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*A special report from the*  
Policy Advice Division of Inland Revenue

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## **Gift duty abolition**

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### ***Sections 2(2) and 61 of the Estate and Gift Duties Act 1968***

The new legislation abolishes gift duty for dispositions of property made on or after 1 October 2011. The change follows a review of gift duty, which revealed that the compliance costs far outweigh both the revenue it collects and the limited protections it has offered to prevent tax avoidance, social assistance targeting and defeat of creditors.

The definition of a “gift” in section 2 of the Estate and Gift Duties Act 1968 (EGDA) is amended so that the term refers only to dispositions of property before 1 October 2011. The Bill also amends section 61 of the EGDA to ensure that gift duty is payable only for gifts made from the Act’s commencement until 1 October 2011.

### **Background**

Gift duty has existed in New Zealand since 1885. Its original purpose was to protect the estate duty base (by discouraging the gifting of assets before death) and to raise revenue. When estate duty was abolished in 1992, the government of the day decided to retain gift duty to protect against income tax avoidance and social assistance targeting until alternative protection measures could be introduced.

Ministers and officials have received frequent requests for exemptions from gift duty and for a review of the gift duty thresholds over the past few years. The thresholds of \$27,000 for non-dutiable gifts and \$12,000 for the filing of gift statements were set in 1984 and have not been revised since. In addition, administration of gift duty has become antiquated, with no provision for the electronic filing of gift statements or any form of payment other than by cheque. Further, the valuation of annuities for the purposes of gifts under the Estate and Gift Duties Act is set according to life expectancy data that is more than 25 years out of date.

With this background, a review of gift duty was initiated. Options considered included:

- narrowing the scope of gift duty to apply only to gifts between individuals, trusts and closely held companies;
- raising the thresholds at which gift duty applies;
- removing the requirement to file gift statements for non-liable gifts;
- introducing electronic systems for the filing of gift statements and payment of gift duty; and
- updating life-expectancy tables for valuing annuities under the Estate and Gift Duties Act 1968.

As the review progressed, a strong case for outright abolition emerged. Some of the concerns which existed in 1992 have been addressed or reduced by the strengthening of existing legislative provisions. Remaining areas of concern were scrutinised in consultation with the Treasury, the Ministry of Economic Development, Ministry of Justice, Ministry of Health, New Zealand Police, the Ministry of Social Development, and Housing New Zealand Corporation. None of these agencies opposed gift duty abolition and several have said they will make administrative changes to support its abolition.

The review concluded that gift duty no longer raises any significant revenue and imposes a high level of compliance costs on the private sector. The protections offered by gift duty in the areas of income tax, creditors and social assistance have been incidental rather than intended policy goals. The analysis undertaken across government revealed that the protection gift duty offers is inefficient, limited and outweighed by the significant compliance costs that it imposes on the private sector. Therefore Ministers decided to abolish gift duty and an effective date of 1 October 2011 was chosen to provide certainty for the private sector.

The government agencies mentioned above will monitor the effects of gift duty abolition on their respective areas of responsibility and a post-implementation review will ensure there are no unintended consequences.

## **Key features**

- Gift duty will not be payable for dispositions of property made on or after 1 October 2011.
- Gift statements will not need to be filed for dispositions of property made on or after 1 October 2011.
- Gift duty and gift statements will remain due for dispositions of property made prior to 1 October 2011.

## **Application date**

The new legislation abolishes gift duty for dispositions of property made on or after 1 October 2011. The EGDA remains effective with respect to dispositions of property before this date.

## **Detailed analysis**

### **Record keeping requirements**

Gift statements will not be required for dispositions of property made on or after 1 October 2011. However, requirements to ensure the legal certainty of gifts, such as deeds of gift for trusts, are unchanged. Taxpayers may, therefore, still need to consult a lawyer when making a gift.

### **Income tax implications**

The abolition of gift duty does not have any impact on income tax anti-avoidance rules. As has always been the case, a gift may be deemed to be part of a wider arrangement of tax avoidance under section BG 1 of the Income Tax Act 2007.

There is a range of provisions in the Income Tax Act 2007 designed to directly ensure integrity around arrangements involving gifts, in addition to the general anti-avoidance provisions. These include:

- Section HC 35 minor beneficiary income rule;
- Section EW 38 rules for the disposal of financial arrangements for less than fully adequate consideration;<sup>1</sup>
- Section HD 15 joint and several liability of company directors and controlling or interested shareholders where a company enters into an arrangement that results in an inability to meet its tax liability;
- Sections CD 6 – CD 6 deemed dividends for transfers of value from a company to an individual;
- Section CX fringe benefit tax rules for gifts to employees;
- Sections FC 1 and FC 2 treatment of distributions from companies and trusts, gifts, and transfers of assets and liabilities upon death as disposals and acquisitions at market value;
- Section GC 1 rules for disposal of trading stock for less than fully adequate consideration; and

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<sup>1</sup> Section EW 44 provides an exception to this rule where the creditor forgives the debtor's debt because of the natural love and affection the creditor has for the debtor.

- Section 10(3) of the Goods and Services Tax Act 1985, which treats the associated supply of goods and services as if they were for market value where there is no fully adequate consideration.

### **Gift duty abolition – questions we’ve been asked**

*Q: Won’t gift duty abolition increase trust use? Why not wait until after the Law Commission’s Review of Trust Law is completed, before abolishing gift duty?*

A: The Law Commission’s Review of Trust Law seeks to address much broader issues than gift duty, including trust regulation, trust use and judicial responses. Gift duty is not the appropriate mechanism to deal with any inadequacies in New Zealand trust law, so the outcomes of the review are unlikely to impact on the decision to abolish gift duty. Although gift duty has made gifting compliance cost intensive, it has not stopped people from doing so.

The gift duty review did not find any evidence to support the claim that the abolition of gift duty will lead to an increase in the number of trusts or the value of the assets that they hold. Gift duty has not prevented the considerable growth of trusts in New Zealand over the past 30 years. It should also be noted that, although gift duty abolition will reduce the compliance cost associated with gifting, there are still significant costs involved in establishing a trust, and deeds of gift will still be required in order to make new dispositions. Aside from cost, there are other important considerations that need to be considered in deciding whether to establish a trust, such as whether the potential settlor is willing to give up ownership and control over their assets and whether there are better ways of meeting their needs.

*Q: Won’t getting rid of gift statements mean that gifts will no longer be recorded?*

A: Due to the strict secrecy requirements of the Tax Administration Act 1994, Inland Revenue has not been able to provide details of gift statements to private entities or other government agencies, except to the Official Assignee and Police in limited circumstances. Therefore, gift statements have not provided the government with a general record of trusts or gifts, and they have not been used to determine eligibility for government entitlements such as residential care subsidy.

In the absence of gift statements, evidence will continue to exist in the forms of deeds of gift, land transfer records for real property, registration details for motor vehicles and banking records for cash transfers. Each of these independent records could be expected to show both the donor and the recipient of the gift, just as gift statements have done.

*Q: What remedies are available to creditors when the debtor has gifted away their assets?*

A: Three existing statutes contain provisions to allow the claw-back of dispositions for the benefit of creditors:

- Sections 204 and 205 of the Insolvency Act 2006 allow the Official Assignee to automatically cancel gifts made within two years before adjudication, or within five years if the bankrupt cannot demonstrate solvency at the time the gift was made;

- Section 292 of the Companies Act 1993 gives the Official Assignee similar powers but over shorter timeframes (6 months and 2 years); and
- Subpart 6 of the Property Law Act 2007 empowers the Courts to set aside property dispositions where there was an intention to prejudice the interests of a creditor. This provision is not time-limited.

The Ministry of Economic Development has committed to monitor future cases brought under these Acts, and a government-wide post-implementation review will consider any impacts resulting from gift duty abolition.

*Q: What remedies are available in relationship property disputes where one partner has gifted away their assets? Are there any remedies if a person is not adequately provided for under a will and the testator gifted away assets prior to death?*

A: The effect of gift duty abolition on relationship property rights and succession claims was considered as part of the gift duty review, in consultation with the Ministry of Justice. The review concluded that gift duty has not been a means of addressing any perceived problems with relationship property and succession law, as gift duty has not prevented dispositions from occurring, though it has had practical impact on how some dispositions have been structured in terms of their timing.

Ministry of Justice officials do not consider changes to the Property (Relationships) Act, Family Protection Act and the Law Reform (Testamentary Promises) Act are required. The underlying philosophy of these Acts is that individuals are generally free to deal with their own property as they wish – any entitlement one person may have to the property of another does not arise until the actual event of separation or death.

There are several legislative provisions that may remedy gifts made in some circumstances:

- The Property (Relationships) Act allows the courts to restrain or to set aside transfers of property to trusts where there was an intention to defeat a spouse's or partner's claim at the time the disposition was made.
- If the disposition was not intended to defeat a claim, but had that effect, the courts are able to grant compensation (although in this circumstance the court cannot set aside the trust). Compensation can include other non-trust assets or the income of the trust, but does not include the capital of the trust (the power to unwind the trust could disadvantage other beneficiaries, including children of the relationship).
- Section 182 of the Family Proceedings Act allows the court to vary the terms of an agreement or settlement (made before or after a marriage or civil union) if, at the end of the marriage or civil union, an applicant no longer derives the benefit he or she reasonably expected to receive from the agreement or settlement. This includes the ability for the courts to vest part of a trust in an affected partner, for their benefit.

The Ministry of Justice will monitor any impacts of gift duty abolition to inform the government-wide post-implementation review.