What is a Family Trust?

A legal introduction to
Trusts and Asset Management.

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This information booklet provides an overview of what a trust is, and how it can help you meet your needs. For information on different types of trusts, please contact your solicitor who will be able to provide you with additional information.

What is a trust?

A trust is a fiduciary relationship established between the person who creates the trust (the settlor) and the person the settlor has chosen to hold the trust assets (the trustees). The trustees hold the trust assets in their own names on trust for the benefit of the persons who may enforce that obligation (the beneficiaries).

Trusts are used to protect assets for individuals and their families, preserving them for the future. Family trusts are one of the most common types of trusts and are perfectly set up to benefit a group of family members, often across several generations.

In New Zealand, the most typical form of family trust is a discretionary family trust. A discretionary trust is one where the trustees may exercise their right to distribute assets to the beneficiaries in accordance with their discretion and the provisions contained within the trust deed.

Unlike a company, a trust is not a separate legal person. It is the trustees who hold the legal title to the trust assets however they do not hold the beneficial interest in those assets. Trust assets become the property of the beneficiaries (both legally as well as beneficially) when the trustees exercise their rights and powers to transfer the legal ownership of those held on trust to the beneficiaries personally.

Who are the parties associated with a trust?

Settlor

The settlor is the person who originally establishes the trust. Usually that person will determine the provisions of the trust deed and choose the trustees. The settlor will normally also at the time of creation of the trust transfer a nominal amount of property or cash to the trust to be held by the trustees for the certain purposes specified in the trust deed.

Trustees

The trustees are the persons who hold title to the trust assets and deal with them in accordance with the provisions of the trust deed. The trustees can be natural persons or an organisation such as a trustee company. The trustees must hold and administer the trust property as directed under the terms of the trust deed. The power to distribute income and capital of the trust to the beneficiaries must be made in accordance with the powers and discretions conferred upon the trustees under the trust deed and the law.

Appointors

An appointor is a person who has the power to appoint and remove trustees, and in some cases to add and remove beneficiaries and to attend to certain other matters. In most cases, the settlor is also the appointor, but this is not necessarily always the case.

Beneficiaries

The beneficiaries are the people for whose benefit the trust is established. Beneficiaries can be defined by a class for example discretionary beneficiaries, income beneficiaries and capital beneficiaries amongst other things. Beneficiaries can be natural persons as well as charities and other trusts.

Trust Deed

The trust deed is in essence the trustees’ rule book. The trust deed specifies who the trustees are holding the trust assets on behalf of and defines the trustees’ duties, powers and obligations. The trustees must act in accordance with the trust deed and the law.

What are the advantages of a family trust?

Every person considering setting up a trust has a different set of reasons and a different purpose in mind. You should talk specifically with your advisor as to your reasons as to why you wish to create a trust. Outlined below are some of the general reasons people establish trusts:

Creditor protection

Assets in a trust (assuming they have been properly gifted) are usually protected from any creditors of the beneficiaries. This is because until the trust property is actually vested in the beneficiaries personally, beneficiaries do not own the trust assets in their own right.

Protection against relationship property claims

When a person has been in a relationship for 3 or more years, their personal property and assets become vulnerable to a claim under the Property (Relationships) Act 1976 should the relationship come to an end and the parties have not contracted out of the provisions of the Act.

Transferring your assets to a trust before a relationship commences affords much greater protection from potential Relationship Property claims because the assets no longer belong to you, but rather are being held on trust.

Protecting property from spendthrift beneficiaries

If you have any concerns about the ability of your children to manage their financial affairs, then a trust provides a useful mechanism to ensure the trust can provide your children with income and/or capital to meet their legitimate cash requirements as they arise. By ensuring the trust assets remain in the trust and distributions are only made as needs arise, the core value of the assets are preserved and protected for the long term value of your family.

Tax advantages

There are various tax advantages that may arise as a result of transferring certain assets to a trust. As the number of advantages are wide and relatively particular we suggest you discuss these with your advisor.

Are there any disadvantages of a family trust?

The most important thing to remember when establishing a family trust is that if you transfer your personal assets to a trust, then those assets are no longer owned by you. Although you may retain a degree of control either as an appointor or a trustee, the trust assets no longer belong to you and must be administered in accordance with the provisions of the trust deed. If you continue to treat the trust assets as your own, then the trust could be open to challenge and the benefits of a trust structure eroded.

There is also a cost associated with the formation and ongoing annual administration of the trust. These will depend on the complexity of your trust and the nature of the assets to be transferred.

Before determining whether you need a trust it is important to discuss every aspect of why a trust could be useful to you, what objective you wish to achieve and whether there are any other alternatives to a formation of a family trust to obtain the same benefit.

The key to the success of a trust is also in fully understanding how a trust operates and the restrictions and limitations imposed upon you once the assets are transferred into the trust.

Establishing a trust important decisions

There are number of particularly important decisions you need to make in establishing a family trust. The five major decisions you need to make in establishing a family trust are:

- What is the purpose or objective of the trust?
- Who will be the trustees?
- Who will be the beneficiaries?
- How will you structure the trust deed?
- What assets do you intend to transfer to the trust?

What is the purpose or objective of the trust?

The purpose or objective of your trust will depend on your own particular set of circumstances. These could include wanting to keep your private assets (e.g. your home) separate and quarantined from any business ventures you intend to enter into or preserving a family asset (e.g. a bach) for future generations.

You should discuss fully with your advisor what your desired purpose is and they can advise if a trust is the most appropriate way to achieve your objective or purpose.

Who will be the trustees?

The starting point in choosing a trustee is picking a person that you trust. It is usually preferable to have more than one trustee and for those people to comprise of a mixture of persons who know your family well (e.g family member or friend) and a person or persons who are familiar with the legal aspects of a trust (e.g a professional advisor such as a lawyer/accountant). It is possible for a trustee to also be a beneficiary of your trust although there are some restrictions on the ability of trustees who are also beneficiaries to exercise certain powers. In such a case it may also be appropriate to appoint an independent trustee (that is, being a person who is not a beneficiary).

Who will be the beneficiaries?

The beneficiaries are the persons you wish to benefit from the trust assets. Generally these will be family members but may also be a charity or another trust. Discretionary beneficiaries do not have an automatic right to receive benefits from the trust, they only have a right to be considered by the trustees when the trustees decide to make benefits available. This means that the group of persons you choose should be wide enough to include people who you actually want to benefit from the trust but not so wide that the trustees have to consider the needs of a large disparate group.

Generally the trust deed will contain a power for you to add further beneficiaries to the trust once it has been established so that the trust can be changed to meet the future needs of your family.

How to structure the trust deed?

The trust deed sets out the rules for how the trust will be administered. The trust deed needs to be as flexible as possible while at the time reflecting your intentions in setting up the trust. It is very difficult to change the trust deed once it has been executed therefore it is very important to ensure that the trust deed is prepared correctly from the outset. Your advisor will be able to help you correctly structure your trust deed in accordance with your wishes and to achieve the objectives you have in the formation of your trust.

What assets to transfer?

In considering what assets to transfer to the trust you should look at assets you wish to protect and assets which are likely to increase in value. Most often people will transfer their family home to a trust or investment properties to a trust. In other cases where a person operates a business they may wish to transfer their personal assets into one trust and have a separate trust for their business assets.

Assets are transferred to the trust either by way of gift or by way of a sale and purchase. The method of transferring assets to the trust will depend on your circumstances at the time. When the assets are sold to the trust they are usually sold at their current market value. As most trusts do not have cash to pay the purchase price, this sale creates a debt due to the settlor which is forgiven, either immediately or over time by way of a gifting programme. It is important that you get advice on what sort of gift arrangement you should enter into as there are a number of issues to work through before making a decision to make a lump sum gift (see “Gifting” on the following page).

Any debt which is not forgiven is a personal asset and is thus available to personal creditors, as well as being vulnerable to other claims such as relationship property claims and claims under the Family Protection Act. The only assets protected by the trust are therefore:

- The amount of any gifts made to the trust.
- The increase in value, if any, of assets transferred to the trust over their original market value at the time of transfer.
- The amount of income earned by the trust from trust assets which had not been distributed to the beneficiaries.

Gifting

Prior to 1 October 2011, if a person made a gift which exceeded $27,000 in a 12 month period they would be liable to pay gift duty. To ensure gift duty was not payable most people entered into gifting programmes to gift off the value of the debt owed to them by their trust over a long period of time.

Gift duty was repealed on the 1st of October 2011. It is therefore now possible to make gifts of any amount of money without incurring gift duty. There are however a number of other matters that need to be taken into consideration before you make a significant gift. Some of these are listed as follows:

- Have you entered into a personal guarantee and by making a gift of a significant asset will you be in breach of that guarantee?
- Are you in a relationship of more than 3 years duration? If so, would the gift potentially defeat a claim by your spouse for property that would otherwise be considered to be relationship property?
- Are you solvent at the time of making the gift? If you are insolvent or aware of any real and potential claims against your assets then your gift maybe be overturned on the basis it is considered to have been made for the purpose of defeating creditor claims.
- Is it possible you may one day need access to a residential care subsidy? If so, you may need to consider entering into a limited gifting programme.
- Will the gift void certain gifts left under your Will?

For more information about gifting, please talk to MDS Law.

Administration

Once a trust has been established it is very important that it is administered properly. When you establish your trust your advisor will discuss with you the requirements for the ongoing administration of your trust. They will also be able to assist you with the ongoing administration requirements.

In general, trustees of a family trust should:

- Meet on a regular basis, at least annually, to review the trust's investments and the needs of the beneficiaries.
- Be involved in all trust decisions and record the decisions in writing.
- Ensure that they comply with the legal obligations imposed on trustees.
- Ensure that the trust meets its income tax obligations such as filing a tax return if the trust receives income.
- Trustees have an obligation to invest prudently. This obligation is imposed upon them in accordance with the Trustee Act 1956. These obligations may be excluded or reduced to a degree by the provisions of the trust deed however a trustee is still expected to exercise a reasonable level of responsibility and prudence in carrying out their duties.

How can I access trust capital?

The distribution of trust capital is usually at the discretion of the trustees. Capital can usually be paid to any one or more of the discretionary beneficiaries in accordance with the provisions of the trust deed. If you are a beneficiary of a trust entitled to receive capital distribution then you may receive capital distributions if the trustees exercise their discretion to do so. Alternatively if you are owed money by the trust you may be able to access the trust capital by demanding repayment of all or part of the outstanding loan.

When the trust is eventually wound up any remaining capital will be distributed amongst the beneficiaries and according with the provisions of the trust deed.

How can I access trust income?

The distribution of trust income is at the discretion of the trustees exercising their discretion in accordance with the powers contained within the trust deed. A trust deed will generally contain a provision which allows the trustees to make distributions of income to the beneficiary as and when the trustees determine such distributions can be made. If income is not distributed it can be accumulated in a trust and distributed at a later point in time.

How do trustees make decisions?

Trustees make decisions by having a meeting and determining their decisions by agreement. The trust deed will generally specify where the trustees decisions have to be made unanimously or by majority. In most cases the requirement is for trustees' decisions to be made unanimously. Decisions are generally recorded by way of a trustee resolution and those resolutions are kept within a trustee minute book. Much like a company, trustees should hold meetings and keep a record of any decisions they make.

Where to from here?

If you are interested in setting up a trust you should contact your advisor to have an initial discussion with them about your objectives for setting up a trust, whether a trust is the most appropriate way to meet those objectives and to answer any further questions you may have about the process.

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