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*In this paper Dr Tony Molloy QC comments on some of the implications arising from the abolition of gift duty. Tony is New Zealand's leading silk in the area of trusts. He has specialized in trusts for much of his career and is the co-editor of 'Trusts and Trustees'. Tony is an honorary member of the Chancery Bar Association and is a regular guest speaker at international conferences on trusts.*

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## IMPLICATIONS OF THE ABOLITION OF GIFT DUTY

Tony Molloy QC

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### **Abolition of Gift Duty reminds us of the sex life of the elephant**

Gift Duty never made sense as a stand-alone tax. It existed to make it hard to escape Estate Duty. Estate Duty was abolished in 1992. Politicians soon were pointing out that Gift Duty was not a cost-effective tax, and that its abolition was inevitable. It has taken them nearly two decades to get around to it.

This invites comparison between, on the one hand, the way that Departments of State conduct their business, and, on the other hand, the sex life of elephants.

In the daily work of these Departments, as in the sex life of elephants, all the action takes place at a very high level; any movement forward is accompanied by loud trumpeting noises; and years then elapse before any developments occur.

So, at last, we shall have abolition later in the year.

### **Objections and consequences**

Three thoughts come to mind immediately:

- There can't be serious objection to the abolition of a tax that is costing

the country almost as much to collect as it brings in. A waste of resources.

- Nobody's trust, and nobody's tax or estate or financial plan, is going to fail just because gift duty shall have been abolished.
- However, when settlors can fire ahead without having to spare a thought for gift duty avoidance, there is every chance that trust administration work that is at present sloppy will become even sloppier—and *that* may cause problems.

### **Deferred payment sales**

Almost always, the standard method of getting assets into a trust was described as a sale accompanied by the "lending back" to the trustees of the purchase price.

Almost always that description was inaccurate.

As far as I have ever been able to tell, trustees rarely paid the settlor the price of the asset, and then borrowed it back again in the expectation of the debt being progressively forgiven over time.

The normal deal seems to have been one in which the purchase price of the asset was payable on a deferred basis. It was a credit sale.

There are well-known comments on the distinction:

- *Rossiter v Commissioner of Inland Revenue* [1977] 1 NZLR 195:  
Where a father had sold his farm to his son for payment of \$20,000 in cash, and a further \$41,500 to be secured by a mortgage and repaid over 10 years. The trial had been argued on the basis that the \$41,500 had been a loan from the father to the son.  
Because the point made no difference to the outcome, the Court of Appeal was content to decide the case on that agreed basis. At page 198, Woodhouse J doubted the correctness of that agreed approach. The transaction seemed to him to be a simple transfer or alienation of the land for a stipulated money consideration which permitted payment on terms.
- *Duggan & Ryall v Federal Commissioner of Taxation* (1972) 3 ATR 413, 416 (Stephen J):  
It also seems to be clear on the evidence that Mr and Mrs JF Dennis, the parents of the relevant beneficiary Julie Dennis, have not made any loans to the relevant private company, JF Dennis Pty Ltd, in which the trustees of that beneficiary's settlement hold shares. What occurred was that instead of demanding

prompt payment by that company of the purchase price on their sale to it in 1963 of shares in the Dennis group of operating companies they have ever since allowed much of the purchase price to remain outstanding. A similar result could, no doubt, have been achieved by a payment in full by the company accompanied by a lending back of money by Mr and Mrs Dennis to it but this was not the method of financing which was in fact adopted.

- *Goldfinch and Coley v Commissioner of Inland Revenue* (1988) 12 TRNZ 194, 203, where Smellie J held:  
That the position as to the consideration is unaffected by any labels the parties may have affixed in their documentation of the transaction.

It is always dangerous to characterise a transaction wrongly at the outset. It can cause confusion later.

#### **Might deferred payment sales remain good practice?**

It could be dangerous, also, to think that the sale on, "on-demand", credit terms won't continue to be useful in the post-gift duty era.

*For example*, its use could provide a settlor with a sort of insurance policy against an unexpected future need for funds that she can call in if she finds that she is short of money later on.

If this course is adopted, the settlor will need to make a will. This could forgive the trustees their indebtedness. Or, as the circumstances of her life change, it could maintain that indebtedness, and leave the money to some person or purpose that she had not

contemplated when she settled the terms of her trust.

If the trustees are not to expose themselves to thwarting purposes and options like these, they will have to ensure that:

- they produce accounts each year;
- the accounts acknowledge the indebtedness, so that the Limitation Act doesn't make the debt irrecoverable; and that
- the accounts go to the settlor, so that she receives the acknowledgement.

*For another example*, while a substantial debt remains unforgiven, it could give the settlor a sense of leverage over the trust, without actually involving her as a trustee or power-holder.

Needless to say, the trustees would be obliged to reject any attempt she might then make to use that leverage to coerce them to take a course of action against their better judgment.

Direct settlor control can attract misguided attacks from beneficiaries; and equally misguided attacks from the courts.

The indebtedness of trustees to the settlor can't absolve them from their duties. If they allow themselves to be coerced, and the trust estate suffers, the trustees will be held accountable, and will have to make up the loss from their own pockets.

So, of itself, this indebtedness will offer no legal basis for any attack on the validity of the trust by reason of settlor power.

#### **One danger in removal of the discipline that gift duty avoidance imposed**

Contracts of this sort won't be a panacea for all ills. Meticulous documentation is critical. In practice it is often sloppy. The worry is that removal of the documentary discipline that gift duty avoidance required may make sloppy advisers even sloppier: with the usual

sad consequences for them, their clients, and their insurers.

#### **The doctrine that will pose another danger following removal of the discipline that gift duty avoidance imposed**

A critical reason for scrupulosity with the documentation can be found in the doctrine in *Milroy v Lord* (1862) 4 De G F & J 264, and particularly Turner LJ's classic statement 274-275:

I take the law of this Court to be well settled, that, in order to render a voluntary settlement valid and effectual, the settlor must have done *everything which, according to the nature of the property comprised in the settlement, was necessary to be done in order to transfer the property and render the settlement binding upon him.*

He may of course do this by actually transferring the property to the persons for whom he intends to provide, and the provision will then be effectual, and it will be equally effectual if he transfers the property to a trustee for the purposes of the settlement, or declares that he himself holds it in trust for those purposes; and if the property be personal, the trust may, as I apprehend, be declared either in writing or by parol; but, in order to render the settlement binding, one or other of these modes must, as I understand the law of this Court, be resorted to, *for there is no equity in this Court to perfect an imperfect gift.*

The cases I think go further to this extent, that if the settlement is intended to be effectuated by one of the modes to which I have referred, the Court will not give effect to it by applying another of those modes. If it is intended to take effect by transfer, the Court will not hold the intended transfer to

operate as a declaration of trust, for then every imperfect instrument would be made effectual by being converted into a perfect trust. These are the principles by which, as I conceive, this case must be tried.

### That danger illustrated

A relatively recent English Court of Appeal decision illustrates the fix that you can get into over documentation. It illustrates also that the courts are willing to discover how far the boundaries of the doctrines will stretch. But of course, they *are* limits, and it's best not to stray too close to the edge of the precipice.

*Pennington v Waine* [2002] 1 WLR 2075; [2002] WTLR 387 is the case. A client told her accountant she wanted to give her nephew 400 of her shares in a particular company *in which* she was a major shareholder, and *of which* the accountant's firm was the auditor.

The accountant instructed one of his staff to prepare a transfer form for the 400 shares. The client signed it. A member of the staff of the firm then put it on the company's file with the accounting firm.

In the meantime the client had told her nephew that she wanted to give him some of her shares, and that she wanted to put him on the board of the company. On her instructions, her accountant had sent the nephew an advice that he had been appointed to the Board on 1 September 1998. He told the nephew that the aunt had instructed him to arrange the transfer of 400 shares to the nephew, and that this required no action on the nephew's part. And he sent the nephew the prescribed form of consent to act as a director. The nephew signed the form. The aunt countersigned it.

The share transfer form that the aunt had signed continued to lie on the company's file with the accounting firm.

Because the accountant was also the auditor, he had allowed the odd thing to escape his notice. For example:

- That the transfer on that form was in breach of a provision in the constitution conferring on the other members of the company the right of first refusal of those shares "at a fair value to be fixed by the company's auditors."
- That that breach triggered s 291 of the Companies Act 1985 (UK), so that the nephew would be deemed to have vacated office as a director on 30 October 1998 if he had not obtained his share qualification by that date.

On 10 November 1998, the aunt executed a will in which she made specific gifts of the 1,100 balance of her shareholding in the company. The will did not mention the remaining 400 shares.

Then she died.

### The authorities invoked

In *Rose v IRC* [1952] 1 Ch 499, 518, Jenkins LJ held:

In my view, a transfer under seal in the form appropriate under the company's regulations, coupled with delivery of the transfer and certificate to the transferee, does suffice, as between transferor and transferee, to constitute the transferee the beneficial owner of the share, and the circumstance that the transferee must do a further act in the form of applying for and obtaining registration in order to get in and perfect his legal title, having been equipped by the transferor with all that is necessary to enable him to do so, does not prevent the transfer from operating, in accordance with its terms as between the transferor

and transferee, and making the transferee the beneficial owner.

In *Mascall v Mascall* (1984) 50 P&CR 119, Browne-Wilkinson LJ explained that:

The basic principle underlying all the cases is that equity will not come to the aid of a volunteer. Therefore, if a donee needs to get an order from a court of equity in order to complete his title, he will not get it. If, on the other hand, the donee has under his control everything necessary to constitute his title completely without any further assistance from the donor, the donee needs no assistance from equity and the gift is complete. It is on that principle, which is laid down in *Re Rose*, that in equity it is held that a gift is complete as soon as the settlor or donor has done everything that the donor has to do, that is to say, as soon as the donee has within his control all those things necessary to enable him, the donee, to complete his title.

His Lordship said further that, in *Milroy v Lord*, Turner LJ had required only that, in order to make the gift, the settlor or donor must have done everything that was necessary *for her* to do to make the transaction binding. There *may* remain steps to be taken by the donee in order to acquire legal title, but there *must* remain nothing further for the donor to do.

In *Pennington v Waine* [2002] 1 WLR 2075; [2002] WTLR 387, Lady Justice Arden, with whom Schiemann J agreed without qualification, usefully discussed that issue:

54 Thus explained, the principle that equity will not assist a volunteer at first sight looks like a hard-edged rule of law not permitting much argument or exception. Historically the emergence of the principle may

have been due to the need for equity to follow the law rather than an intuitive development of equity. The principle against imperfectly constituted gifts led to harsh and seemingly paradoxical results. Before long, equity had tempered the wind to the shorn lamb (ie the donee). It did so on more than one occasion and in more than one way.

55 *First* it was held that an incompletely constituted gift could be upheld if the gift had been completed to such an extent that the donee could enforce his right to the shares as against third parties without forcing the donor to take any further step.

56 That exception was extended in *Rose v Inland Revenue Comrs* [1952] Ch 499 and other cases by holding that for this exception to apply it was not necessary that the donor should have done all that it was *necessary to be done* to complete the gift, short of registration of the transfer. On the contrary it was sufficient if the donor had done all that it was *necessary for him or her to do*.

57 There is a logical difficulty with this particular exception because it assumes that there is a clear answer to the question, when does an equitable assignment of a share take place? In fact the question is circular. For if by handing the form of transfer to Mr Pennington in this case, Ada completed the transaction of gift and the equitable assignment of the 400 shares, Harold can bring an action against Mr Pennington [her accountant] to recover the shares as his property, and the principle that equity will not assist a volunteer is not infringed. If on the other hand, by handing the share transfer to Mr

Pennington, Ada did not complete the transaction of gift or the equitable assignment of the shares, Harold cannot recover the shares because to do so would mean compelling the donor or the donor's agent to take some further step. The equitable assignment clearly occurs at some stage before the shares are registered. But does it occur when the share transfer is executed, or when the share transfer is delivered to the transferee, or when the transfer is lodged for registration, or when the pre-emption procedure in article 8 is satisfied or the directors resolve that the transfer should be registered? I return to this point below. According to counsel's researches, the situation in the present case has not arisen in any reported cases before. I note that in her recent work, *Personal Property Law, Text, Cases and Materials* (2000), p 241 Professor Sarah Worthington takes it as axiomatic that

“notwithstanding any demonstrable intention to make a gift, there will be no effective gift in equity if the donor simply places matters (such as completed transfer forms accompanied by the relevant share certificates) in the hands of the *donor's* agents. In those circumstances the donor remains at liberty to recall the gift simply by revoking the instructions previously given to the agent. The donor has not done all that is necessary, and the donee is not in a position to control completion of the transfer. It follows that the intended gift

will not be regarded as complete either at law or in equity.”

59 *Secondly* equity has tempered the wind (of the principle that equity will not assist a volunteer) to the shorn lamb (the donee) by utilising the constructive trust. This does not constitute a declaration of trust and thus does not fall foul of the principle ... that an imperfectly constituted gift is not saved by being treated as a declaration of trust. Thus, for example, ... in *Rose v Inland Revenue Comrs* [1952] Ch 499, the Court of Appeal held that the beneficial interest in the shares passed when the share transfers were delivered to the transferee, and that consequently the transferor was a trustee of the legal estate in the shares from that date. ...

...

63 There are countervailing policy considerations which would militate in favour of holding a gift to be completely constituted. These would include effectuating, rather than frustrating, the clear and continuing intention of the donor, and preventing the donor from acting in a manner which is unconscionable. As Mr McGhee pointed out, both these policy considerations are evident in *T Choithram International SA v Pagarini* [2001] 1 WLR 1. It does not seem to me that this consideration is inconsistent with what Jenkins LJ said in *In re McArdle, decd* [1951] Ch 669. His point was that there is nothing unconscionable in simply (without more) changing your mind. That is also the point which Professor Worthington makes in the passage I have cited.

64 If one proceeds on the basis that a principle which animates the answer to the question whether an apparently incomplete gift is to be treated as completely constituted is that a donor will not be permitted to change his or her mind if it would be unconscionable, in the eyes of equity, vis-à-vis the donee to do so, what is the position here? There can be no comprehensive list of factors which makes it unconscionable for the donor to change his or her mind: it must depend on the court's evaluation of all the relevant considerations. What then are the relevant facts here? Ada [the aunt] made the gift of her own free will: there is no finding that she was not competent to do this. She not only told Harold [her nephew] about the gift and signed a form of transfer which she delivered to Mr Pennington for him to secure registration: her agent also told Harold that he need take no action. In addition Harold agreed to become a director of the company without limit of time, which he could not do without shares being transferred to him. If Ada had changed her mind on (say) 10 November 1998, in my judgment the court could properly have concluded that it was too late for her to do this as by that date Harold signed the form 288A [consent to act as a director], the last of the events identified above, to occur.

65 There is next the pure question of law: was it necessary for Ada to deliver the form of transfer to Harold? ... [T]he ratio of *Rose v Inland Revenue Comrs* [1952] Ch 499 was as I read it that the gifts of shares in that case were completely constituted when the donor

executed share transfers and delivered them to the transferees even though they were not registered in the register of members of the company until a later date.

66 However, that conclusion as to the ratio in *Rose v Inland Revenue Comrs* does not mean that this appeal must be decided in the appellants' favour. Even if I am correct in my view that the Court of Appeal took the view in *Rose v Inland Revenue Comrs* that delivery of the share transfers was there required, it does not follow that delivery cannot in some circumstances be dispensed with. Here, there was a clear finding that Ada intended to make an immediate gift. Harold was informed of it. Moreover, I have already expressed the view that a stage was reached when it would have been unconscionable for Ada to recall the gift. It follows that it would also have been unconscionable for her personal representatives to refuse to hand over the share transfer to Harold after her death. In those circumstances, in my judgment, delivery of the share transfer before her death was unnecessary so far as perfection of the gift was concerned.

67 It is not necessary to decide the case simply on that basis. After the share transfers were executed Mr Pennington wrote to Harold on Ada's instructions informing him of the gift and stating that there was no action that he needed to take. I would also decide this appeal in favour of the respondent on this further basis. If I am wrong in the view that delivery of the share transfers to the company or the donee is required and is not dispensed with by reason of the fact that it would be unconscionable for Ada's personal representatives to

refuse to hand the transfers over to Harold, the words used by Mr Pennington should be construed as meaning that Ada, and, through her, Mr Pennington became agent for Harold for the purpose of submitting the share transfer to the company. This is an application of the principle of benevolent construction to give effect to Ada's clear wishes. Only in that way could the result "This requires no action on your part" and an effective gift be achieved. Harold did not question this assurance and must be taken to have proceeded to act on the basis that it would be honoured.

#### Prudent standard practice

While it's a comfort to know that you might be able to argue your way out of any tight corner into which inadequate practices with documents might have landed you, it's probably best to avoid getting into the situation where all this finely-honed, and precariously-balanced, argument is necessary.

Before she embarked on the foregoing discussion Lady Justice Arden had pointed out that:

51 The *legal title* to a share may today be conveyed by the execution and registration of an instrument of transfer (s 182(1) of the Companies Act 1985). However, the *equitable*

*interest* in a share *may pass under a contract of sale* even if the contract is not completed by registration (*Hawks v McArthur* [1951] 1 All ER 22). In addition, a share may also be the subject of a valid equitable assignment: see for example *Re Rose, Rose v IRC*.

52 This appeal raises the question of what is necessary for the purposes of a valid equitable assignment of shares by way of gift. *If the transaction had been for value, a contract to assign the share would have been sufficient*: neither the execution nor the delivery of an instrument of transfer would have been required. However, where the transaction was purely voluntary, the principle that equity will not assist a volunteer must be applied and respected.

The obviousness of these propositions should not blind us to the worth of holding on to the old disciplines of the gift duty era by creating—as a prudent standard practice—a written contract for a consideration that is not payable save on demand, and ultimately may be forgiven.

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