

Family Trusts

You have probably heard of this thing called a Family Trust. Perhaps it came up in conversation when your parents were talking about protecting their assets, or maybe your friend swears that a Family Trust is the way to go if you're thinking about buying a house. Perhaps you even have your own Family Trust. None of these circumstances would be surprising, considering that there are apparently somewhere between 300,000 and 500,000 Trusts in New Zealand right now.

Also not surprising is the fact that Family Trusts are a big part of our practice here at Kevin McDonald & Associates. Over the years, we've helped so many of our clients establish, manage and maintain their Family Trusts. From this experience, we understand that Family Trusts can sometimes be a hard thing to get your head around. We get it. Trusts, like many legal constructs, can be a complicated business. In this guide, we would like to take it back to basics, breaking down exactly what a Family Trust is, the "pros and cons" of having your own one, and how they actually work in practice.

What is this thing that we call a family trust?

We'll start at the beginning. A *Trust* is a legal structure or arrangement. The defining feature of this legal structure is the relationship between key people and assets (such as money or property). A Trust exists when:

- A person, known as the **Settlor**, decides to transfer certain personal assets, such as money or property, to a person called the **Trustee**.
- The **Trustee** then holds the assets according to certain rules, and, specifically, for the benefit of a person called the **Beneficiary**.
- The **Beneficiary** receives the benefits from this arrangement. This may include receiving payments periodically or being entitled to the assets of the Trust in time.

A *Family Trust* is simply a Trust that works to benefit particular members of a family.

Some other important information

Let's talk a little bit more about the key components of a Trust:

- **Trust Deed:** A document called a Trust Deed is the founding document of a Trust. This document confirms which people are the Settlers, the Trustees and the Beneficiaries as well as explains the role, duties, powers and obligations of Trustees in relation to the property held in the Trust. It also explains exactly how the Trust is going to be managed and operated, and how/when Beneficiaries will benefit from the Trust.
- **Settlor:** The Settlor is the person that, effectively, sets up the Trust by transferring some property to the Trust. That property can be a multi-million-dollar property portfolio, or even just a \$1 coin. It is relatively common that the Settlers are Trustees *and*

Beneficiaries in a Family Trust situation. (However, we can't have a Trust where one person is the sole Settlor, the sole Trustee and the sole Beneficiary as this is just one person pretending to have a Trust!)

- **Trustees:** Trustees play a very important role as they are required to manage the Trust and comply with various requirements and legal duties under the Trust Deed and the law relating to Trusts. Trustees are the legal owners of the property in the Trust and are able to do the same sorts of things with the property that owners can do, for example, they can own property, have mortgages and set up bank accounts, as long as they act according to the Trust Deed and the relevant laws relating to Trusts. The most important thing to know about Trustees is that they must act in the very best interests of the Beneficiaries. It is common to have at least two Trustees of a Family Trust.
- **Independent Trustee:** An Independent Trustee is a person appointed to the role of Trustee who is independent of the other Trustees and the Beneficiaries and will take no benefit from how the Trust is run. Often times a lawyer or accountant is an independent Trustee of their client's Trust.
- **Beneficiaries:** There are two types of Beneficiaries: Discretionary Beneficiaries and Final Beneficiaries. Discretionary Beneficiaries have a *right to be considered* for benefits from the Trust, but don't have an automatic right to receive anything. The Trustees have the discretion to decide what benefit the Discretionary Beneficiaries receive. Final Beneficiaries, however, have a *right to property* of the Trust at a certain time.
- **Lifetime of a Trust:** Most Trusts can't last forever. Generally, a Family Trust cannot exist for longer than 80 years and the Trust Deed must set a date on which the Trust has to finish. This is known as the "date of distribution".

Here are some Pros of having a Trust

Asset Protection	<p>Many of the benefits of having an effective Family Trust come down to protecting certain assets and wealth against business and other risks. How does that work? Well, the people who start the Trust, the Settlers, transfer their property to the Trustees. The Trustees become the legal owners of the Trust property, but they don't own it for personal benefit, they own it purely for the benefit of the Beneficiaries.</p> <p>This means that the Trust property does not form part of the personal estate of the Settlers (because they transferred the property out of their names to the Trust), the Trustees (because, although they legally own the property, they only own it on behalf of the Beneficiaries) or the Beneficiaries (because the property has not yet been transferred or distributed to them). If you transfer assets to a Trust, this arrangement may be useful in various circumstances, including, for example:</p>
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	<ul style="list-style-type: none"> If you are a business owner and someone tries to sue you, or your business fails, your assets are generally protected in a Trust, as they do not make up your own personal property.
	<ul style="list-style-type: none"> If you're worried that your personal property will become intermingled with your partner's under relationship property laws, placing property in a Trust is an option to keep personal property separate from relationship property.
Future Generations	Trusts are sometimes used to help ensure that family property is passed down from generation to generation without interference or complications that arise from relationship break ups or other "modern family" scenarios that sometimes place inheritances at risk.
Tax Planning	Depending on your circumstances, there may be possible tax benefits by having your assets in a Trust. It's worth talking to your lawyer or accountant to discuss whether this would be the case for you, keeping in mind that tax benefit isn't allowed to be the main reason for forming a Trust.
Providing for Family Members	You can keep assets safe in a Family Trust in order to provide for a specific circumstance, such as paying education costs for your kids, or providing for a family member who may have special needs (for example, a child with a disability). Alternatively, Trusts can be useful to help manage the assets of a person who can't look after their own affairs, perhaps through age or sickness.
Confidentiality	Trusts are a very private structure, which may be an advantage if you would like to keep your affairs, and your assets, private. At the moment, there is no public register for private Trusts in New Zealand and there is no legal requirement that Trusts disclose information publicly. A Trust's annual accounts and activities are only available to the Settlor, the Trustees and the Beneficiaries.
Simplifying matters after you pass away	Having property or assets in Trust may lessen the chance of family members or other people challenging your will after you pass away, as well as providing a clear framework for how your property should be distributed. This can reduce complications (and cost) during an emotional and challenging time for your family.

Now for the Cons of having a Trust

Set-Up Costs	Creating a Trust is an important decision and, depending on your personal and financial circumstances, the process can be time consuming and costly. You'll need your lawyer's help with, firstly, discussing and deciding on an appropriate Trust structure, personalised for your situation, and, secondly, preparing the relevant Trust documents
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	and, if necessary, arranging for assets to be transferred to the Trust.
Loss of Ownership	If you transfer your assets into a Trust, this means that you no longer own these assets, which can take some getting used to. Even if you are the Trustee, your role in relation to the property has changed. Trustees will be limited in what they can do by the duties set out in the Trust Deed and other laws relating to Trusts. If Trustees continue to deal with the assets like they were their own, and for their own personal benefit rather than the benefit of the Beneficiaries, this may be evidence that the Trust isn't a "real" Trust and may also be a breach of the Trustees' obligations. We'll talk about this consequence below when we discuss "Sham Trusts".
Administration	There are ongoing costs and responsibilities associated with having a Trust. Trustees in particular have a number of duties they have to fulfil, which can be a big responsibility. For example, the Trustees must (among other duties) know the terms of the Trust, keep proper accounts, make unanimous decisions, act in the Beneficiary's best interests, treat Beneficiaries fairly, invest sensibly and take an active part in all Trust decisions. Not only is this a big responsibility, it can be costly too.
Future law changes	Although there are currently certain benefits associated with holding assets in a Trust, it can't be guaranteed that these benefits will last forever. There is always the possibility that the laws affecting Trusts will be changed and benefits will be lost.

Sham Trusts

We've mentioned that Trusts can be useful for protecting assets in certain circumstances. This is probably the most important benefit of having a Trust. However, placing property in a Trust is not a guarantee that it will be secure from the claims of other people. The law allows property held by a Trust to be "clawed back" in various circumstances if it appears that the Trust is not a "real" or genuine Trust. For example, if it is clear that assets were transferred to a Trust to get around relationship property laws, avoid creditors or "hide assets" from the Government when you apply for certain benefits (for example, rest home subsidies, legal aid, unemployment benefit), it is possible for a Court or the Government to look at the property held by the Trust and even unwind the Trust to place the property back into the hands of the Settlor if it believes necessary.

What does this mean? Well, in order to ensure that any Trust is effective and serves your purpose, it is crucial that you talk to your lawyer about your circumstances before creating a Trust. Your lawyer will help you decide whether a Trust is a good idea, and, if so, tailor the Trust to meet your specific needs. Once a Trust is set up, it's important to administer the Trust professionally and according to all the relevant guidelines. If you don't fulfil all of your legal obligations, your Trust may not be effective in the eyes of the law, or a Court may later decide it's not a real Trust. In this case, your Trust will be of no benefit to you.

Have more questions? Here are a few that we get often:

What should I name my Trust?

If you're setting up a Family Trust, you'll need to decide on a name for it. You can decide whether to keep it simple or get really creative, it's up to you. When helping couples set up

Family Trusts, we often see them decide on a name along the lines of “The Jim and Joan Smith Family Trust”, for example. (That’s not to say we don’t appreciate ones that are more unique!)

How do I transfer property into a Trust?

For many Family Trusts, it is very common to see the family home or other properties transferred to a Trust. In this case, you can simply “gift” the property to the Trust through completing the right paperwork. Your lawyer will help you prepare this, including registering a change of ownership with New Zealand’s land information registry from your name to the names of the Trustees. If the property you’re transferring has a mortgage, it will be necessary to talk with the bank and refinance the property as part of this process. Whether it is a house or any other asset, it is important to talk to your lawyer about how to transfer this to the Trust so that it is done correctly.

What does it mean if my Family Trust owns our home?

Let’s say that you and your partner created a Family Trust and, as Settlers, you transferred your family home to the Trust. Your Trust Deed specifies that you and your partner are the sole Settlers, two of the Trustees and two of the Beneficiaries of the Trust. Your children and grandchildren are also beneficiaries. The Trustees of the Trust may decide, acting together, that the house is available to you and your partner to live in as Beneficiaries of the Trust. This could be recorded in the Trust Deed, or put into a separate document recording the decision. On a practical level, the Trustees should make sure that the insurance policies for the family home, as well as rates notices, are in the name of the Trust or Trustees.

Does the Trust need its own bank account?

If your Trust is going to receive income and pay expenses (including, for example, mortgage repayments), a separate bank account must be opened in the name of the Trustees. This helps show the world that the Trust is a real structure, as well as making sure that personal and Trust finances are kept separate to avoid any confusion. Mixing personal and Trust finances is, in some circumstances, treated as evidence that no real Trust exists.

How do Trustees make decisions?

The way Trustees make decisions for a particular Trust comes down to what is written in the Trust Deed, which you consider and decide upon when you set up your Trust. An important component of this document is specifying how Trustees can make decisions. There are two main options. You can specify that Trustees make unanimous decisions, or that they make decisions by a majority. It is good practice to record all Trustee decisions in writing with signatures from those Trustees supporting the decision.

I am the Settlor of a Trust and I want to change the Trustees and/or the Beneficiaries. Can I do this?

Once again, this is a power that is specified in the Trust Deed of your Trust. It’s good to talk to your lawyer about this power when you set up your Trust as it’s an important one. If you want to retain the power to change the Trustees and/or the Beneficiaries, this must be specified in the Trust Deed. It is very common for the Settlor to retain this power as it means the Settlor manages to have some control over the people who have ultimate responsibility for managing the Trust’s assets (the Trustees) and the people who receive the benefits of the Trust (the Beneficiaries).

A related note: If the Trustees do get changed, there is usually a bit of work to be done to update ownership records of the Trust's assets, which can take time and cost money as you'll generally need to work with your lawyer to make sure it is done correctly.

Should I appoint an Independent Trustee?

There is no legal requirement that you have an Independent Trustee, but, in many cases, we recommend that one be appointed to help run and organise the Trust and provide an objective perspective for certain decisions. Having an Independent Trustee also helps ensure that the Trust is effective and, in the eyes of the law, a "real" Trust. We recommend talking to your lawyer about this for further details. Many lawyers (including us) have a Trustee Company that acts as an Independent Trustee for many Trusts set up by their clients.

I'm a Trustee of a Trust. What am I liable for?

Being a Trustee is a big responsibility. Firstly, you are required to manage and run the Trust in accordance with the Trust Deed and all relevant laws for the benefit of the beneficiaries. You owe special duties in this job to act sensibly. Secondly, as a Trustee you are *personally liable* for the debts incurred by the Trust, including tax liabilities. There are some situations where you can "contract out" of liability by negotiating with the other party and getting their consent. For example, if the Trust borrows money from a bank, the Trustees could try to negotiate with the bank to limit the personal liability for the Trustees to the assets of the Trust. However, this negotiation may not be successful or possible in various situations.

Let us know how we can help you

We put together this guide as a very general overview to Family Trusts. However, there are innumerable factors that may become relevant or crop up in any given situation that weren't covered here. We can't talk about them all in one guide, so, for the very best guidance and support, we recommend you give us a call so we can work together to make sure you're looked after, taking into account all of your specific circumstances.

Have a question about Family Trusts? Or perhaps you just fancy a chat about how this information applies to your situation? If so, we would love to help. You can give us a call or send us an email for more information.

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