

# New Zealand Law Society

## SUBMISSION ON THE TAXATION (TAX ADMINISTRATION AND REMEDIAL MATTERS) BILL

### **Introduction**

1. The New Zealand Law Society (Society) welcomes the opportunity to comment on the Taxation (Tax Administration and Remedial Matters) Bill (Bill) and the proposed repeal of gift duty.<sup>1</sup>
2. The Society does not oppose the repeal of gift duty but is concerned that this needs to be considered beyond the context of income tax, creditors and social assistance (Explanatory Note, p4). The Property (Relationships) Act 1976 and the Family Protection Act 1955 currently provide remedies to protect relationship property rights and succession claims; repealing gift duty will render the remedies less effective, and in so doing undermine the social aims of those Acts. The Society considers it is important that legislative amendments are made to restore protection under those Acts.

### **Clause 110 – Abolition of gift duty**

3. Before the Bill was introduced, the Society wrote to the Minister and subsequently met with staff from the Inland Revenue Department (IRD) and the Ministry of Justice to express its concern about the likely detrimental effect that the repeal of gift duty would have on the enforcement of claims under the Property (Relationships) Act 1976 (PRA) and the Family Protection Act 1955.
4. Although the Society does not oppose the repeal of gift duty, it is concerned that the impact of the repeal on relationship property rights and succession claims is underestimated in paragraphs 109 and 110 of the Regulatory Impact Statement prepared by the IRD.
5. The Society agrees that the repeal of gift duty does not affect the principles underlying the PRA and the Family Protection Act. Those Acts allow owners to deal with their assets freely until a relevant event occurs. But the effect of gift duty has been to enable those Acts to have some practical effect when the relevant event occurs. The general susceptibility of asset transfers to gift duty slowed down the alienation of assets, thus (for a period) preserving property against

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<sup>1</sup> The New Zealand Law Society will be making a separate submission, with the New Zealand Institute of Chartered Accountants, on the Taxation (Tax Administration and Remedial Matters) Bill's provisions relating to tax disputes procedures.

which claims under those Acts could be made. Paragraph 110 of the Regulatory Impact Statement concludes that:

“... adequate protection already exists under the Property (Relationships) Act 1976 and the Family Protection Act 1955 to prevent or remedy the disposal of property where this is intended to defeat the interests of another party. The Property (Relationships) Act 1976 gives the Court power to make financial adjustments if relationship property has been transferred to a trust or company which has the effect of defeating the interests of one of the parties.”

6. The Society is not satisfied that these existing remedies are adequate. The repeal of gift duty is likely to render the remedies even less effective.

### **Property (Relationships) Act 1976**

7. The PRA has two remedies to deal with dispositions of property that defeat relationship property rights of a spouse or partner. Section 44 allows dispositions to be set aside that are intended to defeat a spouse's rights, while ss 44C and 44F empower the Court to order the respondent spouse or partner to compensate the applicant if a disposition of relationship property to a trust or company has the effect of defeating the applicant's rights.
8. Section 44 has been part of the law since the Matrimonial Property Act was enacted in 1976, but proving the requisite intent deprived that provision of much of its usefulness. The use of trusts and companies therefore undermined the relationship property regime. It was for that reason that ss 44C and 44F were inserted in 2001. However, neither of those provisions allows compensation orders to be made against the capital of a trust or company. Capital orders can only be made against separate property or relationship property owned by the respondent spouse or partner. To avoid gift duty, dispositions to trusts and companies were structured as sales with a debt back to the transferor(s). It is the debt back that has been a significant source of capital from which compensation orders under ss 44C and 44F have been made. When gift duty is repealed, there will be no need to sell the assets to a trust or company and thus, no debt back. There may then be insufficient separate property or relationship property from which to order compensation. If the disposition was made to a trust, then, as a last resort, the Court has power to divert income from the trust to compensate the applicant spouse or partner. That option will be of no use if the trust does not produce an income, for example, because the trust's asset is the family home. There is no equivalent power if the disposition was made to a company. The debt back is therefore often the main, and in some cases, the sole source from which compensation can be ordered.

9. The facts of *Ward v Ward* [2009] SCNZ 125 illustrate the limits of ss 44 and 44C. A couple entered into a contract under the PRA vesting 50% of the husband's farming shares in his wife. Immediately after signing the contract, the parties transferred their shares into trust for the then market value. The purpose of the contract vesting half the shares in the wife was to enable both parties to forgive the debt back, thus reducing the debt at twice the rate. When they separated a few years later, Mrs Ward moved into rental accommodation with the children and ceased receiving support from the trust, while her husband continued to reside and work on the farm, thus retaining the benefit from the trust. The trust assets had increased in value in the meantime, while the debt back had been reduced. As the disposition to the trust had not been made with the intent to defeat Mrs Ward's rights, the Court had no power to set aside the disposition under s 44. The disposition did meet the requirements of s 44C, because it had the effect of defeating only Mrs Ward's rights. However, the outstanding debt was much less than the value of the assets in trust. It was insufficient to compensate Mrs Ward adequately and the trust had no surplus income either. Section 44C was therefore of no use to Mrs Ward, even though this was precisely the sort of case that s 44C was intended to address. Fortunately for Mrs Ward, she and Mr Ward were married and on divorce she was able to apply for an order under s 182 of the Family Proceedings Act to vary the trust, vesting half the trust for her benefit. Had the parties been in a de facto relationship, this option would not have been available to Mrs Ward. The debt back would have been the only source from which she could have been compensated for the loss of relationship property entitlement, albeit inadequately.
10. Having agreed to the disposition of property into trust, one could argue that Mrs Ward should live with the consequences of her actions. That argument raises the question why s 44C and s 44F were inserted. Those provisions were aimed at preserving relationship property entitlements by providing a remedy if the relationship property had been transferred into a trust or company to the detriment of one of the parties while the other continued to enjoy the benefits of the disposition.
11. The policy of the PRA is equal division of relationship property unless the parties have contracted out of the Act in accordance with prescribed formalities, which include independent legal advice. Trusts and companies to which assets are transferred that would have been relationship property are another means of avoiding the Act's sharing regime. The assets are no longer beneficially owned by the transferors, but they continue to benefit from them, much like a contracting-out agreement reclassifying relationship property as separate property but which both the owning and non-owning party continue to enjoy until their relationship ends. Unlike contracting-out agreements, however, dispositions to trusts or companies do not require agreement between the parties, unless the assets are jointly owned. Nor does the validity of the

disposition depend on independent legal advice, like a contracting-out agreement does. If it had not been for gift duty, Mr Ward could have transferred his shares into trust without his wife's agreement or co-operation or arranging for her to get independent legal advice. Furthermore, once transferred, the disposition could not be challenged on the grounds that serious injustice would result if the disposition were upheld, in contrast to agreements under the PRA.

12. In short, the procedural safeguards that Parliament saw fit to impose on parties wishing to contract out of the PRA do not apply to dispositions to trusts or companies. Unless these dispositions are made with the intent of defeating the relationship property rights of a spouse or partner, they are safe from attack under the PRA. The current remedies to protect relationship property rights are far from adequate. The repeal of gift duty is likely to render those remedies even less effective, thus further undermining the social aims of the PRA.

### **Family Protection Act 1955**

13. As for the Family Protection Act, the Regulatory Impact Statement suggests, incorrectly in the Society's view, that there is also adequate protection in that Act to prevent or remedy the effects of a disposal of property that defeats a claimant's rights. Neither the Family Protection Act nor the Law Reform (Testamentary Promises) Act 1949 has powers to set aside dispositions or to make orders in respect of assets not beneficially owned by the deceased. Debts back have made such claims viable. The Family Protection Act was introduced to prevent family members from becoming dependent on the State for support. If owners are able to dispose of their assets easily, whether to trusts, to companies or to others, dependent family members may once again have to look to the State for support.

### **Trust law review**

14. Family lawyers are acutely aware of the detrimental effect that trusts in particular have on the social aims of the PRA and the Family Protection Act. The repeal of estate duty in 1993 resulted in a sharp rise in the number of trusts. The repeal of gift duty is likely to increase the number of trusts even more. The Society is aware of the Law Commission's Review of the Law of Trusts.<sup>2</sup> While some of the issues raised above may be addressed as part of this review, the concern of the Society is not only with trusts, but with the likely increase in voluntary alienations in general to the detriment of the social aims of the PRA, the Family Protection Act and the Law Reform (Testamentary Promises) Act 1949. Reform of trust law alone will not redress this detrimental effect. Gifts to companies or third parties are likely to rise as well.

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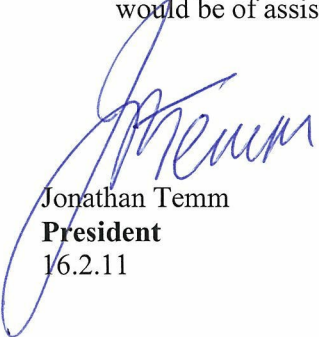
<sup>2</sup> Review of the Law of Trusts in New Zealand: Introductory Issues Paper (IP19), Some Issues with the Law of Trusts in New Zealand: Second Issues Paper (IP20).

***Recommendations***

15. That the select committee consider:
- (a) the implications that the repeal of gift duty will have on the PRA and the Family Protection Act; and
  - (b) what legislative amendment to those Acts might be required to afford adequate protection to prevent or remedy the disposal of relationship property to a trust or company that has the effect of defeating a partner/spouse's rights and/or interests.

**Conclusion**

16. The Society does not wish to appear in support of this submission. However, the Society is willing to meet with the Committee or officials advising it if the Committee considers that would be of assistance.



Jonathan Temm  
**President**  
16.2.11