NEW ZEALAND LAW SOCIETY

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THE FAMILY TRUST

Trusts are becoming an increasingly popular way of protecting property and managing assets.

A trust is created when a person, called the settlor, transfers property to people known as trustees. Trustees are obliged by law to use the property for purposes that the settlor has specified. Usually one of these purposes is to make payments from the trust property to people called beneficiaries.

Although a trust is normally given a name and is often referred to as if it is a separate entity, like a company, it is not. A trust is a relationship between trustees and beneficiaries which imposes duties on the trustees to deal with the trust property in the interests of beneficiaries.

The way the trust property is to be dealt with and the parties involved are usually set out in a document known as the trust deed. Trusts can also be created by wills.

Trusts can be set up for charitable purposes such as education or established specifically for the benefit of the members of a particular family. The terms of trusts can differ markedly depending on the purpose for which a trust has been established.

This guide deals with one particular type of trust – the family trust – but much of the information will also apply to other types of trusts.

WHY HAVE A FAMILY TRUST?

Reasons for establishing a family trust include:

- To protect assets for family members – by transferring the ownership of some assets to a trust, a settlor may be able to undertake a higher risk occupation or venture knowing that those assets will not be put at risk.

- To ensure certain assets – such as a family business or farm – are transferred intact to the next generation.
- To make sure some assets are retained for other family members when one or more members needs rest home or hospital care.
- To protect family members or a family business from possible relationship property or family protection (contesting a will) claims.
- To manage the assets of someone who is unable to manage their own affairs, perhaps through age or infirmity.
- To assist with estate administration (and cost savings) by transferring assets to a trust before death.
- To change tax liability. More or less tax may be payable. Tax liability should be reviewed regularly.

WHO IS INVOLVED?

The main parties to a trust are:

The settlor: the person (or people) who makes the initial transfer of property, which may be as little as $1, to the trustees of the trust. Anyone who transfers assets to the trust is a settlor.

The trustees: a trust normally has two or more trustees. They should be people whom the settlor is confident will manage the trust prudently. A settlor can choose to be a trustee of his or her own trust. In some circumstances, it is advisable also to have an unrelated trustee, who might be a family friend, the settlor's lawyer or accountant for example, or a corporate trustee. One of the matters to look at when choosing trustees is how the trust is to be managed. Will the settlor do this or will a professional trustee have a continuing involvement with the management and account keeping?

The beneficiaries: people for whose benefit the trust has been established. They can be either named individuals or a class, such as "children" or "grandchildren". There are generally two types of beneficiary – discretionary beneficiaries and final or ultimate beneficiaries.

Discretionary beneficiaries have a right to be considered by the trustees for payments from the trust property but they do not have an automatic right to receive payments from the trust.

The following are often named as discretionary beneficiaries:

- The settlor(s);
- Children and grandchildren of the settlor.

Settlors often have power to add beneficiaries and they may, for example, decide to add members from the wider family or a charity.

Final or ultimate beneficiaries have a legal right to the trust property on the date the trust finishes. They are often named and are often the settlor's children with provision for grandchildren if a child dies before the trust finishes.

HOW LONG DOES A TRUST LAST?

In simple terms, a family trust cannot exist for longer than 80 years and the trust deed must set a date on which the trust has to finish. This is known as the **date of distribution**. Trustees are usually given the power to bring the trust to an end before the date of distribution. Some trust deeds give trustees a power to extend the distribution date so long as it does not go beyond 80 years.

WHO CAN APPOINT AND REMOVE TRUSTEES?

The trust deed usually gives someone the power to appoint new trustees and sometimes the power to remove trustees. Usually this power is given to the settlor. If the trust deed does not mention this, the trustees together can appoint new trustees. If they cannot agree, the Court has the power to appoint new trustee(s).

HOW DOES A TRUST OPERATE?

Trustees are the owners of the property and can do the same sorts of things with the property that owners can do. They can hold property, raise mortgages, hold bank accounts and generally hold all types of assets and investments as long as it operates according to the powers set out in the trust deed.

GETTING ASSETS INTO A TRUST

Assets can be transferred into trust at any time. They can be gifted into trust or sold into trust. The settlor will usually transfer the assets into trust, or the trustees may acquire the assets from someone else.

Before gift duty was repealed it was common for settlors to sell the assets to the trustees. If there were no funds in trust to pay for the asset, the trustees signed a document acknowledging that they owed the settlor the purchase price.

The settlor then usually forgave the debt gradually in instalments not exceeding $27,000 per year. That sum was the maximum amount that could be gifted without incurring gift duty. The debt was an asset owned by the settlor.

Any increase in the value of the asset sold to the trust belongs to the trust and not to the settlor personally.

Similarly, any income from the trust assets is usually trust income and not the income of the settlor.

REPEAL OF GIFT DUTY

The repeal of gift duty in October 2011 means that assets of any value can be transferred into trust after that date without incurring gift duty.

This means:

- The settlor can forgive any outstanding debt owed by the trustees to the settlor in respect of assets sold into trust in the past;
- The settlor can transfer assets into trust by gift rather than sale.

But note the caution below.

GETTING MONEY OUT OF THE TRUST

Generally, the trustees decide which payments from income or capital are to be made from the trust and which beneficiaries shall receive them.

In addition, if the trustees owe a debt, the creditor can demand payment of any part of the debt, if the document recording the debt allows such demands to be made. If the debt for the initial purchase of assets is repayable to the settlor on demand, the settlor can require payment of all or any part of this debt at any time. Payments of this kind from the trust to the settlor may be free from income tax.

WHAT ABOUT TAX?

Generally, income will either be taxed in the hands of the trustees as trustee income or in the hands of the beneficiary if the trustees decide to pay income to beneficiaries. If income is paid to a beneficiary over the age of 16 within six months of the end of the tax year, then it is taxed at the beneficiary's personal tax rate. Income that is not distributed in this way is taxed in the trust at the trustees' rate.

TRUST STRUCTURES

The structure of a trust will depend on what the settlor specifically wants the trust to do. It is important to note that trustees, once appointed, cannot do just anything they want with the trust property. They have powers that allow them to do certain things and duties

that must be observed.

These restrictions are based on:

- The trust deed – what does the deed expressly allow the trustees to do?
- Legislation – what does the printed law allow or stop the trustees from doing?
- Case law – what do the cases that have already been decided prohibit or allow the trustees to do?

If you wish to set up a trust, it is important that you understand your trust and what trustees can and cannot do before you establish it.

You should talk to your lawyer to ensure that the terms of your trust fully meet your needs, fulfil the intended purpose and will not be upset by any clawback provisions.

There are many varieties of trust to suit individual circumstances.

One alternative, used when each spouse wants as much protection as possible over one or more assets without the direct involvement of their spouse as a co-trustee or beneficiary, is a cross or mirror trust or a parallel trust. This involves setting up two trusts instead of one. For example, the first spouse can establish a family trust with the second spouse, children and grandchildren as the beneficiaries. The second spouse also establishes a family trust with the first spouse, children and grandchildren as beneficiaries.

Check with your lawyer to see what type of trust you need.

CAUTION

Trusts are subject to various legal requirements and there are several provisions in law that allow property in a trust to be clawed back in certain circumstances. These can defeat the purpose for which the trust was set up in the first place.

A court may set aside transfers of assets that were made with the intention of defeating the rights of creditors or the rights of spouses/partners under the Property (Relationships) Act.

If a couple's relationship property has been transferred into trust and that transfer has the effect of defeating the rights of one of the partners under the Property (Relationships) Act, the court may order the other partner to compensate the partner whose rights are defeated.

Also, transferring assets into trust may affect your eligibility for the residential care subsidy.

These provisions are more likely to apply if you gift your assets into trust rather than selling them and then gradually forgiving the debt owed to you. You should check with your lawyer before gifting property into trust.

You should assess whether a trust is a suitable vehicle to meet your objectives. You

should weigh up the advantages and disadvantages of your various options, including the on-going management compliance costs of each. Your lawyer will be able to help you determine what is required to meet your needs.

DO THE RIGHT THING – SEE YOUR LAWYER FIRST

Lawyers deal with many personal, family, business and property matters and transactions. No one else has the training and experience to advise you on matters relating to the law. If your lawyer can't help you with a particular matter, he or she will refer you to another specialist. Seeing a lawyer before a problem gets too big can save you anxiety and money.

Lawyers must follow certain standards of professional behaviour as set out in their rules of conduct and client care. When you instruct a lawyer, he or she must provide you with certain information, as outlined in our guide *Seeing a lawyer – what can you expect?*

This includes informing you up front about the basis on which fees will be charged, and how and when they are to be paid. The fee, which must be fair and reasonable, will take into account the time taken and the lawyer's skill, specialised knowledge and experience. It may also depend on the importance, urgency and complexity of the matter. There could also be other costs to pay, such as court fees.

Lawyers must have a practising certificate issued by the New Zealand Law Society. You can call the Law Society on (04) 472 7837 or email registry@lawsociety.org.nz to see if the person you plan to consult holds a current practising certificate. You can also check this on the register accessible through the website www.lawsociety.org.nz.

If you have a concern about a lawyer, you can talk to the Lawyers Complaints Service, phone 0800 261 801.

If you don't have a lawyer:

· Ask friends or relatives to recommend one;

· Look in the Yellow Pages under "lawyers" or "barristers and solicitors";

· Inquire at a Citizens Advice Bureau or Community Law Centre;

Check these websites:

· www.lawsociety.org.nz/home/for_the_public/find_a_lawyer;

· www.familylaw.org.nz;

· www.propertylawyers.org.nz.

To the best of the New Zealand Law Society's knowledge, all information in this guide is true and accurate as at the date below. However, the Law Society assumes no liability for any losses suffered by any person relying directly or indirectly on information in this pamphlet. It is recommended that readers consult a lawyer before acting on this information.

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