

## **Abolition of Gift Duty Long Overdue**

The wheels of bureaucracy can sure grind exceedingly slow. Inertia and risk aversion on the part of bureaucrats often defeat overwhelming arguments for change.

The exercise of abolishing gift duty is a good illustration of much that is wrong with the policy advice process in Wellington.

Gift duty has applied in New Zealand since 1885. Its original purpose was to protect the estate duty base (by discouraging the gifting of assets prior to death) and to raise revenue.

Estate duty was abolished in 1992. In terms of modern tax principles, estate duty, gift duty and any other form of inheritance tax are inefficient and unfair.

In effect they tax income three times: when it is earned, when the return on savings is taxed, and when investment assets are transferred. This weakens the incentive to retain assets and expand businesses.

Gift duty is difficult to implement comprehensively when Australia has had none since the 1970s, and people can easily avoid it by migrating.

When estate duty was abolished, gift duty was retained as a 'temporary' measure to protect against income tax avoidance and support welfare benefit targeting, and more recently to protect creditors.

'Temporary' can mean a long time in government administration.

In 2001 the McLeod Tax Review recommended that gift duty be repealed on the basis that:

- its original rationale – to buttress estate duty – was no longer relevant
- it raised only \$1.6 million a year but involved significant compliance costs, and

- the use of gifting programmes reduced its effectiveness in preventing income splitting and avoidance of asset testing regimes.

These ought to have been slam dunk arguments. But it took until this year to get them over the line.

Credit for the initiative goes to the Policy Advice Division of Inland Revenue. Its longstanding head, Robin Oliver, is one of New Zealand's most able and admired public servants.

Gift duty is now bringing in only around a million dollars a year but costing \$430,000 in direct costs to administer.

Because it is easy to avoid through gifting programmes, only 0.4% of gift statements received by IRD result in liability for payment of gift duty.

The cost to the private sector of complying with gift duty requirements is substantial. Some 225,000 compulsory gift duty statements are filed each year. At an estimated average cost of \$285 plus GST, the ongoing annual compliance costs to the private sector exceed a staggering \$70 million.

A feature of the policy advice process has been an explosion of policy advisers and a plethora of departments, some of which with only peripheral interests, that have to be consulted on recommendations going to Cabinet.

Papers released under the Official Information Act reveal that IRD had to consult the Treasury, Ministry of Economic Development, Ministry of Justice, Ministry of Health, New Zealand Police, Ministry of Social Development and Housing New Zealand Corporation on the gift duty proposal.

All at first resisted it on the grounds that gift duty "could be useful" for various reasons.

The IRD Regulatory Impact Statement accompanying the Cabinet paper is a model of what an RIS should look like but too often isn't.

It outlines the problems with gift duty, considers several options for addressing them, and comes down in favour of repeal.

The RIS discusses issues raised by other departments, notably in relation to tax administration, creditor protection concerns, means-tested welfare benefits, the Residential Care Subsidy, state housing, relationship property disputes, proceeds of crime, trust law concerns, and others.

The point is made that wider policy initiatives such as the government's decision to align the top personal tax rate with the trustee rate from 1 October 2010 reduces the problems of income splitting and the motivation to reduce tax obligations through the use of trusts.

In the end, with MED and its fondness for regulation being the last hold-out, all departments came round to the view that the concerns raised were not material and supported the proposal for repeal.

In respect of crime, for example, the Police concurred with the argument that assets are already transferred outright from criminals to associates despite the gift duty rules, and that "few criminals have a good knowledge of taxation regimes and virtually none pay tax on their ill-gotten gains."

The saga is heading toward a happy ending thanks to the persistence of revenue minister Peter Dunne. Provided the necessary legislation is passed gift duty is to be abolished from 1 October 2011.

The right question to ask is not why this expensive anachronism should be repealed but why on earth it was not done years ago. Only some lawyers will mourn its passing.

And the whole episode illustrates the need for the review of expenditure on policy advice that a committee headed by former Treasury Secretary Graham Scott has been undertaking.

Roger Kerr is the executive director of the New Zealand Business Roundtable. Check out his blog on [www.nzbr.org.nz](http://www.nzbr.org.nz)