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GIFTING SEMINAR 2012

DEFINITION OF GIFT

The definition of a gift is quite broad, but in essence a gift is either the transfer of any assets without consideration, or the release of a debt. It is the latter of these two definitions which this seminar is primarily focused on.

WHY GIFT DUTY?

Gift duty was used as a protection for the Estate Duty regime and it was designed to ensure that people did not try to avoid estate duty by transferring all of their assets prior to their death.

In recent years it was a regular occurrence to sell an asset, usually to a family trust, take a debt back and forgive the debt over a period of time. Generally, the debt was forgiven at a rate of $27,000 per annum being the amount exempted before a gift duty cost was imposed.

Gift duty was abolished as at 1 October 2011. Please note that the changes in the law only apply to gift duty and that there is other legislation where the amount being gifted is still relevant.

SHOULD WE GIFT IN ONE LUMP SUM?

Many people will still have a substantial balance of loan yet to be forgiven – should they take the opportunity to forgive this balance in one lump sum? **Answer: Yes, but…**

CREDITOR PROTECTION AND INSOLVENCY

One of the principal reasons for the transfer of assets to another entity is to protect those assets from creditors. It is common for business people and professionals such as lawyers and accountants to transfer their assets to a family trust and/or some other entity to protect those assets in the event that the transferor was sued and/or threatened with bankruptcy.

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The imposition of gift duty has acted as a disincentive to debtors disposing of their assets to defeat the claims of their creditors. That is because gift duty was levied at quite a high rate and it was expensive to gift significant assets off in one gift. As many of you will be aware, gift duty was not levied on gifts of $27,000 or less. Accordingly, it became routine for individuals to transfer assets to another entity, with that entity signing an acknowledgement of debt for the consideration. Subsequently the debtor would then forgive the debt at a rate of $27,000 per annum.

With the abolition of gift duty, debtors can now transfer assets to another entity and forgive the debt at the same time.

Under the Insolvency Act 2006, the official assignee has the power to set aside solvent transactions which includes insolvent gifts.

Any gift made within two years of bankruptcy may be set aside. Furthermore, any gift made between two and five years before bankruptcy can be set aside if the bankrupt was unable to pay his or her debts at the time the gift was made. The onus of proof is on the recipient of the gift to prove that the debtor was solvent when the gift was made.

The issue of solvency under the old gifting regime was relatively straightforward. Typically, carrying out a gifting program meant that the financial position of the person making the gift did not dramatically change with each gift. On a balance sheet basis, the person making the gift would have the benefit a large loan back from the trust and if required, that loan could be called up, the assets sold and the funds repaid to the person who made the gift. On a cash flow basis, most people would be able to meet their ongoing obligations. Accordingly, under the old gift duty regime, it was only those gifts made within a two year period of bankruptcy which could be clawed back.

Now that people can make large gifts to trusts and other entities it is likely that there will be a much greater number of cases where the official assignee will either attempt to, or be successful in, clawing back gifts. The reason for this is that when you make a large gift your financial position will almost certainly change. The person making a large gift will almost certainly be balance sheet insolvent because they no longer own any assets and will still have ongoing commitments to the bank.

One way in which a donor can protect him or herself from these provisions is to assess his or her financial position before the gift is actually made. Where a donor has no contingent debts or liabilities this will be a straightforward exercise.

However, it will be prudent for a number donors to document their financial position at the time of a gift. In this way, proof of solvency would make it extremely difficult for the official assignee to claw back funds made under such a gift.

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One suggestion is for the donor to complete his/her own solvency certificate, or alternatively, a better option would be a solvency certificate to be provided by a qualified external advisor (presumably an accountant).

THE IMPLICATIONS OF GIFT DUTY REPEAL FOR RELATIONSHIP PROPERTY

The Property (Relationships) Act 1976 (formerly the Matrimonial Property Act 1976) provides that the disposition of property may be set aside if it was made to defeat the claim or rights of the other spouse.

Accordingly, where one partner establishes a trust and gifts assets to that trust (which can now be done instantly) then the other spouse or partner may seek an order compensating the partner whose rights have been defeated by the disposition of property to a trust or company.

However, where a person has established a trust and transferred assets to that trust prior to that relationship, then the defeated partner will have no recourse to those assets. The fact that a person can now gift assets into a trust instantly makes it easier for that partner to have completed the transaction prior to entering into a relationship. Under the old regime of gifting, as it took some time to gift off debt, there would usually be a debt owing back to the partner at the time the relationship was entered into and that debt came within the provisions of the Act.

These provisions are known as the trust-busting provisions of the Property (Relationship) Act 1976. They are likely to be used more frequently than in the past, given the comments I have just made about the fact that under the old regime gifting was a long process. Unfortunately, this will mean that for those people who cannot afford legal representation they will not be able to bust the trust and receive what, under the Act, is rightfully theirs.

STATE BENEFITS - GENERAL PRINCIPAL

Underlying principal is that people are/will be required to look at their own resources before calling on the state to pay.

General Benefits

There are no allowable gifts in the Social Security Act 1964 for persons applying for general benefits and assistance.

Residential Care Subsidies

Residential Care Subsidies (RCS) are available for people who require long-term residential care and who have limited income or assets. Financial means assessments are carried out where an application is made for RCS to find out whether a person is financially able and how much they must contribute toward their care. It assesses both assets and income of the applicant and their spouse.

Exemptions:	***Asset limit as at 1 July 2011***
Single client	$210,000 (including family home and car)
Couple – both in care	$210,000 (including family home and car)
Couple – one partner living in the community	$115,000 (excluding family home and car) OR $210,000 (including family home and car)

A problem can arise when the family home has been transferred to a trust or other family member as the applicant may no longer own an exempt home, and may instead own a debt that is not exempt.

Where there is a family trust the financial means assessment will look at what assets have been settled on the trust, and when and how much gifting has occurred. (Please note that gifts made to other family members may also be considered).

Gifts made prior to an application for RCS are subject to limitations -

- In the five years immediately before application $6,000 per year
- More than five years before application $27,000 per year

We understand that current practice is to recognise allowable amounts on a per application basis. For example, both partners gift $6,000 each -

- If both partners have applied for RCS – allowable gift is $12,000
- If only one partner has applied for RCS – allowable gift is $6,000

Any amounts of excess gifting may be "added back" as part of the financial means assessment.

Timing is important:

- A gift of $30,000 made five years before application can be spread forward.
- A gift of $30,000 made one year before application is limited to $6,000.
- A gift of $100,000 made six years before application is limited to $27,000 with no ability to spread to other years.

DEPRIVATION

We have spoken about transferring assets to a trust and gifting off the associated debt. The financial means assessment also looks at income, the definition of which is broader than the usual income tax rules (may also include loan repayments).

Deprivation can occur when a client (or their partner) gives away or sells assets for less than their value, and includes:

- Waiving of a right to income
  Fail to take action to recover unpaid rent from a tenant.

- Not demanding payment
  Fail to make demand for interest or principal payable on a personal loan.

- Investing in low or non-income producing assets (non-interest-bearing bank account).

- Transferring or selling assets at less than market value to a family member.

- A previous income stream such as estate income or trust income ceases at the request of the applicant (or their partner) or the trustees.

ROUGH RULE OF THUMB

- Less than $500,000 - continue gifting at $27,000 per annum to avoid excess gifting being added back. See example of $100,000 gift above.

- $500,000 to $1million - case by case basis. Will be a trade-off with benefits that you may or may not be eligible for.

- Over $ 1 million – gift off in lump sum if you wish. Unlikely that you will have been entitled to Resthome Care Subsidy or other benefits.

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BEWARE

By transferring assets to a trust you are passing control of these to the trustees. Gifting off the associated loan deprives you of the ability to generate income (interest on the loan) or request repayment of lump sums to support your lifestyle in retirement.

You need to ensure that you have some mechanism in place for access to income or capital from the trust – usually as a beneficiary of the trust.

PRACTICAL MATTERS

Some people have wrongly assumed that given the abolition of gift duty, no documentation is required because they have assumed that the gifting is deemed to have occurred. This is incorrect and the documentation of the gifting process is as important, if not more important, than it has been in the past. It is my opinion that the following formalities will still need to be observed;

1. Valuations obtained for the assets being transferred.
2. An agreement for the sale and purchase or some other deed recording the transfer of assets.
3. The recording of the gift which may or may not be contained in the agreement or deed.
4. A solvency certificate as I have discussed previously.
5. The updating of the trust's asset register.
6. Prepare full and clear financial statements, recording assets and liabilities of the trust, sources and distribution of income and the trust's tax position.

The purpose of this seminar is not to try and sell our services to you, but it is clear to me that the abolition of gift duty makes the issue of gifting more complex and risky and accordingly you should seek professional accounting and legal advice before carrying out any significant gifts. It is likely that the cost of this advice will be far less than the consequences if you get it wrong.

DISCLAIMER

The above comments are general in nature and are not intended to be a substitute for specific professional advice on any matter and should not be relied on for that purpose. Independent professional advice should be obtained before relying on any aspect of the content of these papers and materials.

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