

# *BC'S BUSINESS BRIEFS*

## **TO GIFT OR NOT TO GIFT?**

Most people who have been involved with gifting programs in recent years will be aware that as from 1 October 2011 gift duty has been abolished. The reason that government decided to wipe one of our oldest taxes from its books is that it quite simply collected less revenue than it cost to maintain a collection system within IRD. The reason for this is that people in general gifted away \$27,000 per year (the amount at which any gift in excess of attracted gift duty) and did so in line with a gifting program designed to remove assets from their personal estates over a period of years.

While gifts could be for cash, most gifting programs that individuals became involved in followed a pattern of a significant asset (such as a family home) being sold to a trust for the benefit of the trust settlor and their family members which was paid for by a loan back to the trust by the same settlor. This loan was then gifted away over a number of years at the rate of \$27,000 or \$54,000 per year depending on whether the home had previously been owned individually or by a couple.

Many people will currently be part way through gifting programs and will need to make a decision at some time as to whether they wish to gift away the remainder of the debt as a continuation of a gifting program or in a lump sum. While the answer might seem simple enough (and I have no doubt that a majority of people in this position will simply gift the remaining debt in one sum sometime on or after 1 October), there may be reasons to not do this.

To understand why the answer may not be so simple, a look at the reasons for the establishment of the Trust in the first place may have a bearing. If the trust has been set up for the benefit of a particular class of beneficiary (such as the children of the settlor), a debt owing by the trust which is secured against the assets of the trust may be a principal means of retaining control over the assets of the trust in the event that they have concerns over the beneficiaries likely behaviour should they obtain control. Given that most modern trusts are fully discretionary trusts, it can be more difficult for a disgruntled beneficiary to successfully make a claim against the trustees than against an executor of an estate.

Any gifts made in excess of \$27,000 per year will be deemed to be ineffective for the purposes of claiming an accommodation subsidy from WINZ for long term rest home care even after 5 years. Up to 5 years prior to any assessment, only \$6,000 will be allowed to be gifted. While the rules in this area seem to me to be pretty fluid and in fact open to liberal interpretation by the authorities, the regulations as to the gifting components allowable are laid out in black and white in the Ministry of Health's guidelines. If you would like a copy of these guidelines, please contact us.

Our suggestion is that while in the majority of cases a one off gift for the remaining portion of a debt subject to a gifting program is likely to be appropriate, at least consider the implications before making that decision.



## MAJOR TAX CASE DECISION

While not all of us accountants spend all day consumed with the latest tax cases and what the IRD are arguing in those cases, there has been an ongoing case that has been finally resolved in the Supreme Court in favour of the IRD that is likely to have ramifications for many small business people.

The case known as Penny & Hooper centred around whether Messrs Penny & Hooper who were self employed medical surgeons were required to pay themselves market salaries. IRD argued that they were and after various decisions at lower levels of the court system in NZ, the Supreme Court agreed with the IRD and deemed the arrangement that Penney & Hooper into constituted tax avoidance, for which there are significant civil penalties.

The decision however (as is often the case) did have some rather specific factors relating to it that only time will tell whether they impact the decision in a general sense. Some of those factors were;

- 1 Messrs Penny & Hooper were running successful businesses as self employed surgeons and were earning in excess of \$500,000 each per annum with the obvious tax consequence of paying in excess of \$400,000 each at the top individual marginal tax rate;
- 2 After taking advice, Penney & Hooper restructured their businesses into Trading Trusts and became employees of those trading trusts, at the same time reducing their personal income dramatically so that the amount of income they received and paid tax at the top rates of tax (39%) became minimal while the profits were retained in the trust and taxed at 33%;
- 3 While it has been a long held tax principle that someone can restructure their affairs if there are sound commercial reasons for doing so, Messrs Penney & Hooper had difficulty in providing a credible reason for the restructure, other than tax reduction (avoidance). They tried to argue that the main reason was to mitigate business risk but the court believed that with the current ACC law in NZ as it relates to medical professionals and their insurance cover, this was not credible;
- 4 From an outsiders perspective nothing changed in terms of the services that were offered to their clients by Penney & Hooper after the restructure. The fact that the taxpayers chose a Trading Trust to restructure into, given how unusual it is for businesses to trade under this structure (although not unheard of) and the fact that in their case it would be hard to imagine anything than tax reasons for using this structure over a limited liability company, probably didn't help their cause.
- 5 From a practical point of view, the salaries that are paid to working proprietors in a company situation must now be considered when finalising income tax returns for small businesses in relation to market rates and the particular company circumstances.
- 6 With the aligning of the top personal tax rate at 33% alongside the trustee rate at a similar level, there may not be the same incentive as there has been in the past for taxpayers and their advisers to enter into these types of arrangements. Nevertheless while the company rate now sits at 28% with a 5% differential to the top individual rate, some advantages (mainly timing) will still arise and we will be ensuring that any shareholders salaries are considered in light of this case in future.

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