TRUSTS GUIDE

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INTRODUCTION

The information contained in this summary is intended to outline in general terms the nature of a Trust, some of the potential benefits of a Trust, the various steps which are involved in setting up a Trust, transferring an asset to that Trust, and the role which Currie Lawyers as solicitors will play in assisting you to set up a Trust.

Please note that your own circumstances may involve aspects which are not expressly mentioned in this guide. Similarly, there may be information contained in the guide, which is not relevant to your own situation. This is a general guide only.

WHAT IS A TRUST?

A Trust is an arrangement whereby a person known as the 'Settlor' transfers ownership of property to another person or persons, the 'Trustees' for them to hold on behalf of third persons, the 'Beneficiaries'. The assets are placed under the control of the Trustees for the benefit of the beneficiaries or for a specified purpose.

A Trust is a separate legal entity. The Settlor no longer has a legal interest in the assets transferred. This is important from a banking perspective because the basis of lending (usually the beneficiary's income) and the ownership of assets may be separated. It has been said, "the reason a Trust is used is simple. There is no other way of safely protecting your assets".

Some of the commonly used terms are: -

Settlor

The Settlor is the person or persons who set up the Trust, so typically, is the person who owns the property or assets, which will be transferred to the Trust. The Settlor appoints the trustees, gives those trustees certain powers and decides who will be the beneficiaries, all recorded in the trust deed.

From an income tax perspective, any person who settles property or assets on a trust is deemed to be a Settlor. However legally, the person named as Settlor in the Trust Deed is the Settlor for the purposes of this guide.

Trustees

The Trustees are the people to whom the Settlor's property or assets are transferred. They have legal ownership of such property or assets, but they can only deal with them in accordance with the powers given to them by the Settlor and they must always act in the best interests of the beneficiaries.

You can have a number of Trustees and this can be decided in consultation with us depending on the particular circumstances. From a practical point of view it may be inconvenient geographically

and foreign resident trustees may create tax residency issues, in regard to who is appointed as trustees. The Settlor can be and often is a Trustee also, particularly as most people want to retain a degree of control over the administration of the Trust themselves. We also recommend the appointment of an independent Trustee.

Beneficiaries

The beneficiaries are the people who can receive a benefit from the Trust property. To enable maximum flexibility most Trusts provide for "discretionary beneficiaries" who can only benefit from the Trust at the Trustees' discretion.

WHY FORM A TRUST?

There are a number of reasons why people choose to set up Trusts, whether it is for risk management and asset protection reasons or for family or other reasons. It is important that individual circumstances are considered carefully because everyone's circumstances are different.

Some of the reasons include.

Preservation of family assets

- Invariably the primary reason behind every Trust is the genuine desire to preserve hard earned family assets for children and grandchildren

Family Protection

- To protect assets from claims by undeserving children in certain circumstances
- To provide for the needs of dependants without giving them the right to demand money or capital
- To provide flexibility to cater for the needs of beneficiaries at various times in their lives (i.e. children and grandchildren) – a trust can last for up to 80 years
- In your will you have certain legal obligations to next of kin and omission from a will can give rise to claims against estates under The Family Protection Act. However, if on your death, certain assets are owned by a Trust, then they do not form part of your estate and are less likely to be subject to such claims

Relationship Property matters

- Having property in a Trust presents a more "comfortable" option to some people than the alternative, a 'pre nuptial' or Section 21 agreement
- To cater for children of a particular relationship separately. A Trust can enable you to cater for those children whilst still

recognising obligations to children from other or subsequent relationships

- To ensure that the husband, wife or de facto partner of one of your children is not able to gain any interest in family assets upon the failure of a relationship

Taxes

- To protect family assets from new laws which may introduce such taxes as capital gains tax, wealth tax, reintroduction of estate duty, succession tax and inheritance tax
- To enable flexibility in income distribution thereby enabling effective income splitting among beneficiaries at the lower marginal tax rates (however there are new tax laws which tax 'minors' – children under the age of 18 years – at higher marginal rates)

Creditor protection

- To protect assets from being at risk to possible creditors and from unsecured business debts

Risk Management

- Used in conjunction with companies, trusts may be used to ring fence assets such as intellectual property (patents, trade marks, registered designs, and trade secrets) by having the ownership of such assets separate from their trading activities associated with them.

Protection from user pays charges

- To increase the likelihood of qualifying for certain income or asset tested benefits such as rest home subsidies, child support, student benefits etc, by removing ownership of assets and or income producing assets from yourself and putting them in the Trust

Confidentiality

- Trusts, unlike companies, are not a matter of public record and do not need to be registered thereby enabling the extent of the trust assets to be kept confidential

Flexibility

- Trusts are flexible and can therefore cater for unforeseen and differing needs of beneficiaries at various times
- Trusts can also be used in conjunction with other entities such as companies to limit liability and channel income to beneficiaries at their respective marginal tax rates

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HOW A TRUST WORKS

Any assets, which are transferred to a Trust, must be sold at market value; otherwise the Inland Revenue Department can assess you for gift duty on the difference between the value you allocated at the time of sale and the actual market value.

Gift duty is payable in New Zealand for gifts in excess of $27,000 in any 12-month period. The rate of duty is payable on a sliding scale commencing at 5% and increasing to 25% if the gifting goes beyond $75,000. For example, a gift of $100,000 would attract gift duty of $12,850.

As an example, a couple own a home worth $300,000, and it is sold to a Trust. The Trust does not actually have $300,000. It must borrow the money from the couple (usually the Settlors). The debt is secured by way of an acknowledgment of debt from the Trustees, to each of them for an amount of $150,000. In effect the couple exchange their ownership of the home, for a debt of $150,000 owed to each of them by the Trustees. The result is that the house is then owned by the Trust.

In most situations, the couple would want the debt to be reduced and eventually forgiven altogether. This is usually achieved by the couple each gifting the amount of $27,000 in each consecutive 12 month period, commencing with the first gift on the initial transfer and sale of the home to the trust. In the example above, each couple's debt will reduce:

Year 0 – the debt is reduced to $123,000 ($150,000 - $27,000)

Year 1 – the debt is reduced to $96,000

Year 2 – the debt is reduced to $69,000

Year 3 – the debt is reduced to $42,000

Year 4 – the debt is reduced to $15,000

Year 5 – the debt is nil

From the above example, you can see that forward planning is essential. The transfer of assets without the payment of gift duty can be a time consuming procedure.

Trustees' Duties and Obligations

It is important that the Trustees understand what is expected of them, and what are their duties and obligations. Trustees must have a thorough understanding of their duties, which include;

- Managing the Trust
- Making information available to beneficiaries
- Acting personally (and not delegating)

- Investing prudently and properly
- Acting in the best interests of the beneficiaries
- Being aware and prudent in relation to tax requirements

Currie Lawyers have a system in place to monitor Trust activities and to ensure that the Trust is more effectively and properly managed. A minute book of all Trustees resolutions is kept. Critical dates are monitored and new law changes which affect Trusts advised to clients.

FREQUENTLY ASKED QUESTIONS

Do I lose control?

Generally we would recommend that the person setting up the Trust is also a Trustee and, depending on the circumstances, also a discretionary beneficiary. That person would retain the power to “hire and fire” the Trustees. In addition, the Currie Lawyers trust deed contains provisions where possible to vary the terms of the Trust and vary the beneficiaries. Accordingly, control is retained as much as possible.

What happens if the law changes?

Although there can be no guarantees, the Currie Lawyers trust deed contains the power to “resettle” the Trust assets on another Trust, should the need arise. The new Trust would be prepared with any new laws in mind. It must be noted that we work within current laws and cannot advise on what laws may or may not be enacted in the future and the impact of any future law on a current Trust situation.

Can a Trust protect my assets from existing creditors?

No! A Trust may be set aside if it purpose is to avoid or defeat existing creditors and also if its purpose is to evade income tax.

What property or assets can a Trust own?

Basically, a Trust can own any assets – real estate, shares, stock, plant, racehorses, insurance policies, boats, caravans, investment portfolios and the list goes on. It is however important to consider which assets should be transferred into the Trust. Generally, we would not recommend that a depreciating asset be transferred to a Trust as tax losses can not be transferred to beneficiaries. Special consideration should be given to “negatively geared” assets such as rental properties as there are income tax issues to consider.

Can the Trust property be transferred back to me?

If you are a discretionary beneficiary, and generally you would be, any Trust property can be distributed directly to you pursuant to the terms of the trust deed. Such a distribution is made without the necessity of having to go through the gifting process.

What, if any, are the disadvantages?

There is an initial lump sum cost of setting up a Trust and transferring assets, such as the family home, into the Trust. After that there is a charge for the ongoing annual gifting program until the debt is forgiven and gifting completed. In any Trust transaction such as the sale of Trust property, all Trustees' signatures are required. It is possible that future law changes may affect Trusts, but such changes are unlikely to be retrospective and would be unlikely also to make you worse off than if you had never established a Trust.

What does it cost?

The typical cost for formation of the Trust, transfer of the family home to the Trust, Acknowledgment of Debt, Deed of Forgiveness of Debt, filing Gift Statements with the IRD and all other associated documentation required in year one is usually in the region of $2,500 to $3,000, plus GST and disbursements. It is however difficult to give an indicative cost as every situation is different and needs to be looked at on its own merits. In subsequent years there are ongoing costs for forgiveness of debt and filing of gift statements with the IRD of approximately $200 to $250 plus GST per annum. There may also be some additional costs for annual Trust maintenance.

GENERAL

The above summary is intended to provide you with a basic understanding of the legal aspects of trusts. It is a general guide only.

Every situation is different and we welcome the opportunity to discuss with you fully whether in your circumstances, a Trust is a preferable course to follow.

Effective asset protection planning must be done long before an emergency arises. The preparation and establishment of trusts is only one aspect of asset protection. Consideration of wills and preparation of enduring powers of attorney may only be required. We can assist you with that planning to ensure that you receive the best objective advice available and to take the appropriate steps.

Recommended Reading:

"Trusts – using Trusts to protect your assets" by Ross Holmes (2nd edition)

"Family Trust-A New Zealand Guide" by Martin Hawes

"Protect your Assets – Using a Trust to save your assets for you" by Ross Holmes (1st edition)

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