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TRUSTS - THE BASICS

Reasons for a Trust

1. To protect family assets from creditors.

2. To protect assets from relationship property claims.

3. To reduce the risk of the Court "remaking" your Will under provisions of either the Family Protection Act or the Property (Relationships) Act 1976.

4. To preserve assets for your children where the possibility of a second marriage of your surviving spouse on your death could result in family assets going to complete strangers.

5. To provide special assistance and support for a disadvantaged child.

6. To preserve family assets against possible reintroduction of death duty.

7. To reduce family assets allowing a family to maximise social welfare or other benefits, such as rest home fees.

8. Utilisation of a trust for income-splitting purposes, in some circumstances.

9. Through the use of trading trusts for business trading activity, fringe benefit tax and ACC levies can be reduced and compliance costs can also be lowered.

10. Confidentiality of asset ownership.

11. Capital taxes planning. To reduce effect of tax on sale of land.

12. To transfer wealth carefully from one generation to another.

CORNERSTONES OF ESTATE PLANNING

1. Family Trusts.
2. Relationship Property Agreements.
3. Transfer of personal assets to Trust.
4. Wills.

Used to achieve separate ownership of assets while preserving the benefit of the assets for you and your family.

OVERCOME OBJECTIONS

Costs

- Alison Green's Law Office provides affordable solutions to all of your Estate Planning requirements.

Loss of Control

- This can be minimised by ensuring that the Settlor continues to have an input in decision-making undertaken by the Trustees. The Settlor can be one of the Trustees.

Limitation of liability

- With Trading Trusts, a potential disadvantage is the loss of limited liability that a company structure provides. This may be overcome by utilising a corporate Trustee which will resolve this potential problem in most instances.

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STEPS IN PREPARING AN ESTATE PLAN

1. Position Statement

- Assets and Liabilities.
- Ownership of assets.

2. What do you want?

- Ultimate ownership of your assets.
- Marital status.
- Family Protection Act.
- Power to Control.
- Advantages and Disadvantages.

3. Review Possible Techniques

- Trusts.
- Joint Family Home.
- Property (Relationships) Act 1976.
- Review existing Trusts and/or companies.

GIFTING PROGRAMMES

- If a property is not gifted or transferred under a Relationship Property Agreement sale is necessary.
- Price is left as debt and debt progressively gifted off to reduce gift duty.
- Gift Duty was repealed effective 1 October 2011.
- Asset Planning involves maximising gifting opportunities ie spouses gift separately, not jointly.
- Each gift is a separate disposal which attracts its own time limits.
- Programmes require monitoring and management.
- Be careful about tax on gifts between paying entities.

* Beware Ministry of Social Development rules regarding Residential Care Subsidies. Gifts in excess of $27000 per annum per couple are deemed deprivation of capital and put subsidy applications at risk.

TAX ISSUES TO CONSIDER

- Utilisation of marginal tax rates.
- Fringe benefit and ACC savings.
- Use of Marshall clauses for loans.
- Triggering of depreciation recovered.

TYPES OF TRUSTS

Popular examples of Trusts used in ownership planning include:

- Discretionary Trusts
  - Single Person Trust
  - Joint Married couple Trust
  - Parallel Trusts (couples)

- Trading Trusts

- Education Trust

- Charitable Trust

- Special Purpose Trust with definite objectives

FAMILY TRUSTS – WHAT ARE THEY?

Most legal systems have laws relating to trusts.

What is a trust? A trust is - obligations placed by a Settlor on trustees to administer trust property given to them, usually by the Settlor, for the benefit of the beneficiaries named in the Trust Deed.

A trust is a separate and distinct legal entity with legal rights. A trust is separate from the settlor who set it up, from the trustees who administer it, and from the beneficiaries. Trustees, hold the Trust property independently of themselves, and of the settlor, and of the beneficiaries.

Settlement of property on trust or gifts made to a trust with an intention to defraud creditors can be set aside by the Courts and that property then made available to creditors.

Common reasons for establishing a trust:

1. To protect family assets from creditors.

2. To reduce the risk of the Court "remaking" a Will on death pursuant to the provisions of the Family Protection Act.

3. To protect the assets of one spouse from a relationship property claim.

4. To provide support for a vulnerable child.

5. To preserve assets for your children where the possibility of a second marriage of your surviving spouse on your death could result in family assets going to complete strangers.

6. To maximise social welfare such as rest home fees and student allowances.

7. Confidentiality of asset ownership.

8. To limit the size of an individual's estate in case death duty is reintroduced.

9. Through the use of trading trusts for business trading activity.

10. For income splitting purposes, in some circumstances.

11. To plan wealth transfer from one generation to another.

A trust is established by the signing of a written Deed of Trust by the Settlor and Trustees.

You can choose how many trustees to have (if individuals usually 2 or 3). You can also have a trustee company to act as trustee if you wish. A trustee must be completely reliable. Ideally together the trustees should also have a good knowledge of law, accounting, investing and business.
There will be "discretionary beneficiaries" who will usually be the Settlor(s) and his or her spouse, their children, grandchildren and others. There will also be "final beneficiaries" who will take the balance of the Trust Fund remaining when it comes time to wind up and distribute the Trust Fund. There could be scope to widen those groups of beneficiaries.

A modern flexible Deed of Trust should address the following:

1. Give the Trust a distinctive name.

2. Have two or three trustees, or possibly a Trust Company in whom or which you have complete confidence.

3. Prescribe how trustees are to be appointed and removed.

4. Define the date the beneficiaries must get the Trust Fund - usually when the Settlor and his or her spouse have died.

5. Include a provision enabling the Trust Deed to be altered.

6. Make sure a resettlement clause is included so you can set up a new and different trust with the Trust Fund established.

7. Provide carefully how the income is to be dealt with and vested.

8. Allow for the addition and removal of beneficiaries.

9. Allow for the Trust Deed to be amended.

FAMILY TRUST ADMINISTRATION

It is important that a family trust is properly run to be effective. A minute book should be kept recording all major decisions made by trustees. And, annual financial statements should be kept recording the Trusts balance sheet of assets and liabilities and the Trusts income and expenses. If the trust derives a taxable income then an income tax return must be prepared and filed. These obligations are much like those that apply to any business.

Trusts can be challenged when they are a sham to defraud creditors and trust assets can be ordered to be made available to creditors. The TRA has warned that proper procedures must be followed otherwise "there may be unintended consequences and desired effects may not have been achieved".

Below are guidelines to assist in avoiding challenge by the Inland Revenue or creditors:

1. Always have a separate bank account for the trust and use it exclusively for the trust for trust purposes.

2. The trustees must determine who is to get the income, and if more than one, in what proportions. This must be done by way of resolution of the trustees properly drawn up and signed by them and affixed in the minute book.

3. All major decisions made by the trustees must be properly recorded by written resolution signed by them and affixed in the minute book. Ideally trustees should meet at least once a year and should be actively involved in the management and control of the trust. Trustees must all have full information concerning trust assets liabilities, income and expenses and be actively involved.

TRADING TRUSTS

Introduction

A trading trust is a form of discretionary trust which as its name indicates, is actually involved in business trading activity as opposed to the more passive role of a discretionary family trust. Some accountants have favoured the flexibility available with the use of trading trusts and there has been an increase in the use of trading trusts by many business people.

Tax Effectiveness

Clients are encouraged to speak to their accountants about the tax effectiveness of a trading trust for their particular circumstances. In this regard note that it is the core business activity that is transferred to the Trust. You will also need to ensure that the business is valued and sold to the trust at fair market value.

Advantages

The advantages of establishing a trading trust as stated above is predominantly related to tax effectiveness of a trading structure. The major tax advantages are as follows:

1. **Income-splitting**: This is a major tax benefit for many people. With differential tax rates there has been a stretching of the differential between the top rate of tax and the bottom rate.

2. **Fringe Benefit Tax** does not apply to beneficiaries of trusts

3. **Compliance costs** may lower because financial statements do not have to be so full. The Companies and Financial Reporting Legislation do not apply to trusts.

4. **ACC levies** are eliminated for the business' "owners" or principals.

Disadvantages

The disadvantages associated with a trading trust are similar to those associated with a discretionary family trust. First, there are the costs associated with establishing a trust and secondly there is the loss of legal control of the assets.

A small significant disadvantage with a business is the loss of limited liability that a company structure provides. Trustees may also be potentially liable for debts incurred by the trust unless it is specifically agreed with creditors that their liabilities are to be limited to the assets of the trust. This potential difficulty may be met by utilising a corporate trustee which will resolve this potential problem in most instances.

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ESTATE PLANNING AND FAMILY TRUSTS

Beware of Limitations

In recent times it has come to our attention that there are an increasing number of unqualified parties representing to the general public that they are competent to handle complex Estate Planning matters and in particular the preparation and administration of Family Trusts.

As a pioneering nation, New Zealanders have a proud history of “do it yourself” initiatives. However it is essential that clients take care to ensure that vital work undertaken with Estate Planning legal tasks is handled by competent and experienced professionals who do not have a vested interest in any specific outcome that may lead to investment arrangements for that financial advisor.

We urge clients to take care to ensure that the advice that they receive in this vital area of law is undertaken by specialist professionals who have the competence to deal with complex work for their clients.

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DUTIES OF TRUSTEES

1. The duty of efficient management

- Be familiar with the Trust Deed and other Trust documents.
- Ensure important trust documents are kept safely.
- Adhere to the terms of the Trust.
- Identify the beneficiaries and their circumstances and needs.
- Supervise management and administration of Trust.

2. The duty to invest prudently

- Act with care and due diligence in the management of the Trust's assets. The standard of care is that a person of ordinary prudence and vigilence would exercise in managing their own affairs.
- Keep administration costs to reasonable levels.
- Consider employing an independent professional adviser regarding investment strategies.
- Monitor investments.

3. The duty to keep accounts and render them to beneficiaries

- Good accounting records must be kept at all times. Employ an accountant to prepare financial statements.
- Employ an accountant to prepare and file a tax return, if the Trust derives income.
- Make available to beneficiaries, upon request or voluntarily, documents such as the Trust Deed, Financial Statements and Investment Strategies.
- Keep all Trust records for the term of the Trust and for a reasonable period following termination.
- Ensure that a clear audit and paper trail is kept of all decisions, transactions, minutes and financial statements and correspondence.
- To handle trust moneys, open a bank account in the name of the Trust.
- If the Trust will earn taxable income, obtain an IRD number.

- All Trust moneys should be paid into this account and all Trust expenses debited to this account.

- Do not use this account for personal expenditure.

4. The duty to act personally

- A Trustee must be personally involved in the decision-making process. Do not allow anyone to dictate to you how your decisions should be exercised.

- Most Trust Deeds require unanimous decisions by Trustees.

- A delegation of Trustees' powers is only permitted where the Trust Deed specifically authorises such delegation, or:

  - the Trust property is outside New Zealand;
  - the Trustee will be absent from New Zealand;
  - the Trustee is physically incapable of performing duties as a Trustee.

- Have regard to the wishes of the Settlor(s) who may have expressed those wishes.

- Properly appoint professional advisors such as lawyers, accountants and financial or other advisors.

5. Fiduciary duty

- You must not profit from your position as a Trustee. There is an exception where the Trustee is authorised to be paid for their services under the Trust deed, with consent of all the beneficiaries or by statute or Order of the Court.

- Without prior authorisation (ie in the Trust Deed) or the consent of all the beneficiaries, you must not sell property to, or purchase property from, the Trust.

- Avoid personal conflicts of interest if at all possible, ie avoid situations where your personal interests conflict with your duties to the Trust.

- Protect the interests of the beneficiaries.

- Always act in the best interests of both present and future beneficiaries and be impartial between beneficiaries.