



Our Gift to You

**Abolition of gift duty -
options and risks**



CCH

a Wolters Kluwer business

Gift duty does not apply to gifts made on or after 1 October 2011. Any gifts made prior to 1 October 2011, whether or not formally recorded as a gift, will still be subject to gift duty if the gift exceeds the gift duty threshold.

The abolition of gift duty will change the nature of asset and estate planning. This is because the current “model” of sale with a debt back that is progressively forgiven has been driven by gift duty. Who can benefit from a trust where debts have been forgiven has been effectively limited to avoid application of the financial arrangement rules.

The use of sale of an asset with a debt back to transfer assets to trust developed to avoid gift duty. Now that gift duty no longer applies it is now possible to gift assets directly to a trust. This can be done either through declaring a trust in respect of specific property or by gifting property to an existing trust. To be recognised as valid deeds of gift will need to record that the gift has both been made and accepted.

Practitioners will need to develop or invest in new gifting precedents.

Whether to gift?

The appropriateness, or otherwise, of forgiving outstanding debts, or otherwise making gifts will depend on the circumstances of each individual. Accordingly, practitioners will also need to up-skill on how to advise clients regarding whether or not to forgive existing (and on-going) debts in whole or in part.

The decisions that require to be addressed will generally fall under one of five headings:

- Identity of beneficiaries
- Residential care subsidy entitlement
- Preservation of rights
- Solvency / Creditor protection
- Relationship property considerations

Where there may be other consequences from debt forgiveness, these consequences need to be balanced against creditor protection considerations, the reasons for why the trust was settled and any other relevant considerations.

Example:

Sara and Hori settled Tess’s Trust in 2002 when they were aged 32 and 38. At the time the Trust was settled Sara and Hori were both employees and had no creditor exposure.

Sara’s mother Patricia had just gone into a rest home and since that time Sara’s mother’s personal resources have been significantly depleted paying for her rest home care. In 2010 Hori started working as a self-employed celebrity photographer. To date Hori has enjoyed a positive relationship with the celebrities that he follows. However, he is aware that a number of colleagues have been sued following altercations with celebrities. Last week Hori’s close friend John, also a photographer had a significant damages award made against him.

When Sara and Hori settled the Trust they were aware that by doing so they might be more likely to qualify for a residential care subsidy in the future.

On 1 October 2011 the trustees of the Trust owe \$360,000 to Sara and the same amount to Hori. If those debts are forgiven by a single gift, applying the current rules, Sara and Hori will not qualify for a residential care subsidy. However, if the debts are not forgiven (or if Sara and Hori continue a gifting program that meets residential care subsidy criteria) and Hori is sued, any debt still owing to Hori will be an asset available to satisfy any judgement against him.

In deciding what to do, Sara and Hori must balance the desire to be protected from any claims against Hori with the wish to retain eligibility for a residential care subsidy.

Many of the answers to gifting questions are not immediately apparent, requiring a consideration of the likelihood of the occurrence of uncertain events.

The critical path diagram on the next page highlights some of these decisions.

Identity of beneficiaries

The debt that arises from the sale and debt back mechanism adopted to avoid gift duty is a financial arrangement.

A loan that is interest-free and repayable upon demand is an excepted financial arrangement to the lender (Income Tax Act 2007, s EW 5(10)). This means that no income accrues to the lender from the arrangement.

However, from the borrower’s perspective, the loan is subject to the financial arrangements rules. Where a debt is forgiven, the rules that apply to financial arrangements provide that income can accrue to the trustee borrower. However, these rules do not apply where the debt is forgiven in consideration of natural love and affection: s EW 50. Where the debtor is a trustee, natural persons are able to forgive debts owed to them by the trustee without income tax consequences if the trust was established mainly to benefit “a natural

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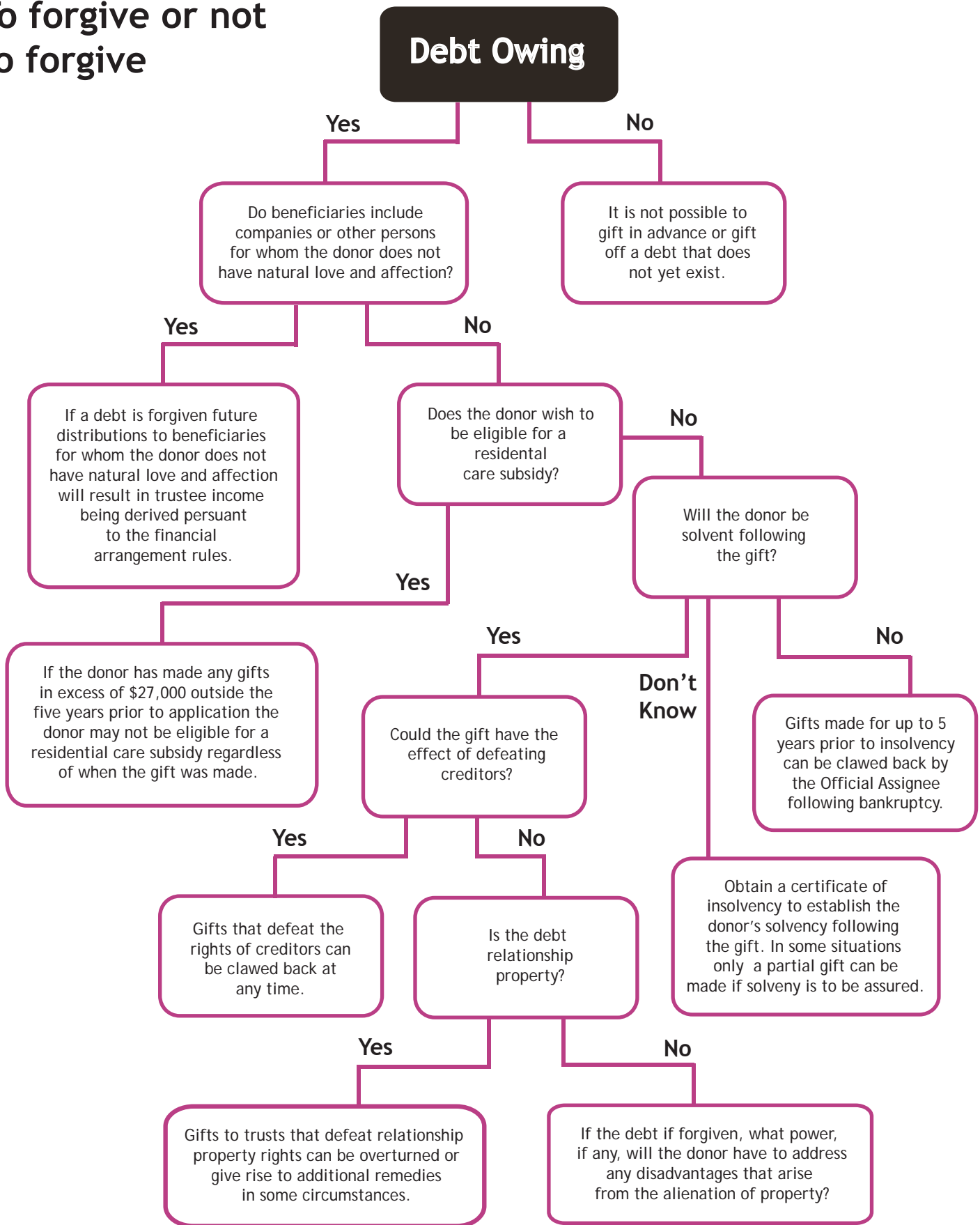
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To forgive or not to forgive



Consider whether it may be appropriate to leave all or part of the debt owing to preserve the donor's rights. This consideration must be balanced against creditor protection and other considerations raised above.

person for whom the creditor has natural love and affection" and/or a charity that is registered with the Charities Commission: s EW 50.

However, where trustee debts have been forgiven, and the trustees of the trust subsequently make distributions to persons other than those for whom the creditor has natural love and affection or registered charities, such distributions will be income to the trustees in the year in which the distribution is made to the extent that the distributions do not exceed the amounts of the debts forgiven: s EW 50.

Following the abolition of gift duty the limitations on beneficiaries that previously applied to avoid financial arrangement income will no longer apply.

This means that if assets are gifted directly to trustees of a trust where no gifting program has been in place there is no requirement to limit the classes of beneficiaries as has been the case.

Residential care subsidy

The eligibility requirements for a residential care subsidy are set out in the Social Security Act 1964 and the accompanying Regulations.

The Social Security Act has means-testing provisions for both assets and income. Section 147A provides that where a person (or the person's spouse or partner) applies for a means assessment, and that person has "directly or indirectly deprived himself or herself of any income or property", the person can be assessed as if the deprivation has not occurred: s.147A.

Deprivation of property includes:

- gifts in excess of \$6,000 per year in the 5-year period before application for a residential care subsidy; and
- any gifts that exceed \$27,000 in any 12-month period prior to the 5-year period.

There is no time limit for the application of the "\$27,000 rule". See regulation 9B of the Social Security (Long-term Residential Care) Regulations 2005.

These eligibility rules, which are enforced by the Ministry of Social Development ("the Ministry") on behalf of the Ministry of Health (MOH), will not change following the abolition of gift duty.

Further, it is unlikely that the MOH's residential care subsidy budget will increase due to the abolition of gift duty. It is also important to appreciate that when looking at whether deprivation has occurred, the Ministry can take into account gifts made by an applicant's spouse or partner: s 147A.

This means that where a couple has gifted \$27,000 each the couple will have "deprived" themselves of \$27,000 because they have exceeded the \$27,000 limit. Where a couple each make an application for a residential care subsidy, \$27,000 each is permissible. Note that this interpretation is currently under review and a "safe" gifting limit for a couple would be \$13,500 per annum.

Gifting is not the only consideration to take into account when assessing residential care subsidy entitlement. Where a person has reserved a life interest in a property before that property is sold, or otherwise transferred to trustees, the value of the life interest will also be taken into account when assessing the applicant's means. The value of the life interest is set at the value the day it was granted or retained, until the property is sold. If the property is sold, the life interest asset will be recalculated, based on the sale value.

While some transactions to trusts that have the effect of defeating a person's entitlement to a residential care subsidy can be overturned, this will not always be the case. Any person who wishes to preserve the ability to apply for a residential care subsidy should seek advice before making any significant gifts.

For more information on this subject see "Asset planning the impact of MSD's means assessment for residential care subsidies" available from <http://www.lawyerseducation.co.nz/shop/Publications>.

Also see http://www.workandincome.govt.nz/manuals-and-procedures/income_support/extra_help/residential_care_subsidy/residential_care_subsidy.html

Preservation of rights

A debt back can provide security for a donor who has sold all his or her assets to a trust. This security can mean that the donor is able to effectively preserve a right to live in trust property or ensure that capital will be repaid to the donor if required. This can be particularly important where the donor does not have powers of appointment.

For this reason, the deed of trust should be reviewed before any major gift is made to ensure that the donor could not be disadvantaged by the gift. Where there is any question as to disadvantage the prudent course of action is to recommend independent advice before the gift is made and for the reasons and basis for the gift to be recorded.

Solvency / Creditor protection

In a post-gift duty era, proof of solvency at the time a gift is made will be critical for some donors and the recipient donee(s). Historically, while it has only been possible to make small gifts each year, the question of donor solvency has rarely been an issue. However, now that bigger gifts can be made, care must be taken to assess and confirm

solvency at the time of a gift. If, as a result of a gift the donor is unable to pay debts as they fall due, or if personal liabilities exceed personally owned assets then the gift may be able to be clawed back from the recipient of the gift, whether or not that recipient is a trustee.

For the purposes of the Insolvency Act, the Official Assignee can claw back gifts made in the two years prior to an adjudication of bankruptcy: Insolvency Act 2006, s.204. Gifts made between 2 and 5 years prior to bankruptcy can also be set aside if the bankrupt was insolvent at the time of the gift. The liability to prove solvency rests on the recipient of the gift: Insolvency Act 2005, s. 205. There is a rebuttable presumption of insolvency in this case.

Given the claw back tests for solvency, it may be appropriate to make gifts as early as possible, sometimes on multiple occasions during the year as each gift recorded provides a "marker" in relation to claw back provisions.

To minimise risks when making substantial gifts the prudent donor should consider that person's financial position before and after the gift is made. Where the donor has no contingent debts or liabilities this will be a straight-forward exercise.

However, it will be prudent for some donors to document their financial situation at the time of a gift so that a contemporaneous record of solvency can be provided if the donor's solvency is challenged in the future. Proof of solvency would present a substantial burden for the Official Assignee in the face of a claim under the Insolvency Act. The best evidence of solvency would be a solvency certificate provided by a qualified external adviser. Alternatively a declaration of solvency may also assist.

The CCH Trust Service will have a declaration of solvency precedent added to it that will address issues of solvency and good standing.

Any gifts that have the effect of defeating creditors can also be set aside at any time: Property Law Act 1952, Property Law Act 2007. While a solvency certificate or declaration of solvency may not be a total defence to a claim under either Property Law Act, it could be helpful.

However, more useful might be communications at the time of a transfer putting any person who might be disadvantaged on notice. If transfers could be shown to have been made by consent, together with some evidence as to solvency, it might then be possible to defend a claim that a disposition was made to defeat a creditor's interests.

Relationship property

The relationship property legislation is not being amended due to the abolition of gift duty. Accordingly, as was the case prior to the abolition of gift duty, if relationship property is disposed of into a trust, either through a gift of property or through the forgiveness of a relationship debt, it may be possible for the disposition or gift to be overturned on application under the Property (Relationships) Act 1976 or lead to additional remedies against the donor or the trust. Any significant gifts of relationship property should be recorded in a s.21 agreement if the gift is being made in fulfilment of relationship property rights. The CCH Trust Service includes a s.21 agreement precedent.

The possibility of claims under the Family Proceedings Act 1980 must also be taken into account. Again, where there is any question as to disadvantage the prudent course of action is to recommend independent advice before the gift is made and for the reasons and basis for the gift to be recorded.

Other considerations

When assessing whether to gift or not it will often be useful to consider why the trust was settled. For example, if the primary motivation was to ensure inter-generational asset protection, the fact that a large gift might mean that a residential care subsidy will never be available may be largely ameliorated by the subsequent asset protection afforded.

How to gift

Following the abolition of gift duty there will be no requirement to file gift statements and associated deeds. This means that it will be necessary to reconsider how gifts are recorded and what documents are required. Trustees will still be required to keep a record of all forgiveness of debt and distributions to beneficiaries over the life of the trust: Tax Administration Act, s 22B.

Although there is no legal requirement that gifts (other than real property) are recorded in writing, in the absence of any formal record of a gift, proving that a gift has been made may be difficult.

Where a gift cannot be proven, it may be treated as an advance or as having failed such that the "gift" is still the donor's property and is available to creditors.

Requirements to ensure the legal certainty of gifts, such as deeds of gift for trusts will still be required. See the special report on the abolition of gift duty at www.taxpolicy.govt.nz

It may also be appropriate to review current practices where beneficiaries meet costs such as rates and insurance as consideration for living in trust owned property. As such costs are more correctly incidental to ownership, rather than occupation, a more prudent approach would have such payments regularly recorded and documented as gifts.

Method of gift

Following the abolition of gift duty it is likely that the "old" practise of selling property to trust with a gift back will generally be supplanted by a gift directly to trust. This means that practitioners will need to develop new precedents and review practises. The CCH Trust Service will have a new deed of gift to deal with this.

Where gifts are made directly rather than by debt forgiveness the financial arrangement rules will no longer apply. This means that moving forward, wider classes of beneficiaries will be possible for newly settled trusts, where no debts have ever been forgiven, without the possibility of financial arrangement income being derived following distributions to beneficiaries for whom the donor does not have natural love and affection.

See Taxation of Trusts (ed 2), chapter 14. However, as was the case prior to the abolition of gift duty, a valid gift must also be in respect of property that is in existence. It is not possible to gift in anticipation.

With the introduction of the new legislation, CCH has a range of products which can help you with gifting and other topical trust issues.

Trust Administration

- The CCH Trust Service
The complete trust administration package

Updating Trust products

- The Trust and Asset Planning Guide
- CCH Trust Cases

Trust Books

- The Trustee's Handbook
- Taxation of Trusts
- New Zealand Master Trusts Guide

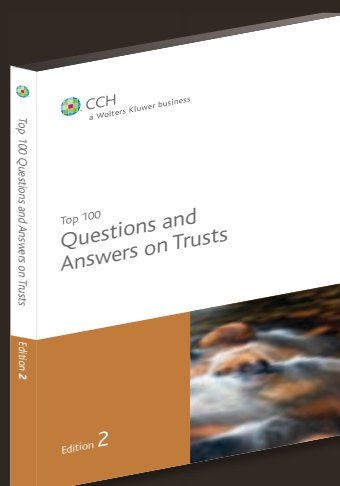
FREE BOOK

Offer

Top 100 Questions and Answers on Trusts

When you request an appointment with a CCH Account Manager to view the *CCH Trust Service* or the *Trust and Asset Planning Guide* and *Trust Cases*.

**EMAIL: GIFTING@CCH.CO.NZ
TO MAKE AN APPOINTMENT
AND RECIEVE YOUR FREE BOOK**



The Trust and Asset Planning Guide



Comprehensive trust commentary, legislation and cases

The CCH Trust and Asset Planning Guide provides comprehensive commentary which is supported by up-to-date legislation, case law and bulletins. The Guide gives clear guidelines on an array of asset and estate planning topics with worked examples which help you understand the concept and how it would be applied in practice.

Why you need the Trust and Asset Planning Guide

- An essential research tool for anyone involved with Trusts
- Comprehensive commentary which stays true to the legislation but written in straight-forward language
- Easy-to-use and gives clear guidelines on an array of asset and estate planning topics
- Commentary is supported by references to case law, legislation and other recognised sources like rulings issued by the Inland Revenue Department.
- Worked examples help you understand the concept and how it would be applied in practice
- Bulletins which include case notes, legislative updates, practical advice for trustees and trust administrators.
- A headnote provides a summary of each decision so that relevance can be quickly ascertained
- Detailed professional index so it is easy to find the paragraph that deals with your specific topic of interest

Commentary, Legislation, Cases and bulletins for:

1. **Asset planning structures and implications**
 - Tax planning business and funding structures
 - Gift duty
 - Partnerships
 - Companies
2. **Trusts**
 - Express Trusts
 - Wills
 - Intestacy
 - Powers of Attorney
3. **Trust Administration**
 - Duties
 - Powers
 - Rights of Trustees
 - Settlers and Beneficiaries Rights
 - Powers of Court Appointers and Protectors
 - Sham Trust
 - Trusts Taxation
4. **Precedents**
 - Understanding a Family Trust deed
 - Understanding a Trading Trust deed
 - Charitable Trust Deeds
 - Charitable Trust board deeds
5. **Insurance planning**
 - Life Insurance
 - Business Life Insurance
 - Medical and Professional Indemnity Insurance

For more information:

The CCH Trust Service

The complete trust
administration package

Streamline the creation and administration of trusts.

With the gifting changes in place it is as important as ever to keep accurate trust records and record gifts to eliminate risks to you and your business. Created to meet the trust administration needs of legal and accounting firms the CCH Trust Service is a software package designed to streamline the creation and administration of trusts. It is the most widely used trust administration package in New Zealand and can reduce your workload by up to 80%.

The CCH Trust software allows you to collect the following information for each Trust:

- Standard trust data which can be customised
- A register of each person associated with the trust
- Notes: general and dated
- Legal summaries
- Responsibilities
- Assets and liabilities
- Distributions
- Gifting Accounts
- Document register
- Minute book
- Tasks scheduled and task history
- Calendar

Why you need the Trust Service?

- All trust information is in one place and easy to access.
- Contains essential trust precedents and minutes developed by a leading law firm
- Can generate a wide range of reports
- Can be customised to suit your firms needs
- Uses Microsoft Word for document creation.
- A CCH technical helpdesk is available for support
- Access to the CCH Question and Answer service for queries about trusts and their administration answered by CCH trust analysts.

For more information: