THE FAMILY TRUST

Do the right thing – see your lawyer first

NEW ZEALAND LAW SOCIETY

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1. | The family trust

Trusts are becoming an increasingly popular way of protecting property and managing assets.

A trust is created when a person, called the **settlor**, transfers property to people known as **trustees**. Trustees are obliged by law to use the property for purposes that the settlor specifies. Usually, one of these purposes is to make payments from the trust property to people called **beneficiaries.**

The way the trust property is to be dealt with and the parties involved are usually set out in a document known as the **trust deed**. Trusts can also be created by wills.

Trusts can be set up for charitable purposes such as education or established specifically for the benefit of the members of a particular family. The terms of trusts can differ markedly depending on the purpose for which a trust has been established.

This pamphlet deals with one particular type of trust – the **family trust** – but much of the information will also apply to other types of trusts.

2. | Why have a family trust?

Reasons for establishing a family trust include:

- To protect assets for family members – by transferring the ownership of some assets to a trust, a settlor may be able to undertake a higher risk occupation or venture knowing that those assets will not be put at risk.
- To ensure certain assets – eg, a family business or farm – are transferred intact to the next generation.
- To make sure some assets are retained for other family members when one, or more, members needs rest home or hospital care.
- To protect family members or a family business from possible relationship property or family protection (contesting a will) claims.

- To manage the assets of someone who is unable to manage their own affairs, perhaps through age or infirmity.
- To assist with estate administration (and cost savings) by transferring assets to a trust before death.
- To change tax liability. More or less tax may be payable. Tax liability should be reviewed regularly.

3. Who is involved?

The main parties to a trust are:

The settlor: the person (or people) who makes the initial transfer of property, which may be as little as $1, to the trustees of the trust. Anyone who transfers assets to the trust is a settlor.

The trustees: a trust normally has two or more trustees – usually people whom the settlor is confident will manage the trust prudently. A settlor can choose to be a trustee of his or her own trust. In some circumstances, it is advisable also to have an unrelated trustee, who might be a family friend, the settlor's accountant or lawyer for example, or a corporate trustee. One of the matters to look at when choosing trustees is how the trust is to be managed. Will the settlor do this or will a professional trustee have a continuing involvement with the management and account keeping?

The beneficiaries: people for whose benefit the trust has been established. They can be either named individuals or a class, such as "children" or "grandchildren". There are generally two types of beneficiary – discretionary beneficiaries and final or ultimate beneficiaries.

Discretionary beneficiaries have a right to be considered by the trustees for payments from the trust property but they do not have an automatic right to receive payments from the trust.

The following are often named as discretionary beneficiaries:

- the settlor(s);
- the settlor's children and grandchildren.

Settlors often have power to add beneficiaries and they may, for example, decide to add members from the wider family or a charity.

Final or ultimate beneficiaries have a legal right to the trust property on the date the trust finishes. They are often named and are often the settlor's children with provision for grandchildren if a child dies before the trust finishes.

4. How long does a trust last?

In simple terms, 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**. Trustees are usually given the power to bring the trust to an end before the date of distribution. Some trust deeds give trustees a power to extend the distribution date so long as it does not go beyond 80 years.

5. Who can appoint and remove trustees?

The trust deed usually gives someone the power to appoint new trustees and sometimes the power to remove trustees. Usually this power is given to the settlor. If the trust deed does not mention this, then the trustees together can appoint new trustees.

6. How does a trust operate?

A trust can operate in almost exactly the same way as an individual person can. A trust can hold property, raise mortgages, hold bank accounts and generally hold all types of assets and investments as long as it operates according to the powers set out in the trust deed.

7. Getting assets into a trust

Assets can be added to a trust at any time. Usually the settlor will sell assets to the trust or the trust itself will purchase assets from third parties.

If the trust does not have any money to pay for an asset, the trustees must sign a document acknowledging that the trust owes the settlor a sum equivalent to the value of the asset purchased.

The debt is regarded as an asset owned by the settlor. However, any increase in the value of the asset sold to the trust belongs to the trust and not to the settlor personally.

Similarly, any income from the trust assets will usually be trust income and not the income of the settlor.

8. Reduction of the debt owed by the trust

The amount the trust owes to a settlor can be reduced by:

- the settlor cancelling the debt in amounts of up to $27,000 per year without incurring gift duty. Amounts over this sum will incur gift duty, which is calculated on a sliding scale;
- the trust making payments – out of its income or out of capital – to the settlor in reduction of the debt.

9. Getting money out of the trust

Generally, the trustees decide which payments from income or capital are to be made by the trust and which beneficiaries shall receive them.

In addition, if the document recording the debt allows, the person to whom the trust owes the debt can demand payment of any part of the debt owed. If the debt for the initial purchase of assets is repayable to the settlor on demand, the settlor can require payment of all or any part of this debt at any time. Payments of this kind from the trust to the settlor may be free from income tax.

10. What about tax?

Generally, income will either be taxed in the hands of the trustees as trustee income or in the hands of the beneficiary if the trustees decide to pay income to beneficiaries. If income is paid to a beneficiary over the age of 16 within six months of the end of the tax year, then it is taxed at the beneficiary's personal tax rate. Income that is not distributed in this way is taxed in the trust at the trustees' rate.

11. Trust structures

The structure of a trust will depend on what the settlor specifically wants the trust to do. It is important to note that trustees, once appointed, cannot do just anything they want with the trust property. They have powers that allow them to do certain things and duties that must be observed.

These restrictions are based on:

- The trust deed – what does the deed expressly allow the trustees to do?
- Legislation – what does the printed law allow or stop the trustees from doing?
- Case law – what do the cases that have already been decided prohibit or allow the trustees to do?

If you wish to set up a trust, it is important that you understand your trust and what trustees can and cannot do before you establish it. You should talk to your lawyer to ensure that the terms of your trust fully meet your needs, fulfil the intended purpose and will not be upset by any clawback provisions.

There are many varieties of trust to suit individual circumstances.

One alternative, used when each spouse wants as much protection as possible over one or more assets without the direct involvement of their spouse as a co-trustee or beneficiary, is a cross or mirror trust. This involves setting up two trusts instead of one. For example, the first spouse can establish a family trust with the second spouse, children and grandchildren as the beneficiaries. The second spouse also establishes a family trust with the first spouse, children and grandchildren as beneficiaries.

Check with your lawyer to see what type of trust you need.

12. Caution

Trusts are subject to various legal requirements and there are several provisions in law that allow property in a trust to be clawed back in certain circumstances. These can defeat the purpose for which the trust was set up in the first place.

A court may order some sort of compensation if one partner has made relationship property subject to a trust in a way that has the effect of defeating the other partner's claim or rights under the Property (Relationships) Act. Also, under the Property (Relationships) Act, a partner's interest in a trust can sometimes be treated as relationship property and be subject to the equal sharing rules.

You should assess whether a trust is a suitable vehicle to meet your objectives. You should weigh up the advantages and disadvantages of your various options, including the ongoing management compliance costs of each. Your lawyer will be able to help you determine what is required to meet your needs.

13. Do the right thing – see your lawyer first

Lawyers deal with many personal, family, business and property matters and transactions. No one else has the training and experience to advise you on matters relating to the law. If your lawyer can't help you with a particular matter, he or she will refer you to another specialist. Seeing a lawyer before a problem gets too big can save you anxiety and money.

Lawyers must follow certain standards of professional behaviour as set out in their rules of conduct and client care. When you instruct a lawyer, he or she must provide you with certain information, as outlined in our brochure *Seeing a lawyer – what can you expect?*

This includes informing you up front about the basis on which fees will be charged, and how and when they are to be paid. The fee, which must be fair and reasonable, will take into account the time taken and the lawyer's skill, specialised knowledge and experience. It may also depend on the importance, urgency and complexity of the matter. There could also be other costs to pay, such as court fees.

You should discuss with your lawyer how you will pay for the work and advise if you don't want to spend more than a certain sum without the lawyer checking with you. A lawyer is required to tell you if you might be entitled to legal aid.

The brochure *Seeing lawyer – what can you expect?* also outlines how you can help control your legal costs and get best value from your lawyer.

Choose your own lawyer for independent advice. You do not have to use the same lawyer as your partner or anyone else involved in the same legal matter. In fact, sometimes you must each get independent legal advice.

Lawyers must have a practising certificate issued by the New Zealand Law Society. You can call the Law Society on (04) 472 7837 (or at one of the offices listed below) or email **registry@lawsociety.org.nz** to see if the person you plan to consult holds a current practising certificate. You can also check this on the register accessible through the website **www.lawsociety.org.nz**

If you have a concern about a lawyer, you can talk to the Lawyers Complaints Service, tel 0800 261 801.

If you don't have a lawyer:

- ask friends or relatives to recommend one;
- look in the Yellow Pages under "lawyers" or "barristers and solicitors";
- inquire at a Citizens Advice Bureau or Community Law Centre;
- check these websites:
  - www.lawsociety.org.nz/home/for_the_public/find_a_lawyer
  - www.familylaw.org.nz
  - www.propertylawyers.org.nz
- contact your local New Zealand Law Society branch:

Auckland (including Northland, South Auckland, Coromandel)	(09) 304 1000
Waikato Bay of Plenty (including Taupo)	(07) 838 0264
Gisborne	(06) 867 1562
Hawke's Bay	(06) 835 1254
Taranaki	(06) 758 3238
Wanganui	(06) 345 7092
Manawatu	(06) 356 2214
Wellington (including Wairarapa)	(04) 472 8978
Nelson	(03) 545 2613
Marlborough	(03) 578 7269
Canterbury/Westland	(03) 366 9184
Otago	(03) 477 0596
Southland	(03) 218 8778

Law Awareness Programme

The New Zealand Law Society publishes this pamphlet as part of its *Law Awareness Programme* to inform you of your legal rights, the law and how lawyers can help you. The full list of titles in this series is:

- Buying or selling a property
- Over the fence ... are your neighbours
- Domestic violence
- What happens to your children when you part?
- Dividing up relationship property
- What happens when your relationship breaks up?
- Living together
- The family trust
- Making a will and estate administration
- Powers of attorney
- Motor vehicles, accidents and alcohol
- You and the police
- Giving evidence
- Going into business

Other brochures

The Law Society also publishes the following brochures outlining the standard of service that clients can expect from their lawyers and about the Lawyers Complaints Service:

- Seeing a lawyer – what can you expect?
- How to complain about a lawyer

Copies of the Law Awareness pamphlets and the other brochures may be obtained from the New Zealand Law Society, PO Box 5041, Lambton Quay, Wellington 6145, tel (04) 472 7837, fax (04) 473 7909, email **pamphlets@lawsociety.org.nz** or from Citizens Advice Bureaux or Community Law Centres. They are supplied free to individuals and non-profit community service organisations, and at a small charge to others. They are also available on the Law Society website – **www.lawsociety.org.nz/home/for_the_public/how_can_we_help_you**

To the best of the knowledge of the New Zealand Law Society, all information in this pamphlet is true and accurate as at the date below. However, the Law Society assumes no liability for any losses suffered by any person relying directly or indirectly on information in this pamphlet. It is recommended that readers consult a lawyer before acting on this information.

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