Guide: Family trusts

Family trusts have become a popular way of owning assets and conducting business operations in New Zealand. There are a number of persons who have an interest in a trust.

Settlor

This is the person who establishes the trust and signs the trust document. They may transfer property other than the initial settlement to the trustee(s) to be held on trust.

The initial settlement amount is usually relatively small (usually less than $100) with more substantial assets being transferred by way of sale or gift after the trust has been settled.

It is important that the initial settlement is actually paid to the trustee(s).

Trustees

The trustees are responsible for all aspects of the day-to-day management, investment of monies etc., relating to the trust. Subject to the terms of the deed of trust the trustee can be a natural person or a company. The number of trustees will usually be determined by the deed of trust. The trustees have extremely wide legal and trust responsibilities for the administration of the trust.

The trustee(s) hold assets for the benefit of the beneficiaries of the trust. The trustee(s) of a discretionary trust generally have the power to make distributions of profits and capital to any beneficiary or beneficiaries.

Trustees owe significant obligations to the beneficiaries of the trust. A trustee should be fully aware of its, his or her obligations before accepting any appointment as a trustee. Trustees must be aware of their obligations and the provisions of the Trustee Act 1956, or with effect from 30 January 2021, the Trusts Act 2019.

Trust deed

The trust deed is prepared by a solicitor or administered by an accountant or other person using a suitable precedent. It sets out:

- The purposes of the trust (i.e. who can benefit)
- What the trustee can do
- Investment powers
- Borrowing powers
- Period of the trust (cannot currently exceed 80 years. However, with effect from 30 January 2021 the maximum duration will increase to 125 years)
- Names of settlor, beneficiaries, trustee and appointor(s)

Beneficiaries

Beneficiaries are those people for whom the trust was created. The beneficiaries of a trust can be divided into a number of groups:

- Primary beneficiaries — normally (but not necessarily) the settlors and present and future children
- Secondary beneficiaries — normally future grandchildren and great grandchildren
- Tertiary beneficiaries — other trusts, religious organisations, charities and so on
- Final beneficiaries are the beneficiaries who benefit at the end of the Trust

Business activities

The trust, through the trustees, can conduct virtually any type of business activity that is approved by the trust deed in basically the same way as any other business activity operates.

Appointor(s)

The persons who have the powers of appointment are stated in the trust deed. Subject to the terms of the deed of trust the appointor(s) may have the right to add and remove trustees and beneficiaries, and to approve permitted changes provided for in the trust deed. The extent of these powers can be customised to suit individual circumstances.

Distribution of Profits and Capital Gains

The trustees of a discretionary trust decide how to distribute profits and capital. The trustee is not (subject to the terms of the trust) bound by any fixed or predetermined percentage of distribution.

Taxation

The trustee of a family trust pays income tax on taxable income that is not distributed to any beneficiaries. The trustee rate of tax is currently 33%.

Income distributed to beneficiaries (other than minor children) is taxed at the beneficiary's marginal rate.

Family trusts are a very effective structure for those people entering into a business who do not have existing creditor exposure, but wish to protect assets against future risks.

Trusts are not useful to everyone. Salary and wage earners, or people who derive their income principally from personal exertion are unable to obtain significant taxation benefits from a family trust.

However, in addition to taxation benefits, if any reasons for settling a trust include protecting assets from future creditors; protecting assets from future relationship breakups; preserving assets for a single limb of a blended family; and inter-generational asset protection.

In the majority of cases any distribution from a trust to a child under the age of 16 at the trust's balance date will be taxed at the trustee's tax rate.

Any net loss derived by a trustee cannot be distributed to beneficiaries of a trust in order to be offset against other income derived by them. The losses are carried forward to be offset against future earnings of the trustee.

Advantages

The advantages of a trust include:

- Assets can be protected from a variety of people and organisations, such as:
    - Creditors
    - Family
    - Asset and income tested benefits and assistance
- Income can be distributed or paid out for the benefit of family members
- Care must be taken to administer balances owing to beneficiaries carefully. Any distributions that are unpaid can be demanded as well as being included in the property of the beneficiary for relationship property and other purposes
- The trust is ongoing. It has a life of up to 80 years (and with effect from 30 January 2021, potentially up to 125 years), unless it is wound up and distributed earlier

Disadvantages

Disadvantages include:

- Naturally, there are additional legal and accounting costs to set up a family trust
- There are further ongoing compliance costs to administer a family trust properly. Tax returns and full financial statements must be prepared on an annual basis if the trustees own income producing assets. In addition, the trustee must maintain resolutions approving financial statements, beneficiaries' distributions, and all major transactions. These may also be minuted. The skills of a good accountant must usually be employed. There may also be reporting obligations if FATCA or the CRS applies
- A good knowledge of trustees' responsibilities is required. It is not wise for anyone to agree to act as a trustee until they are fully aware of their duties and responsibilities
- Disgruntled beneficiaries have the power to sue trustees where trustees have acted in breach of trust. Whilst this is rare, it is happening more frequently and it reinforces the need to be fully aware of duties and responsibilities

Trust Losses

Net losses incurred by the trustee in one year are generally available to carry forward against net income in subsequent income years. Losses cannot be passed on to beneficiaries.

Where the trust is a shareholder in a look through company (LTC), any losses from that LTC can be used against the trustee's net income.

Asset Protection

Property and investment assets can be segregated from any business venture of significant risk into separate trusts. Assets can be protected:

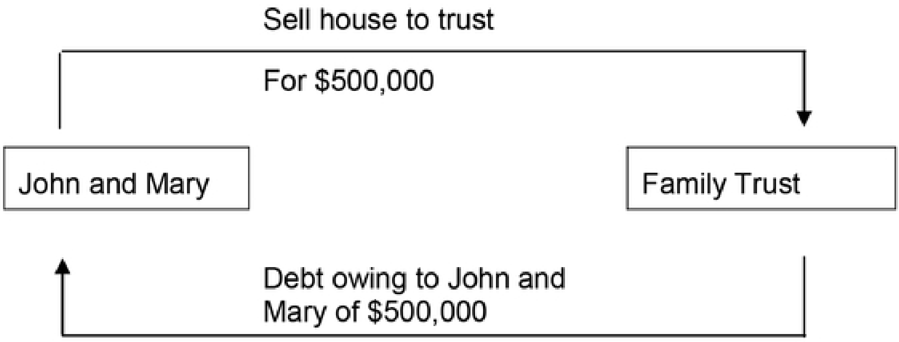
- From potential creditors
- In the event of a relationship property dispute
- For children's education
- So that government income/asset tested benefits are still available

The basic idea is for you to gift your assets to the trust. This can be done in a lump sum or progressively. Say for example you sell an asset (your family home) to the trust. Prior to the abolition of gift duty the usual arrangement was for an interest free loan to be made by you to the trust. The loan to the trust was then 'forgiven' by way of gift at the rate of $27,000 per annum per person without incurring any gift duty. A husband and wife or de facto or civil union partners can jointly reduce the loan at a rate of $54,000 per year.

This is shown in the example below. The loan back to John and Mary is $500,000. Gifting at the rate of $54,000 per year means it will take around nine years to forgive the entire loan and thus transfer the full value of John and Mary's house to the trust.

One big benefit here is that when John and Mary's house is sold to the trust for $500,000 any increase in value belongs to the trust, not to John and Mary.

Provided the trust is a fully compliant discretionary trust, the house should be protected. The debt owing to John and Mary of course will not be protected until forgiven (gifted). The couple could suffer a business disaster but the trust assets can be legally separate, if the basic legal principles have been followed correctly.



Now that gift duty has been abolished, it is possible for assets to be gifted directly to a Trust without a gifting program. Whether assets should be gifted immediately or progressively will depend on the donors' circumstances. However, advice should be taken before any significant gifts are made to ensure there are no adverse consequences from the gift.

Matters to take into consideration before a significant gift include:

- Whether the gift will mean that any entitlement to a residential care subsidy (or other means tested benefit or allowance) might be compromised, either now or in the future
- Loss of control over the asset
- Whether the gift might have the effect of defeating a creditor's issues
- The donor's solvency
- Whether the gift could comprise relationship property

Distribution of profits

Once the trustee has made a distribution to a beneficiary, then that money legally belongs to the beneficiary. The trustee may be empowered by the trust deed to utilise beneficiaries' current accounts for the benefit of the trust — with or without interest. However, any balance attributed to a beneficiary, together with any gains, remains that beneficiary's property.

Capital profit distribution

The trustee may have the discretion to distribute capital to various beneficiaries.

Claim on balance in current account

A beneficiary who is 'sui juris' (20 years old), can claim the balance in his/her name in the beneficiary's account. He or she is also entitled to request a copy of the financial report each year together with other trust documents.

Trustees' Responsibilities

A trustee's role is not necessarily onerous but does carry particular legal significance and specific responsibilities.

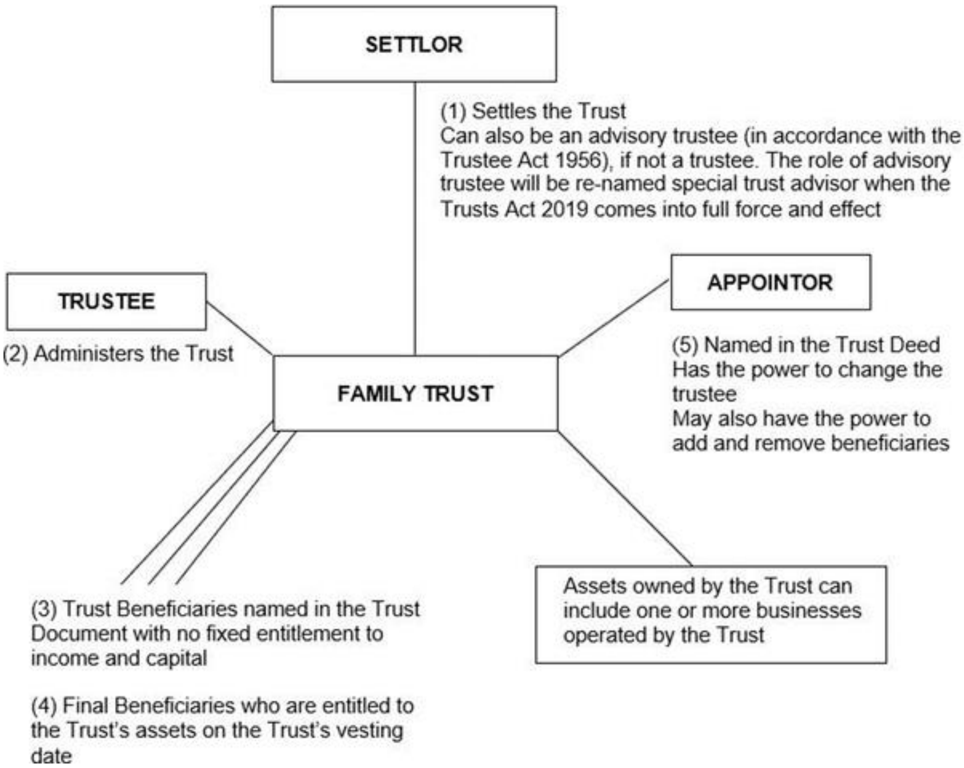
A beneficiary can sue a trustee for a wrong-doing whilst acting as trustee that constitutes a breach of trust.

Trustees may wish to notify beneficiaries of their status when each beneficiary attains the age of 20 years. In the absence of any provision in the deed of trust, there is no obligation at present to do so. However, with effect from 30 January 2021 the Trusts Act 2019 introduces a presumption that trustees will give basic trust information to all beneficiaries. Trustee's decisions, whether made formally or not, are called Trustee Resolutions. Good practice requires that each trustee resolution is recorded. Where a contemporaneous record of a decision is not made, the trustees should ensure that the minutes of the next trustee meeting record the resolution that was made.

Trustees' meetings should be minuted and the trust documentation should be carefully maintained. Some examples can be found in the section on trust minutes.

If you would like to discuss what a trust would entail or what your responsibilities might be as a trustee, please contact us. And, of course, your solicitor can also advise you in this matter.

Discretionary Family Trust Diagram



Example: Minute recording the First Meeting of Trustees

Minutes of the First Meeting of Trustees

Of the [Client Name] Trust

....

Held at — [Location]

Present — [Name/s]

Trust Records

Resolved 'That the Trust records be held at the offices of [Name, Address].'

Accountants

Resolved 'That [Firm Name] is appointed accountants of the Trust. [Firm Name] are also to be instructed to obtain an IRD number for the Trust.'

Solicitors

Resolved 'That [Solicitor Name] be appointed solicitors for the Trust.'

Bankers

Resolved ‘That a banking account be opened with [Bank] by lodging the settlement sum $[Amount] and that such account be operated in accordance with the bank authority, a copy of which is attached to these minutes.’

Acknowledgement of Liabilities as Trustees

The trustees acknowledge their personal liabilities as trustees and that they have certain obligations under the Trustee Act 1956.

With effect from 30 January 2021

The trustees are aware of the mandatory duties imposed by the Trusts Act 2019 and the default duties that have not been modified or negated by the trust deed.

Beneficiaries

Prior to signing the Trust Deeds, the trustees have identified all current beneficiaries and have given due consideration of their current circumstances.

Payments on behalf of beneficiaries

Resolved ‘That in keeping with the objectives of the Trust, the Trustees are to make payments of expenditure on behalf of the following discretionary beneficiaries of the Trust, from time to time.’

[Name]

[Name]

[Name]

[Name]

Trust Deed

Resolved ‘That the trustees have reviewed the Trust Deed and approve it for signing purposes.’

Assets acquired

Resolved ‘That the Trustees purchase the property [Address] for $[Amount].’

Acknowledgement of debt to settlor

Resolved ‘That the Trustees sign an acknowledgement of debt to the settlors for $[Amount].’

Right of Occupancy

Resolved ‘That [Name], as beneficiaries, may reside in the dwelling at [Address] until such time as the Trustees decide to sell or lease the property, provided that they pay all costs of occupation and ownership including but not limited to rates, insurance, maintenance, interest, and light and power, such payments to be recorded as further advances to the Trustees.’

Occupancy by [Name] shall not constitute a lease or any other interest in the property.

The decision to allow [Name] to reside in the property is in accordance with the Trust Deed and the Trust’s investment strategy.

Signed by all the Trustees

______________________________	[Trustee]
______________________________	[Trustee]

Example: Minute distributing Trust Income for the year and approving Financial Reports

Annual Minute

[Trust Name]

....

Minutes of a meeting of Trustees held at [Firm Name], [Address] on [Date].

Present — [Name/s]

Financial Report

Resolved:

That the Annual Reports as prepared by [Firm Name], Chartered Accountants, showing a net surplus of $[Amount] made up of capital profit of $[Amount] and income of $[Amount] for the [Year Ended] be hereby adopted and approved.

In terms of the trustees' resolution dated [Date] that income was allocated as follows:

[Beneficiary Name]	$[Amount]
[Beneficiary Name]	$[Amount]
[Beneficiary Name]	$[Amount]

Trustees	____________________	$[Amount]
Trustees	____________________	$[Amount]

Investments

Investments were reviewed by Trustees and it was agreed that the portfolio was appropriately structured in accordance with the investment strategy agreed [Date].

Beneficiaries

That prior to making the resolutions above, the trustees have given due consideration to the interests of all beneficiaries.

Signed by all the Trustees

____________________ [Trustee]

____________________ [Trustee]

____________________ [Trustee]

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