

DEBT FORGIVENESS IN CONSIDERATION OF NATURAL LOVE AND AFFECTION

PUBLIC RULING - BR Pub 99/7

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Law

All legislative references are to the Income Tax Act 1994 (prior to the enactment of the Taxation (Accrual Rules and Other Remedial Matters) Act 1999) unless otherwise stated.

This Ruling applies in respect of section EH 4(6).

The Arrangement to which this Ruling applies

The Arrangement is the forgiveness by a natural person (in this Ruling referred to as the creditor), including by way of testamentary disposition under a will, of an amount owing under a debt in the following circumstances:

1. The debtor is a relative (for example a father or child, brother or sister, husband or wife (or non-spousal domestic partner), grandchild, niece or nephew) or close friend of the creditor; or
2. The debtor is a trustee or trustees of a family trust, being a fixed trust, where all of the beneficiaries, other than default beneficiaries, are qualifying beneficiaries; or
3. The debtor is a trustee or trustees of a family trust, being a discretionary trust, where all the beneficiaries, other than default beneficiaries, are qualifying beneficiaries.

Such forgiveness may relate to the whole or a part of the relevant debt, and may be conditional or absolute.

This Ruling does not apply to:

- A forgiveness of a debt due by a company (including a family company); or
- A forgiveness by a trustee of a debt due by one or more of the beneficiaries of the trust; or
- A debt forgiveness that forms part of a tax avoidance arrangement subject to section GD 11 or section BG 1.

For the purposes of this Ruling, the term “qualifying beneficiary” means:

- A relative (for example a father or child, brother or sister, husband or wife (or non-spousal domestic partner), grandchild, niece or nephew, and other

descendants or antecedents of the creditor, whether by blood, marriage, non-spousal domestic relationship, or adoption, and whether or not born during the creditor's lifetime), or close friend of the creditor; or

- A fixed trust where all the beneficiaries, other than default beneficiaries, are relatives or close friends of the creditor or are qualifying beneficiaries or a combination of these; or
- A discretionary trust where all the beneficiaries, other than default beneficiaries, are relatives or close friends of the creditor or are qualifying beneficiaries or a combination of these; or
- A superannuation scheme that is a trust established specifically by its deed to provide retirement benefits to qualifying beneficiaries only.

For the purposes of this Ruling, the term "default beneficiary" means:

- A person specified as a beneficiary for the sole purpose of their benefiting from the trust only in the event that all the qualifying beneficiaries pre-decease or no longer exist.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- Amounts owing under debts forgiven in the circumstances outlined in the Arrangement are, in terms of section EH 4(6), deemed to be paid for the purposes of the qualified accruals rules, as referred to in section OZ 1(1).

The period for which this Ruling applies

This Ruling will apply for the period 1 April 1997 to 19 May 1999.

This Ruling is signed by me on the 23rd day of September 1999.

Martin Smith

General Manager (Adjudication and Rulings)

COMMENTARY ON PUBLIC RULING BR Pub 99/7

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Ruling BR Pub 99/7 (“the Ruling”).

The subject matter covered in the Ruling is also dealt with in Public Ruling BR Pub 96/4A (in TIB Volume Eight, No.10 (December 1996) at page 40 under the heading *Debt forgiveness in consideration of natural love and affection*).

This Ruling (BR Pub 99/7) does **not** replace BR Pub 96/4A, which applies from the 1997-98 year to 19 May 1999. This Ruling applies for the period 1 April 1997 to 19 May 1999. Under section 91DB(2) of the Tax Administration Act 1994, this permits taxpayers to rely upon either ruling during the period that both apply. The expiry date for both rulings is 19 May 1999 being the last day prior to the Taxation (Accrual Rules and Other Remedial Matters) Act 1999 having application. That Act provides for a new section EH 5 on debt forgiveness in consideration of natural love and affection.

Background

The relevant provisions of the accruals rules are sections EH 1 to EH 10.

Base price adjustment calculations for financial arrangements are contained in section EH 4. The base price adjustment is effectively a “wash up” calculation of all income or expenditure under a financial arrangement upon the maturity, transfer, or remission of that arrangement.

Generally, under section EH 4, any principal, interest, or other amount payable on a financial arrangement that is “remitted” is gross income to the issuer. If the debt is remitted, the issuer is the debtor.

This is illustrated by the examples below.

Example 1

Creditor lends Debtor \$50,000 repayable in two years with \$10,000 interest. However, in the second year of the loan Debtor is in financial difficulties. Creditor agrees to accept \$50,000 with no interest, in full and final settlement of Debtor’s obligations. The \$10,000 interest is accordingly remitted in the second year. Debtor, however, claimed an income tax deduction for \$5,000 of the interest in the first year (on an accruals basis).

Assume Creditor is not a cash basis holder.

Debtor’s base price adjustment in the second year effectively results in the recapture of her income tax deduction of \$5,000. She has derived gross income of \$5,000. Her gross income is calculated as follows:

$$\begin{aligned} &= a - (b + c) \\ &= \$50,000 - (\$50,000 + \$5,000) \\ &= - \$5,000 \text{ (income)}. \end{aligned}$$

(A negative result is income for an issuer.)

For Creditor, the holder of the financial arrangement, a bad debt deduction for the \$5,000 forgiven would be available if the requirements of section EH 5(1) were satisfied prior to the remission.

Example 2

Assume that Creditor made the loan under *Example 1* and that Debtor had claimed an income tax deduction of \$5,000 in the first year (on an accruals basis). Assume, however, that after the first year, Debtor's financial difficulties lead the parties to agree that only \$40,000 of principal and \$10,000 of interest would be repaid in the second year in full and final settlement. If the balance of the interest (\$5,000) were deductible by Debtor in the second year, she would have gross income of \$5,000 under the base price adjustment. This is because the deductible interest in that year would partly offset her taxable remission income of \$10,000. Debtor's base price adjustment would be:

$$\begin{aligned} &= a - (b + c) \\ &= \$40,000 + \$10,000 - (\$50,000 + \$5,000) \\ &= - \$5,000 \text{ (income)}. \end{aligned}$$

Creditor could only claim a deduction for the remission under section EH 5(2) if she satisfied the requirements of that subsection prior to the remission. Creditor would only be entitled to a bad debt deduction if she carried on a business of holding or dealing in such financial arrangements and was not associated with Debtor.

Legislation

Section EH 4(6) allows issuers relief from the taxation of remissions for certain intra-family and private debts. It replaced, without material amendment, the former section 64F(7B) of the Income Tax Act 1976.

Section EH 4(6)

Section EH 4(6) states:

Where an amount owing under a debt (including any amount accrued and unpaid at the time of the forgiveness) is forgiven by a natural person in consideration of natural love and affection, the amount forgiven shall, for the purposes of the qualified accruals rules, be deemed to have been paid when the amount is forgiven.

Application of the Legislation

Requirements of section EH 4(6)

In summary, for section EH 4(6) to apply:

- There must be an amount owing.
- It must be owing under a debt.
- It may include any amount accrued and unpaid.
- It must be forgiven.
- It must be forgiven by a natural person.
- It must be forgiven in consideration of natural love and affection.

The following discusses some of the requirements of the subsection.

Debt

Section EH 4(6) only applies when there is “an amount owing under a debt”. It is not available for forgiveness of all types of “financial arrangement” that may be subject to the accruals rules. “Financial arrangement” as defined in section OB 1 is a very broad term. For example, it includes sell-back and buy-back arrangements, debt defeasances, and assignments of income. None of these is, in itself, a debt.

“Debt” is not defined in the Act. Accordingly, the expression is given its ordinary or common meaning. In legal terms a “debt” is understood to be a liquidated money demand or something recoverable in court by action for debt. A debt is a certain sum due from one person to another, either by record (e.g. court judgment) or in writing.

Forgiven

An amount under a debt must be “forgiven” for section EH 4(6) to apply. The expression “forgiven” does not necessarily mean the same thing as “remitted” (as defined for accruals rules purposes in section EH 4(9)(c)). “Remitted” includes a wider range of events that are not necessarily forgiveness. These events could include when the issuer has been released from making payments by operation of statute (e.g. the Insolvency Act 1967) or lapse of time (e.g. become statute barred).

“Forgiven” is not defined in the Act. The expression must be given its ordinary or common meaning, i.e. the giving up of any claim to restitution or remedy for an obligation. That forgiveness must be a positive act by the creditor (holder) as opposed to a consequence of the operation of statute or the lapse of time.

Such forgiveness is normally evidenced by a deed or other document.

Partial forgiveness

The Commissioner considers that section EH 4(6) can apply to a partial debt forgiveness. The subsection applies in broadly the same way as to a full debt forgiveness. It deems the amount forgiven to be paid for the purposes of the base

price adjustment calculation. However, a difference is that a partial debt remission does not trigger a base price adjustment, unless it accompanies maturity or transfer of the financial arrangement.

Conditional forgiveness

If a forgiveness is conditional, it does not occur until the conditions are fulfilled. Accordingly, the Commissioner considers that the amount conditionally forgiven is not deemed paid under section EH 4(6) until the conditions are fulfilled.

Natural person

The person forgiving the debt (the creditor or holder) must be a “natural person”. The expression “natural person” is a legal term whose meaning is not altered by the Act. It is a human being as opposed to an artificial person (such as a company): *Pharmaceutical Society v London & Provincial Supply Assn.* (1880) 5 A.C. 857, 869-870.

This commentary sets out the Commissioner’s interpretation of “natural person” for deceased persons and for trusts settled by natural persons.

In consideration of natural love and affection

This requirement of the subsection confines it to family and other private transactions. It does not apply to business or commercial arrangements.

The phrase “in consideration of natural love and affection” is another legal concept. It is not further defined in the Act. It is used to describe an action by a person where the motive is induced not by a promise of something in return but by the natural love and affection the person has for another. An action undertaken in consideration of natural love and affection does not entice reciprocation, i.e. there is nothing in return expected from the debtor. Natural love and affection is generally considered to subsist between relatives, such as father and child, brother and sister, husband and wife (or non-spousal domestic partners), uncle and nephew, grandmother and grandchild, great-grandfather and great-grandchild and other descendants or antecedents of the creditor, whether by blood, marriage, non-spousal domestic relationship, or adoption – whether or not born during the creditor’s lifetime.

Except as discussed below in relation to trusts, the Commissioner considers that section EH 4(6) requires that the natural love and affection exist between the creditor and the debtor.

The Commissioner considers that in some cases it would be possible for natural love and affection to be present outside the family. For example, it could be present between close friends (although not ordinary acquaintances or colleagues). In testing the state of mind of a creditor in establishing the presence of natural love and affection, the Commissioner may look at a number of factors, such as express statements made, past distributions, existing relationships, and future intentions. However, this is by no means a complete list of the factors the Commissioner can take

into account in determining whether the creditor has natural love and affection for the debtor.

Inland Revenue does not propose to publish detailed rules or guidelines on the degree of relationship necessary to establish natural love and affection. This question can only be considered on a case by case basis.

Debt is deemed paid

If the requirements of section EH 4(6) are satisfied, the amount of the debt forgiven is deemed paid; including any amount accrued and unpaid on the debt. This consequence is deemed for all purposes within the qualified accruals rules.

The main provisions when this deemed payment is relevant are sections EH 4 (base price adjustment) and EH 5 (bad debts). Broadly, the effect for the issuer or debtor is that no taxable remission arises on a base price adjustment. For the holder or creditor, no bad debt deduction is available under section EH 5 because the amount forgiven is deemed paid. Also, any interest or accruals income forgiven is taxable to the holder, for the same reason.

Example 3

Assume that the forgiveness is as in *Example 1*, but that Creditor and Debtor are closely related (sisters) and that the requirements of section EH 4(6) are met.

Debtor has claimed a \$5,000 interest deduction in the first year. In the second year, rather than \$5,000 of gross income as in *Example 1*, Debtor's base price adjustment would result in expenditure of \$5,000. This is the balance of the interest remitted that is deemed paid. Her calculation would be:

$$\begin{aligned} &= a - (b + c) \\ &= (\$50,000 + \$10,000) - (\$50,000 + \$5,000) \\ &= \$5,000 \text{ (expenditure).} \end{aligned}$$

(The amount deemed paid, \$10,000, is added into item 'a'.)

Creditor is required over the two years to return the \$10,000 of interest remitted as gross income under the accruals rules. No bad debt deduction is available for the remission as it is deemed paid.

Example 4

Assume that the forgiveness is as in *Example 2*, but that Creditor and Debtor are closely related (sisters) and that the requirements of section EH 4(6) are met.

Rather than \$5,000 of gross income as in *Example 2*, Debtor's base price adjustment would result in expenditure of \$5,000, being the balance of the interest paid. The \$10,000 of debt remitted is not taxable to Debtor, as Debtor is deemed to have paid it. Debtor's calculation would be:

$$\begin{aligned} &= a - (b + c) \\ &= (\$50,000 + \$10,000) - (\$50,000 + \$5,000) \\ &= \$5,000 \text{ (expenditure).} \end{aligned}$$

Creditor is assessed on the \$10,000 interest received. She is not entitled to a bad debt deduction for the remission as it is deemed paid.

Testamentary dispositions and trusts

Testamentary dispositions

The question has arisen as to whether a deceased taxpayer can be a “natural person” for section EH 4(6) purposes. For example, can section EH 4(6) apply to a debt forgiveness by will when the other requirements of that provision are present?

The Commissioner considers that the deceased can be a “natural person” and that section EH 4(6) can apply. This is because, under section 24 of the Wills Act 1837 (UK), in relation to the property of the deceased, a will speaks and takes effect from the time immediately prior to the deceased’s death. (The Wills Act 1837 (UK) has been incorporated into New Zealand law.)

Accordingly, the Commissioner considers that section EH 4(6) will apply to a testamentary debt when its requirements would have been satisfied immediately prior to the deceased’s death.

Example 5

Son owes Father a debt of \$10,000. Father dies, and his will provides for the debt to be forgiven. Section EH 4(6) applies and Son is deemed to have paid the debt to Father for accruals purposes.

Family fixed trusts

The issue has also arisen as to whether the forgiveness of debt to a trust may satisfy section EH 4(6). The situation envisaged is when a trust settlor or creditor is a natural person. He or she has natural love and affection for the trust beneficiaries. The trust is a fixed trust (i.e. the trust deed sets out the share or interest that each beneficiary is to take) for beneficiaries. The trust owes the settlor or creditor a debt. The creditor forgives the debt to the trust.

The Commissioner considers that the subsection can apply, provided that all the requirements are satisfied. The Commissioner considers that it is necessary to “look through” the trust from the creditor to the beneficiaries in determining whether there is natural love and affection. The presence or absence of that state between the creditor and the trustee, in his or her private capacity, is irrelevant. Similarly, the presence or absence of that state between the trustee and the beneficiaries is irrelevant.

The state must exist, or have existed, between the natural person creditor and all of the trust's beneficiaries (subject to the comments below about certain default beneficiaries).

Family discretionary trusts

The position is less clear for discretionary trusts when the class of beneficiaries includes persons for whom the settlor or other creditor has natural love and affection.

Some parties have argued that a creditor does not have to have natural love and affection for all the beneficiaries of a discretionary trust in order to satisfy the section. The section does not mention “all beneficiaries” but merely provides that there must be natural love and affection. However, in the Commissioner’s view, it is implicit in the words of the section that the debt must be forgiven in consideration of natural love and affection towards all the beneficiaries. This is because the forgiveness, in a discretionary trust, could benefit any of the objects of the trust. If the trustee has power to allocate benefits to beneficiaries for whom a creditor could not have natural love and affection such as a company or a charity, this would seem to defeat the clear intention of the section.

The Commissioner considers that the subsection will apply in a family discretionary trust situation, provided that at the time the debt is forgiven all of the objects of the trust (subject to the comments below about default beneficiaries) are persons for whom the creditor has or would have had natural love and affection, i.e. qualifying beneficiaries. The fact that the terms of the trust may include a power to add objects or beneficiaries for whom a creditor could not have natural love and affection will not preclude the section from applying to a forgiveness of debt if that discretion has not been exercised.

Family trusts (fixed and discretionary) with default beneficiaries

A related question is whether the subsection applies if a trust deed specifies default beneficiaries for whom the settlor does not have natural love and affection. For example, it is common for family trusts to have charities and similar bodies as default beneficiaries in the event that the qualifying beneficiaries pre-decease.

There needs to be a legal mechanism whereby the assets of the trust are definitely to be distributed at some point in time. The naming of default beneficiaries to receive trust property if the intended beneficiaries or objects are not alive when the distribution takes place is accepted by the Commissioner as not precluding the application of section EH 4(6), notwithstanding that such default beneficiaries may be persons for whom the creditor does not necessarily have natural love and affection. Therefore, non-qualifying beneficiaries, such as charities, can be default beneficiaries and the section will still apply in a situation of debt forgiveness.

Similarities between family companies and family trust arrangements

The Commissioner has considered submissions that focus upon the similarities between family companies and family trust arrangements. However, there is clear legal distinction between these chosen vehicles, in that a company has separate legal personality from its shareholders. This was affirmed in the House of Lords case *Salomon v Salomon & Co Ltd* [1897] AC 22. Accordingly, any relationship between the creditor and the shareholders is regarded as being irrelevant in a forgiveness of

debt situation.

In contrast, a trust is a form of relationship in which one person (the trustee) holds property in his or her own ownership for the benefit of a second party (the beneficiary). The publication *Nevill's Law of Trusts, Wills and Administration in New Zealand* refers to Keeton and Sheridan's definition of a trust as:

the relationship which arises whenever a person called the trustee is compelled in equity to hold property, whether real or personal, and whether by legal or equitable title, for the benefit of some persons (of whom he may be one and who are termed beneficiaries) or for some object permitted by law, in such a way that the real benefit of the property accrues, not to the trustees, but to the beneficiaries or other objects of the trust. [See *The Law of Trusts*, 10th edition, at page 5.]

In *Garrow and Kelly's Law of Trusts and Trustees*, 5th Edition, 1982, a trust is defined as:

an equitable obligation under which a person having the control of property is bound to deal with that property either:

- (a) For the benefit of definite persons (of whom he may himself be one) and any one of whom may enforce the obligation; or
- (b) For some object or purpose permitted by law.

These definitions emphasise that trust property is vested in trustees who control it and manage it for the benefit of the beneficiaries or objects. A trust is the relationship between the trustee and beneficiaries, whereas a company is a separate legal entity from its shareholders.

A forgiveness to a company or other non-natural person is not in consideration of natural love and affection. A number of commentators share this view. For example, the Valabh Committee commented on this issue in its discussion paper issued in October 1991 on the *Operational Aspects of the Accruals Regime*. The Committee said, at page 37:

The Committee is not persuaded that the natural love and affection exemption should be extended to loans made to companies. Where a loan is forgiven, the relationship between lender and shareholders seems too remote to justify such an extension.

Further comment is provided in the publication *The New Zealand Accrual Regime – a practical guide* by Glazebrook and Oliver. The authors say, at page 169:

However, a person could not have natural love and affection for companies or other non-natural persons. It is certainly difficult to envisage that the forgiveness of debt owed by a company, whoever the shareholders are, could be in consideration of natural love and affection.

In the discussion document *Taxation of Financial Arrangements* issued in December 1997, the following comments were made in respect of the forgiveness of company debt obligations:

- Section EH 4(6) should not be extended to include forgiveness of debts owing by companies whose shareholders were persons for whom the creditor had natural love and affection.

- A company has a separate legal identity from its shareholders. In contrast, a trust is a form of relationship in which one person (the trustee) holds property in his or her own ownership for the benefit of a second party (the beneficiary). The property is held according to terms that are dictated by the person who constituted the trust (the settlor). The function of trust law is to enforce the duties implicit in the trust relationship that exists between the trustee and the beneficiary and to provide remedies for a breach of those duties.
- A forgiveness of a debt owing by a trust will benefit the beneficiaries of that trust. However, there may be situations where a loan to a company that is subsequently remitted does not beneficially flow through to shareholders – for example, if a company is insolvent, or in loss.
- We note that the Valabh Committee, in its 1991 report, was also opposed to extending section EH 4(6) to cover forgiveness of debts owing by companies.

Superannuation schemes as trust beneficiaries

A superannuation scheme may be one of the beneficiaries of a trust. As long as the superannuation scheme is a trust established specifically by its deed to provide retirement benefits to persons for whom a creditor has natural love and affection, i.e., relatives or close friends, any debt forgiven by the creditor will be deemed to have been paid under section EH 4(6).

Charities as beneficiaries

Section EH 4(6) will not apply when a charity is a beneficiary (other than a default beneficiary). Natural love and affection cannot be held for a charity. To interpret section EH 4(6) otherwise would be to ignore the plain words of the section. Charities are not set up for specified or named people but with particular purposes in mind, e.g. relief of poverty, whereas a family trust will have specified beneficiaries as objects. Also, Parliament's intention in enacting the legislation was to provide an exemption for family arrangements – not to deal in any way with the taxation treatment of charities.

Example 6

Mother has established a trust, with her children as beneficiaries as to one-third each. The default beneficiary, if the other beneficiaries pre-decease, is a charity for the promotion of musical education. Mother has sold her business assets to the trust for a debt owed back by the trust of \$100,000. Mother forgives the \$100,000 debt in consideration of natural love and affection for the beneficiaries. Section EH 4(6) applies and the trustee is deemed to have paid the debt for accruals purposes. Although natural love and affection cannot exist in respect of a charity, its presence in the trust as a default beneficiary does not prevent the subsection applying.

Example 7

Prior to his death, the deceased established a family discretionary trust under which the only potential beneficiaries are his children. He lent money to the trust to pay for an overseas trip by his children. His will provided for the loans to be forgiven. Section EH 4(6) applies and the trustee is deemed to have paid the debt for accruals purposes.

Example 8

A discretionary trust is established whose beneficiaries are the settlor's children, other family members, and family superannuation schemes. As long as the superannuation schemes are trusts established specifically by their deeds to provide retirement benefits to family beneficiaries only, debts forgiven by the settlor to the trust will fall within the provisions of section EH 4(6) and the Ruling will apply.

Example 9

A discretionary trust includes within its objects the children of the settlor, a family company, and a charity. Both the company and the charity receive regular payments from the trust, i.e. they are not default beneficiaries. The Ruling will not apply where debt is forgiven to such a trust. The presence of the company and the charity precludes section EH 4(6) from applying in a debt forgiveness situation. Natural love and affection cannot be extended to a company or a charity. The same position will apply if no distributions are made to the company or charity.

Example 10

A trust may have as its beneficiaries family members and a discretionary family trust. Provided that the beneficiaries (apart from default beneficiaries) of the discretionary trust are family members or close friends, i.e. qualifying beneficiaries, the provisions of section EH 4(6) will apply and so too will the Ruling.

Other situations that may arise

Situations will arise that fall outside the examples described here. If taxpayers or their agents are uncertain as to whether the Ruling applies in particular circumstances, they should check with their local Inland Revenue office. If the Ruling does not apply to their arrangement, taxpayers can then ask their local Inland Revenue office for a non-binding opinion on the Commissioner's view of the law as it affects their arrangement. Alternatively, they can apply for a private binding ruling in respect of a particular arrangement.

Other situations where section EH 4(6) does not apply

The Commissioner considers that section EH 4(6) is not applicable if:

- A trustee, acting in his or her capacity as trustee, forgives a debt owed by the trust beneficiaries, in their capacity as beneficiaries, irrespective of a trustee's natural love and affection for the beneficiaries. The trustee's natural love and affection arises in his or her personal capacity. It would be improper for the trustee to forgive a debt in consideration of his or her personal natural love and affection for the beneficiaries. The trustee could only forgive in accordance with his or her duties as trustee (as set out in the trust deed). In the statutory context of section EH 4(6), the Commissioner considers that a trustee acting in his or her capacity as

trustee is not a natural person. The settlor's natural love and affection for the beneficiaries would also be irrelevant as the forgiveness would be by the trustee.

- The debt forgiveness forms part of a tax avoidance arrangement in terms of a provision such as section GD 11 or BG 1. For example, an individual taxpayer owes a bank an amount under a debt which she cannot pay in full. The individual pays what she can, and the bank, in turn, transfers the balance of the debt to the taxpayer's spouse for nominal consideration. The spouse forgives the balance supposedly within section EH 4(6). In these circumstances the Commissioner might invoke an anti-avoidance provision such as section BG 1.

Submissions received from practitioners and others

We received many submissions in response to our initial draft of the ruling and we have adopted some of the suggestions made to us. We set out below how we have dealt with the main issues.

Power of resettlement

We were asked whether a trust having the power of resettlement will prevent the section from applying.

If a trust has the power to resettle, this alone will not prevent the exemption provisions of section EH 4(6) from applying. Provided that a trust currently satisfies the criteria to achieve an exemption, where a resettlement is effected the resulting beneficiary make-up will govern whether a debt forgiven to the trust comes within the section. If the beneficiaries satisfy the criteria, the exemption will apply – the test is whether a debt is forgiven in consideration of natural love and affection. This test is not affected by the ability of a trust to resettle.

Power to nominate further beneficiaries

Commentators suggested that the fact that a trust may have the power to add further beneficiaries to the trust for whom a creditor could not have natural love and affection should not prevent section EH 4(6) from applying to a forgiveness of debt. We agree with this view. Provided that at the time the debt is forgiven all the beneficiaries (apart from default beneficiaries) are persons for whom the creditor has natural love and affection, i.e. the ability to nominate further beneficiaries (other than qualifying or default beneficiaries) has not been exercised, section EH 4(6) will still apply. If, however, there is an intention (at the time of the debt forgiveness) to add such a non-qualifying beneficiary, the Commissioner reserves the right to consider the potential for invoking the anti-avoidance provisions of the Act if the circumstances support this.

Degree of relationship

Commentators stated that reference in the ruling to “near relatives” and “close friends” was too narrow an interpretation of the objects of a person's natural love and affection. We agree with this view. The use of the term “near relatives” and the examples given, left unclear the degree of family relationship to which the section

applies. The current draft ruling now refers to “relatives”, and expands on the examples, to take into account how a typical family trust makes provision for family members including those not yet born.

Classes of beneficiaries

Concern has been expressed as to how to differentiate between primary and minor beneficiaries. The Commissioner now considers that, in a family trust situation, the clear words of section EH 4(6) put the focus on beneficiaries of a trust for whom a creditor can have natural love and affection. The section will apply in all instances if the creditor has forgiven a debt owing by a trust where all the beneficiaries (apart from default beneficiaries) are persons for whom the creditor has natural love and affection, i.e. qualifying beneficiaries. Therefore, no distinction is required to be made between primary and minor beneficiaries.

Companies and charities

It was suggested by commentators that the section required the Commissioner to look through a company in much the same way that one looks through a trust to the beneficiaries. The Commissioner disagrees with this view. In respect of companies, there is a clear legal distinction between a company and its shareholders in that a company has a separate legal personality from its shareholders. Accordingly, any relationship in a forgiveness of debt situation between a creditor and the shareholders is irrelevant. Some parties also suggested that charities should be permitted beneficiaries for the purposes of section EH 4(6) – primarily for perceived policy reasons. For the reasons noted earlier in this commentary, it is the Commissioner’s view that a person cannot have natural love and affection for a charity or other non-natural person. Neither the history nor the wording of section EH 4(6) indicates any legislative intention to deal with charities; concessionally or otherwise.