior to making that decision.

After 1 October should I make a one off lump sum gift?

In some cases it will be appropriate to make one-off gifts and others it will be not. Some of the reasons why it may be preferable not to make a one-off lump sum gift are discussed further below.

We recommend that you do not opt to make a one off gift after 1 October 2011 until you have discussed the implications of doing so with us first.

Requirement for funds

In most cases the debt owed to you by your trust is recorded as a loan. That loan remains your asset until the loan is repaid (or forgiven) in full. The ability for you to make demand for part repayment of the debt provides you with an opportunity to withdraw funds from the trust should you need them (and assuming the trust is in a position to make payment).

Once the debt has been forgiven completely, the only mechanisms for funds to be taken out of the trust for your benefit is by way of distribution or advance – both of which are to be made at the discretion of the trustees.

For those people who may need access to funds in the future they may wish to consider leaving part/all of the debt left owing by the trust to provide some degree of flexibility in terms of access to funds in the future. The requirement for funds must however be balanced against other considerations such as the fact the debt will remain an asset that could be subject to a claim by a third party.

Residential Rest Home Care

A one-off forgiveness of debt may not give rise to any advantages in terms of entitlements to rest home subsidies. Under the existing Social Security Act & Regulations gifts of:

\$6000 per annum per application made in the 5 years prior to an application for a subsidy; and

\$27,000 per annum per application for period beyond that 5 year period;

are currently treated by the Ministry of Social Development as exempt and may not be clawed back for means testing purposes. The flip side however is that gifts made in excess of the amounts referred to above can potentially be clawed back. This suggests that it may be appropriate to maintain a regular gifting programme within the confines of the above amounts if an application for a subsidy is likely to be a real possibility in the future.

Tax Issues

The forgiveness of debt can trigger certain income tax issues where the debt remission falls outside the natural love and affection rules. Currently a person can forgive a debt without triggering debt remission income under the accruals rules provided that the person forgiving the debt has natural love and affection for the person who owes the debt. Where a loan has been made to a company there may be a temptation after the abolition of gift duty to forgive that loan. A forgiveness of debt owed by a company will trigger debt remission income as a company is not a natural person and therefore falls outside the exemption for gifts made for natural love and affection.

A gift of property constitutes a “disposition” which could also trigger income tax consequences such as depreciation recovery. There may also be certain GST consequences where the transferrer of the property is GST registered and the property forms part of that persons taxable supplies.

We recommend that prior to making a gift or transfer of property or funds you seek advice on the tax consequences that may triggered as a consequence of that gift or transfer.

If I want to transfer an asset or funds to my trust after 1 October 2001 will I still need to record that gift?

Yes. It will still remain important to formerly record loans and/or gifts of property and funds to your trust as well as maintain proper trustee minutes and resolutions recording the transactions. These reasons are discussed more fully below.

Establishing proof of ownership and the date when property was transferred

There will be situations where it will be important to establish what property is owned by you and what property is owned by your trust and when that property was transferred to your trust.

This will be particularly important where a challenge is made by a third party in respect of the ownership or disposal of property. The circumstances where this may be relevant include:

- claims by creditors;
- a relationship property claim by a former partner or spouse; and
- when making an application for a residential care subsidy.

Each of these circumstances are discussed below.

Creditor Claims

If a person disposes of property to a trust and later becomes bankrupt, the Official Assignee has the ability to claw back any outstanding loan owed to that person by their trust as well as any gifts made to the trust in forgiveness of that debt within a certain period prior to bankruptcy.

Under the Insolvency Act, the Official Assignee may cancel gifts made within two years of bankruptcy; or within five years of bankruptcy if a person is unable to demonstrate that they were solvent when they made the gift. The Property Law Act also allows the transfer of property to be set aside where there is an intention to prejudice the interests of creditors.

In both cases having a documented evidence of the transfer together with a clear record of why the property is being transferred and the trustees’ reasons for acquiring, will be important for establishing the date of transfer, the intentions of the donor and providing evidence of the donors financial status at the time of making the gift.

Relationship Property Issues

It is possible that there may be an increase in gifting activity as a result of the repeal of gift duty. The ability to gift property without the need to enter into a lengthy gifting programme could result in more people transferring property to trusts in an attempt to defeat the claim of a partner/spouse in a relationship property dispute.

The existing provisions of the Property (Relationships) Act 1976 however will continue to apply. These provisions allow the Court to make financial adjustments if relationship property has been transferred to a trust or other entity which has the affect of defeating the interests of one of the parties.

Where a person intends to transfer his/her separate property to a trust it will continue to remain important to have a clear record of that transfer recording the date of the transfer, the value of the property gifted or transferred and that the property gifted or transferred is separate property.

Residential Care Subsidy

The existing Social Security Act & Regulations (which apply for the purpose of means testing applicants who apply for a residential care subsidy) provide for the adding back of gifts in excess of \$6000 per annum made by an applicant within the 5 years prior to the application for a subsidy and in excess of \$27,000 in the period beyond that 5 year period.

In accordance with the Regulations the Ministry of Social Development has an ability to decline an application for a subsidy where the applicant has deprived themselves of their assets. The term "deprivation of assets" includes a number of things for example; making gifts in excess of the limits set by the Ministries Regulations, failing to make demand for the repayment of a loan, lending funds interest free or selling a property at under market value. It is important to note that the "gifting" thresholds set by the Ministry for residual care subsidies are different to the amounts you are entitled to gift without attracting gift duty.

If gift duty is repealed, it is expected that a greater number of people will want to complete gifting property to their trust or family members as soon as possible. However it is likely that the Ministry of Social Development will going forward apply its discretion to look back beyond the five year period more frequently to ensure that people do not receive the subsidy where they have intentionally deprived themselves of assets over and above the thresholds set by the Regulations.

As stated above it is important that persons who are likely to need residential care to maintain very clear records of the gifts they have made. Further where funds or property are transferred to a family member (for example for help provided by that family member), the Ministry has indicated that in the absence of proper documentation supporting the transfer of property/funds they will take the position that the transfer was a gift and consequently & deprivation of assets.

Compliance with a trustee's fundamental duties and powers

A trustee has a number of fundamental duties and powers they are required to discharge or exercise in their position as trustees. One of those duties is to know exactly what makes up the Trust assets that they control. Another is the duty to maintain proper records and accounts.

Prior to acquiring an asset or property the trustees must ensure that they have the power to acquire it and that the acquisition of that asset is in the best interests of the beneficiaries. For example, is the asset one that generates ongoing income or has potential for capital growth. Does the acquisition fit within the trustees recorded investment strategy?

It is important that trustees prior to acquiring an asset fully document the reasons why they are acquiring the asset and that they have the power to acquire and hold that asset.

Maintaining proper records of the transfer of assets to your trust also ensures you have an accurate record for your accountant in the preparation of the trust's annual accounts.

How can we help?

Gifting programmes have meant that trustees have documented loans, gift, resolutions and minutes around financial transactions well. It also provided an annual touch stone meeting with your advisor to discuss the transactions as well as any additional issues affecting the trust.

As highlighted above there are numerous reasons why it is important to seek advice prior to making a gift and to have proper records recording when an asset, property or funds are being transferred to a trust. We encourage you to contact a member of our private client team if and when you are considering making a gift to your trust so we can properly advise you with respect to the gift you intend to make. We would also encourage you to ensure you maintain your regular trustees meetings with your co-trustees and meet at least annually with your legal, accounting and financial advisors.