

On 22 June 2006, the Inland Revenue Department issued the following policy statement in response to a question asked.

QUESTION WE'VE BEEN ASKED

EXEMPTION FROM GIFT DUTY FOR DISPOSITIONS OF PROPERTY MADE BY OR UNDER AN ORDER OF THE COURT: SECTION 75A(5) ESTATE AND GIFT DUTIES ACT 1968

Background

We have been asked to clarify when the exemption from gift duty provided in section 75A(5) of the Estate and Gift Duties Act 1968 (“the EGDA”) applies to dispositions of relationship property made by or under an order of the Court pursuant to section 25 of the Property (Relationships) Act 1976.

Application

The interpretation of the law outlined in this item will be applied by the Commissioner to dispositions of property made after 5 October 2005 by or under an order of the Court pursuant to section 25 of the Property (Relationships) Act 1976.

The Commissioner has published a Notice of Withdrawal giving notice of the withdrawal of the previous policy statements contained in the item entitled “Gift Duty Exemption Clarified” published in *Taxation Information Bulletin* Vol 9, No 6, June 1997 and the item entitled “Gift Duty Exemption Further Clarified” published in *Taxation Information Bulletin* Vol 9, No 8, August 1997.

Legislation

Section 75A of the EGDA provides for exemptions from gift duty for certain dispositions of property made pursuant to the provisions of the Property (Relationships) Act 1976 (“the PRA”) (formerly called the Matrimonial Property Act 1976).

Section 75A of the EGDA as a whole was re-enacted by the Property (Relationships) Amendment Act 2001 with effect from 1 August 2001. The substituted provision took into account the changes made by the amendment Act to the Matrimonial Property Act 1976. The changes in wording widened the group of people who could be parties to an exempt transaction by including de facto partners but did not change the other requirements for an exempt transaction.

Section 75A(5) of the EGDA concerns a disposition of property by or under an order of the Court made pursuant to section 25 of the PRA.

Prior to 25 September 1993, section 75A(5) did not limit the dispositions that were exempt from gift duty if they were made under a court order pursuant to section 25 of

the PRA. From 25 September 1993, amendments to the EGDA restricted the application of the exemption to dispositions “to” a spouse or former spouse or dispositions made “solely for the benefit of” minor or dependent children of the marriage. These amendments were made to counter the effect of the decision in *Wilson v Wilson (No.2)* (1991) 7 FRNZ 519 which allowed a gift duty free transfer of matrimonial assets directly to a discretionary family trust.

Section 75A(5) was subsequently amended by the Estate and Gift Duties Amendment Act 2005 to include references to civil unions and children of civil unions. These amendments took effect from 26 April 2005.

Section 75A(5) of the EGDA provides as follows:

Any disposition of property by or under an order of the Court under section 25 of the Property (Relationships) Act 1976 does not constitute a gift to the extent that the disposition is to a spouse, civil union partner or de facto partner or former spouse, civil union partner or de facto partner or is solely for the benefit of minor or dependent children of the marriage or, as the case requires, minor or dependent children of the civil union or de facto relationship.

Application of the legislation

We have been asked to clarify the application of section 75A(5) of the EGDA, particularly in the context of dispositions made to a fixed or discretionary non-charitable trust. The wording of the subsection raises the issue of whether a disposition “to” or “solely for the benefit of” a person can be made through a disposition to a fixed or discretionary trust where the person concerned is a named beneficiary of the trust.

Disposition to a spouse/civil union partner/de facto partner or former spouse/civil union partner/de facto partner

The exemption contained in section 75A(5) of the EGDA is available in respect of dispositions to a spouse/civil union partner/de facto partner or former spouse/civil union partner/de facto partner where the disposition of property is made “to” the person. The word “to” in the context of section 75A(5) means a disposition towards a person, i.e. the giving of something in the direction of a particular person (the spouse/civil union partner/de facto partner, or former spouse/civil union partner/de facto partner). A disposition of property by way of **direct transfer** to the person concerned would be a disposition *to* that person.

The exemption is not available where the disposition of property is made **to a fixed trust** where the spouse/civil union partner/de facto partner or former spouse/civil union partner/de facto partner is a named beneficiary because the disposition is not made directly to the person but is instead made directly to a third party, the trustee. The Commissioner does not consider that the receipt of a beneficial interest in the trust property is sufficiently direct to attract the exemption from gift duty. This is on the basis of the words used in the subsection which can be contrasted with the words used in respect of dispositions to children, being “for the benefit of”, which clearly intend the use of a trust vehicle. The legislative history of the provision supports an interpretation of the text of the provision that the subsection differentiates between the type of disposition that is acceptable in terms of adults, and the types of disposition

that are acceptable in terms of dispositions to minor or dependent children. The use of trusts was to be restricted to situations where the ultimate recipient of the property was a minor or dependent child, and a more direct disposition was required where the recipient was an adult.

The exemption is not available where the disposition of property is made **to a discretionary trust** where the spouse/civil union partner/de facto partner or former spouse/civil union partner/de facto partner is a potential beneficiary because, again, the disposition is not made directly to the person but is instead made directly to a third party, the trustee. In addition, there is no certainty that the person will receive any part of the trust property. This would be the case whether or not the class of possible beneficiaries was closed. On the plain meaning of the words used in subsection (5), a disposition of property by way of a discretionary trust is not a disposition “to” a person who *may* later become a beneficiary.

The words “to the extent that” in subsection 75A(5) apply to all categories of disposition but in the context of a disposition “to” a person, apportionment will only be possible if a disposition is divided between a *direct* gift to a spouse/civil union partner/de facto partner or former spouse/civil union partner/de facto partner and a gift to others (by way of trust or otherwise). The disposition to the spouse/civil union partner/de facto partner or former spouse/civil union partner/de facto partner would then be exempt under section 75A(5).

The same analysis is relevant in terms of subsections 75(A)(2) and (3) of the EGDA which apply to dispositions of relationship property “to” a party to an agreement under section 21 of the PRA. The disposition of property would have to be made directly to the party concerned in order for the exemption to apply.

Disposition solely for the benefit of minor or dependent children of the marriage, civil union or de facto relationship

The use of the words “for the benefit of” recognise that, in many situations where relationship property is being transferred, the intended recipient will, at the time of disposition, be a minor and unable to hold property him or herself. In such a situation the use of a trust in the child or children’s favour is often an appropriate way of disposing of the property. However, there are still some limitations on the use of trusts in this context which are imposed by the words used in the section.

The *Concise Oxford Dictionary* (10th ed) defines “benefit” as follows:

- n. **1** an advantage or profit gained from something. **2** a payment made by the state or an insurance scheme to someone entitled to receive it, e.g. an unemployed person. **3** a public performance designed to raise money for a charity. • v. (**benefited** or **benefited**, **benefiting** or **benefiting**) receive an advantage; profit.

In *Re Remnants Settlements Trust* [1970] 2 All ER 554, Pennycuik J stated that:

The Court is entitled and bound to consider not merely financial benefits but benefits of any other kind.

In *Re W* [1970] 2 All ER 504, Ungood-Thomas J stated that:

It seems clear to me that it is not restricted to material benefit, but it is of wide significance comprehending whatever would be beneficial in any respect, material or otherwise. The word “benefit”, prima facie, carries such wide significance; it is not limited to any particular aspect of benefit.

The word “for” has many meanings; it is defined in the *Concise Oxford Dictionary* (10th ed) as meaning:

- prep. **1** in favour of. **2** affecting or with regard to. **3** on behalf of or to the benefit of. **4** having as a purpose or function. **5** having as a reason or cause. **6** having as a destination. **7** representing. **8** in exchange for. > charged as (a price). **9** in relation to the expected norm of. **10** indicating the extent of (a distance) or the length of (a period of time). **11** indicating an occasion in a series.

The most appropriate definitions of the word “for” in the context of subsection (5) would be the fourth and fifth definitions. The definitions are of more relevance when read as part of the phrase in section 75A(5), “solely for the benefit of” as follows:

“solely *having as a purpose or function* the benefit of minor or dependent children”

“solely *having as a reason or cause the benefit* of minor or dependent children”

The word “sole”, of which “solely” is a derivative, is defined in the *Concise Oxford Dictionary* (10th ed) as meaning:

- adj. **1** one and only. > belonging or restricted to one person or group. **2** archaic (especially of a woman) unmarried. > alone.

In *Ministry of Health v Fox* [1950] 1 All ER 1050 the meaning of the words “solely for the purposes of that hospital” in section 7 of the National Health Services Act 1946 (UK) were interpreted in relation to the application of money by a trust towards a maternity home. As the trustees were applying the funds and its income towards the maintenance and conduct of the maternity home, and for no other purpose, the funds were held to be employed “solely for the purposes of that hospital”, in terms of section 7 of that Act. This case was cited with approval in *Re Majoribanks Indenture* [1952] 1 All ER 91, which was applied in *Re Galloway, Hollins v AG* [1952] 1 All ER 1379.

Therefore, from the preceding analysis, the word “solely” means something which belongs or is restricted to one person or group of persons.

Where the minor or dependent children of a marriage/civil union/relationship are the sole beneficiaries of a fixed trust, the disposition of property would be “for the benefit of” those children, as the purpose of the trust and the responsibilities of the trustees would be to apply the property “solely” for the benefit of those children, and they would likely receive a financial advantage. Despite the trustees holding the legal interest in the property, the ultimate recipients of any benefit would be the children. Such a disposition would be “solely” for their benefit because they would have a clear beneficial interest which could not be affected by another person.

The inclusion of the words “to the extent that” in subsection (5) indicates that the children do not have to be the sole beneficiaries of a fixed trust. The words clearly anticipate apportionment and such would be easily done in the context of a fixed trust where the interests of each beneficiary are identifiable.

However, under a discretionary trust, it is not possible to identify the interests of the beneficiary until such time as the trustee exercises his or her discretion. Where the only beneficiaries of the trust are the minor or dependent children of the marriage, civil union or relationship, and there is no ability for the trustees to add or substitute beneficiaries, such a disposition would be “solely for the benefit of” the children notwithstanding that their share is not quantifiable. The subsection is concerned with ensuring that no one other than the parents and the children can benefit and, in a discretionary trust where *only* the children can *ever* benefit (even if not all of them actually do) the disposition would satisfy the requirements of the section.

There may appear to be an anomaly in section 75A(5) of the EGDA because of the differences in the application of the subsection in terms of dispositions to adults and dispositions in favour of children. However, the text of section 75A(5) deliberately distinguishes between dispositions “to” and dispositions “for the benefit of” a person. This would indicate that the text requires a direct disposition in the case of dispositions to a spouse, civil union partner or de facto partner but accepts more indirect dispositions where children are concerned.

The legislative history of the provision supports an interpretation that the subsection differentiates between the type of disposition that is acceptable in terms of adults, and the types of disposition that are acceptable in terms of dispositions to minor or dependent children. The use of trusts was intended to be restricted to situations where the ultimate recipient of the property was a minor or dependent child, and a more direct disposition was required where the recipient was an adult.

There is case authority to the effect that a settlement on trust that would benefit not only the primary beneficiary but also her future children, came within the phrase “for the advancement or benefit ... of any person” (“any person” being the primary beneficiary). In *IRC v Pilkington* [1964] AC 612 the House of Lords held that a settlement on trust for an infant child would be to her benefit even if others (namely her future children) also benefited. The decision referred to incidental benefits to other persons (unrelated third parties) that would also be considered to be “for the benefit of” the primary beneficiary. The Commissioner considers that this analysis does not apply in respect of section 75A(5) because of the use of the word “solely” - the disposition of property must benefit *only* the primary beneficiary and cannot benefit another person, either directly or indirectly.

Conclusions

The exemption from gift duty contained in section 75A(5) of the EGDA is available in respect of the following dispositions:

- A disposition to a spouse/civil union partner/de facto partner or former spouse/civil union partner/de facto partner where the disposition of property is made directly to the person;
- A disposition directly to a minor or dependent child;
- A disposition to a fixed trust where the minor or dependent child or children receive a beneficial interest in the trust property. Where there are other beneficiaries of such a trust, the interests of the children can be apportioned and be exempted from gift duty; and
- A disposition to a discretionary trust where:
 - The closed class of beneficiaries includes **only** the minor or dependent children of the marriage/relationship,
 - There are no other possible beneficiaries named or described (including default beneficiaries); and
 - No ability exists for the trustee or some other person or persons to subsequently add further beneficiaries, or to resettle the trust in a way that adds further beneficiaries, unless the further beneficiaries are also minor or dependent children of the marriage/relationship.

The exemption is **not** available in the following situations:

- The exemption is not available where the disposition of property is made to a fixed trust where the spouse/civil union partner/de facto partner or former spouse/civil union partner/de facto partner is a named beneficiary. If the minor or dependent children of the relationship are also named as beneficiaries of that fixed trust, the disposition is exempt to the extent that it is made for the benefit of those children.
- The exemption is not available where the disposition of property is made to a discretionary trust where the spouse/civil union partner/de facto partner or former spouse/civil union partner/de facto partner is a potential beneficiary.

These conclusions differ from the previous published items because a disposition **to a fixed trust** where the spouse/de facto partner or former spouse/de facto partner is a named beneficiary is no longer considered to be exempt. However, a disposition made to the same fixed trust “solely for the benefit of” minor or dependent children of the marriage/relationship can be apportioned and exempted from gift duty. In addition, a disposition **to a discretionary trust** where the spouse/de facto partner or former spouse/de facto partner is a potential beneficiary as well as minor or dependent children of the marriage/relationship is not exempt from gift duty and no part of the disposition can be apportioned.

Submissions Received

Submissions received by Inland Revenue on an exposure draft of this item raised the issue of an apparent inconsistency between the treatment of a disposition to the trustee of a will following the death of a testator (which would be exempt from gift duty) and the treatment of an *inter vivos* gift (which is subject to gift duty).

When estate duty was abolished in 1992, the Government accepted that testamentary dispositions of property would not be subject to any kind of duty or tax. Such dispositions have never been subject to gift duty and are expressly excluded from the definition of “gift” in the EGDA. It was never intended that these two types of disposition be treated in the same way - when estate duty was abolished a decision was made by the Government to retain gift duty because it acts as a barrier to people gifting their assets to associated parties such as family trusts to avoid income tax and government assistance targeting and defeat creditors.

Some submissions received also referred to a number of Family Court decisions regarding the disposition of relationship property (for example *Ford v Ford* (2001) 21 FRNZ 109 and *Re Roberts’ Application* [1994] 1 NZLR 200). These cases do not relate specifically to gift duty, nor do they discuss the gift duty implications of the dispositions involved. The cases are therefore of limited value in the context of this item.