

Information on Family Trusts

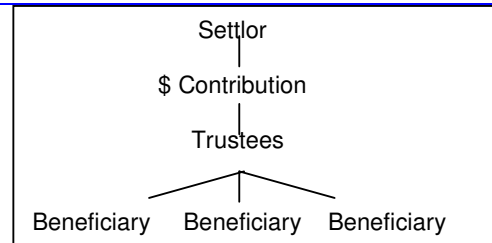
The use of Family Trusts has become more prevalent recently and many clients have asked for further information.

This booklet is designed to give general information only. It is not designed as a detailed document and each situation is different. Accordingly, the intent is to give you a general background on Trusts, but before making your final decision on whether or not to utilise a Trust, full consultation with your legal adviser and with a partner in our firm is essential.

WHAT IS A TRUST?

A Trust is a legal relationship where a person or persons (the Trustees), holds property for the benefit of another person or persons (the Beneficiaries).

The Trustees operate in accordance with a Trust Deed which is set up by the person establishing the Trust (the Settlor).



HOW DOES THE TRUST WORK?

The Trust purchases an asset or assets from the Settlor, or any other person, and the Trustees then manage that asset in the best interests of the Beneficiaries in accordance with the powers given to them under the Trust Deed.

THE TRUSTEES

As indicated, the Trustees are the people who hold ownership of the assets that are sold or gifted to the Trust. In doing so, they have the ability to deal with those assets, control them and/or sell them if they wish. They can decide (subject to the Deed) which beneficiaries will benefit from the Trust income and/or capital, and in what proportion as it is normal for the Trust Deed to provide the Trustees with full discretion. Usually there is no requirement for Trustees to bestow a benefit to any particular beneficiary and in any particular proportion, although of course this can be provided for in the Deed, if desired, and Trustees must act impartially in good faith and in the best interests of the beneficiaries.

CONTROL OVER TRUSTEES

Effectively the Trustees control the assets and neither the Settlor nor any other person has any control over a Trustee, other than any controls which may be written into the Trust Deed. It is essential therefore that in setting up a Trust and appointing Trustees to choose carefully. The choice of Trustees is critical. It is possible for the Settlor to retain, in the Trust Deed, the ability to appoint, or discharge, a Trustee and you can be a Trustee yourself. However, to ensure a clear delineation between the Trust and yourself as an individual, it is preferable to have an independent Trustee or Trustees to demonstrate an independence of decision making by the Trust.

A Trustee can be any person providing they are over the age of 20 years and they may be individuals or even a Company. There are no limits to the number of Trustees, however the more Trustees you have the more practical difficulties arise, such as attaining signatures for documents, etc.

You should realise that your Trustees, once appointed, will become the registered owners of any assets transferred to the Trust. Their names will appear on Certificates of Title, etc, and of course the Trustees take on personal liability, particularly for any liabilities of the Trust. This difficulty can be eliminated by inserting a clause in the Trust mortgage document, and/or Deed, stating that the Trustees liability is limited to the assets of the Trust. This is a normal clause in a Trust Deed.

The Trustees have obligations to manage the Trust and its property, maintain records, document meetings showing reasons for their decisions, and invest with diligence and prudence. The prudent person test means that they should invest, as any person would prudently invest another's assets. If the Trustee is a professional, he or she has a greater duty of care. The position of Trustee is an onerous one, which carries obligations and liabilities, and will require your Trustees to invest, in some cases, significant time in managing the Trust.

Accordingly, it is normal to provide an ability to make a payment to the Trustees for services provided to the Trust and you may find that some individuals will not take appointment as Trustees because of the liability and obligations involved.

BENEFICIARIES

The Beneficiaries are those who eventually benefit from the Trust. They can be any person or thing capable of owning and dealing with property. They can be individuals, Company's, Trust's, Charities, Club's etc. Usually the beneficiaries will be members of your family or people that you want to benefit from the assets you have placed in the Trust. The Trust income can be separately dealt with from the Trust Capital, or more normally the Trustees are given complete discretion. Beneficiaries have very few rights and in a discretionary Family Trust, the Trustees normally have absolute discretion. A beneficiary who feels they have missed out normally has no claim against the Trust or the Trustees, unless the Trustees have failed in some way to carry out their duty of care to the Trust and the beneficiaries.

However, there is Case Law which provides that beneficiaries on attaining the age of 20, should be advised by the Trustees of their interest, whether it is vested, contingent, or discretionary. This can create difficulties for the Trustees, particularly in a Family Situation, but the current weight of opinion is the Trustees do have a duty to advise beneficiaries of their status once they attain the age of 20 years.

ADVANTAGES AND DISADVANTAGES OF A FAMILY TRUST

Advantages

- **Continuity**

Because Trust's normally operate for 80 years, they can operate following the death of the Settlor without the need for any winding up or an estate sale or distribution of assets.

- **Protection**

Nobody can protect family assets indefinitely. However, placing family assets in a Trust, and once the value of those assets has been gifted off to the Trust, there is no claim under an Estate to those assets. This can be useful in protecting those assets in the event that family members experience unfortunate marriage break-ups, or any other family issues.

There is also protection, particularly for professional people such as Doctors etc, or anyone in business where there is the likelihood of failure, as the assets, once owned completely by the Trust, cannot be claimed on by any party taking legal action against the Settlor or person selling the asset to the Trust for things such as malpractice, negligence or business failure. This can be important in today's environment.

- **Protection against Death Duty and Capital Gains Tax**

While Death Duty and Capital Gains Tax do not exist at the present time, there is no reason to believe that they could not be introduced. Therefore assets transferred and completely owned by a Trust would be outside the realm of Death Duty and probably Capital Gains Tax, depending on its structure.

Accordingly, assets that are likely to appreciate in value are some of the first that should be considered for transference to a Trust.

- **Family Protection Act**

Assets in a Trust are safe from Family Protection claims against a will by disgruntled family members.

- **Rest Home Subsidies**

At the current time only income distributed from a Trust to a Beneficiary would be taken into account when the Department of Work & Income consider a Rest Home Subsidy.

- **Taxation**

There can be benefits in being able to spread income among beneficiaries to take advantage of lower tax rates. This should not be the primary purpose of forming a Trust, but rather an ancillary benefit.

Disadvantages

- **Reliance on Trustees**

When you establish a Trust and sell assets to it, in nearly every aspect you are alienated from those assets. You no longer own them, the assets are no longer in your name. This means that you are reliant on your Trustees. Even if you are one of the Trustees, you will, nevertheless, require the compliance and goodwill of other Trustees to achieve personal aims. This can be a disadvantage.

- **Cost**

There is a cost in administering and maintaining a Trust.

- **Taxation**

At the time of selling a particular asset to a Trust, there could be taxation disadvantages. This would need to be considered carefully. Such matters as depreciation recovered can create a substantial tax liability at the time the asset is sold to the Trust.

- **Trustee Liability**

As indicated earlier, Trustees do take on personal liability. Some of this liability can be alleviated via the Trust Deed and of course by the processes and procedures that Trustees use to make their decisions. However, the personal liability of a Trustee should not be minimised.

SUMMARY

The formation of a Family Trust is particular and specific to each individual. A Trust is a flexible vehicle for ownership, but as with all situations there are advantages and disadvantages. The decision to form a Trust is an important and far reaching one and more particularly the contents of the Trust Deed, the appointment of Trustees and the decision of which assets to place in the Trust are important. Also, any gifting programme to the Trust must be carefully considered.

The objectives desired when forming the Trust must be clearly defined and professional advice from your Accountant and your Lawyer are important. Trusts can provide asset protection, asset control and asset preservation. A carefully constructed approach to this decision can provide you with a useful vehicle to meet your long term aims and objectives.

We are happy to provide a free, no obligation independent assessment of your personal and business taxation obligations.

For further details contact any of the partners or www.mcp.co.nz.

OUR PARTNERS

Invercargill Office

Murray Rankin

Email: murray.rankin@mcp.co.nz

Stephen Brown

Email: stephen.brown@mcp.co.nz

Ross Jackson

Email: ross.jackson@mcp.co.nz

Greg Munro

Email: greg.munro@mcp.co.nz

Mark Bain

Email: mark.bain@mcp.co.nz

Queenstown Office

Grant McCulloch

Email: grant.mcculloch@mcp.co.nz

Donald Bennett

Email: donald.bennett@mcp.co.nz

Donald Jackson

Email: donald.jackson@mcp.co.nz



Success Builds Success

Cnr Kelvin & Spey Streets, PO Box 844, Invercargill
Phone 03 218 6179 Fax 03 218 2238

34 Camp Street, P O Box 64, Queenstown
Phone 03 442 7020 Fax 03 442 7032


McCULLOCH
AND PARTNERS
CHARTERED ACCOUNTANTS & BUSINESS ADVISERS
www.mcp.co.nz