

**MEMORANDUM
REGARDING TRUST FORMATION**

CT LEGAL
■ BARRISTERS & SOLICITORS ■

1. WHAT IS A TRUST?

A trust comes into existence when individuals wishing to create the trust (called the settlors) transfer ownership of assets to the trustees to be held on trust for certain persons (called the beneficiaries).

The trustees own and manage those assets for the benefit of the beneficiaries of the trust and will be guided by the terms of the trust deed.

Normally, both of you, and at least one independent trustee, hold the assets of the trust as trustees for the beneficiaries you nominate. All or any of these beneficiaries could benefit as to income and capital from the trust during the term of the trust.

On the eventual winding up of the trust the trust assets are distributed in accordance with the formula incorporated into the trust deed, or any other directions that you have given.

2. A TRUST CAN:

- (a) provide the settlors with a convenient vehicle through which to distribute their wealth to children and grandchildren;
- (b) guard against potential business claims and/or director's liability;
- (c) protect against possible future problems with creditors;
- (d) make sure that assets earmarked for children do not get caught up in relationship property disputes with their husbands, wives or de facto partners;
- (e) in a preliminary way, just move your assets out of harm's way as far as the possibility exists of death duty coming back; and
- (f) possibly have benefits in relation to the New Zealand Superannuation Surcharge and Residential Care Subsidy means tests, although there is no guarantee of this.

3. BENEFITS OF A FAMILY TRUST

One of the main advantages of using a trust is that it has a separate existence distinct from yourselves. This makes it effective as an independent holder of assets of which you wish to divest yourselves.

3.1 Divestment of Assets: Most benefits of a trust flow from the separation of beneficial and legal ownership. While you may continue to benefit from the assets as beneficiaries of the trust, legal ownership of those assets will rest with the trustees. As a result:

- (a) those assets may be protected against claims by your creditors, provided the trust has been established properly

without the primary intention of defeating creditors' claims against you;

- (b) those assets may no longer be taken into account in calculating your personal entitlements to certain benefits and subsidies that are asset-tested; and
- (c) those assets will not form part of your personal estates on your deaths, and so may not be assessed for death duty, if this duty is reintroduced in its previous form.

3.2 Advantages of Trust over Wills: The advantages of using a trust over a will for distributing wealth are:

- (a) the trust may continue after your deaths;
- (b) distributions may not be contested in the same way that gifts under a will may be challenged under the Family Protection Act 1955; and
- (c) trusts can be a useful way of providing for future generations.

4. OTHER CONSIDERATIONS

4.1 Reasons for Establishing Trust: You must not establish a trust with the primary purpose of achieving the benefits that flow from the divestment of your assets (noted above). These benefits must, at best, be only incidental to your main purpose for setting up a trust. This is because certain legislation prohibits you from transferring your assets to a third party (such as a trust) in order to:

- (a) defeat creditors;
- (b) defeat spouse's claims;
- (b) avoid asset or means tests; or
- (c) avoid or reduce your liability to pay taxes and duties.

4.2 Trusts and Companies Compared: A family trust is generally considered to be a better independent owner of assets for the purposes outlined above than a family company, because:

- (a) the trust is confidential to you and the trustees (of which each of you can be one); and
- (b) it also has much more flexibility as far as the underlying ownership of the assets is concerned.

In a company, the shareholders are a matter of public record and changing shareholders requires a transfer of shares. It is possible to use a nominee owner of shares, but that adds another layer of complexity.

In a trust, both of you, or the survivor of you, can change the beneficiaries so that at the end of the day legal ownership of the trust assets is quite flexible.

4.3 Disadvantages of a Family Trust: There is no advantage in having a family trust if you do not need one. Your particular situation will need to be analysed to see if a trust is beneficial for family, asset protection and tax reasons.

Some of the disadvantages of trusts are as follows:

- (a) assets transferred to a trust are no longer your assets, which means that you cannot deal with these assets as your own — you will have surrendered personal ownership and control over those assets to the trust;
- (b) the trustees must manage the trust's assets prudently for the beneficiaries and carry out the terms of the trust deed — they may be personally accountable to the beneficiaries if they fail to do this;
- (c) the trustees need to agree on any decisions about the management of the trust's assets and the distribution of any income from the trust — this means that the trustees, including any independent trustees, must concur on decisions made for the trust;
- (d) setting up and maintaining a trust costs money — these costs will depend on the complexity of your particular situation;
- (e) you will need to have separate records and accounts for the trust, in addition to any records you have for your personal assets and business dealings; and
- (f) the ongoing administration of a trust may require the services of a lawyer, accountant or financial adviser — if you appoint a professional trustee, like a trust company, they will charge for their services.

All these possible disadvantages must be balanced against the potential benefits of a trust.

4.4 Powers of Appointment: You may reserve for yourselves:

- (a) the power to appoint new trustees — that power may rest with you jointly, and with the survivor of you after one of you has died;
- (b) the power to appoint additional beneficiaries to benefit at the discretion of the trustees during the term of the trust; and
- (c) the power to determine who the final beneficiaries of the trust will be when the trust is wound up — however, your

trust deed should also have a fall-back position which will record who the final beneficiaries of the trust will be if you make no other nomination.

4.5 Your rights under the Property (Relationships) Act (“Act”): If both of you own (either jointly or in common in equal shares) the assets which you are intending to transfer to your trust, then those assets may be relationship property. This typically applies to the family home, even if both of you are not recorded as the registered owners. It can also apply to assets acquired by either one of you before your marriage or de facto relationship started, if those assets were:

- (a) acquired in contemplation of your marriage or de facto relationship; and
- (b) intended for the common use and benefit of you both.

It may also apply to assets that either one of you acquired alone after your marriage or relationship began.

As of 1 February 2002, the Act gives a husband, wife or de facto partner the right to claim that a disposition of relationship property to a trust had the effect of defeating that person’s claim (for example, the claim that person may otherwise have had to a one-half share in the property as relationship property).

In appropriate circumstances, we may recommend that:

- (a) both of you enter into an agreement under the Act to contract out of the provisions of the Act; and/or
- (b) either one of you obtain independent legal advice about your rights under the Act;

before allowing the transfer of your relationship property to the trust to take place.

5. INSTRUCTIONS FROM YOU

We need to discuss the following issues with you in order to clarify your instructions:

- (a) your reasons for establishing a trust;
- (b) your family structure;
- (c) your income position;
- (d) your asset position; and
- (e) your future income earning and life expectancy issues.

6. LEGAL STRUCTURE OF TRUSTS GENERALLY

We first need to determine what sort of trust structure is suitable for your needs and then settle on the form of the trust documents themselves. We will need to discuss the following issues with you.

6.1 The Settlers: The settlers make the initial settlement of assets (normally \$10.00 cash) to the trust.

We will discuss with you whether you wish to be the named settlers of your trust or whether there is someone else who would be suitable. Some persons like to have a parent or other close relative make the initial settlement.

Whether or not you are recorded as the settlers in the trust deed, it is likely that you will settle on the trust the majority of assets that will form the trust fund, in which case you may be viewed as the settlers.

6.2 The Trustees: You will need to decide whom to appoint as trustees. Having trustees who have no relationship with the beneficiaries provides the ultimate protection against the trust being attacked, but it results in a loss of control to those independent trustees.

Currently there is no problem legally with both of you being trustees of your own trust. Furthermore if there should be a law change, your trust deed may be flexible enough that you could resign and appoint replacement trustees.

In addition to appointing yourselves as trustees, we would recommend that you appoint one or two independent trustees who will help with:

- (a) situations where a beneficiary/trustee is put in a position of conflict; and
- (b) (specifically) situations where a beneficiary/trustee needs to exercise a trustee discretion to confer a benefit on himself or herself as a beneficiary.

6.3 Beneficiaries: Anyone who will, or may, derive a benefit under the trust is a beneficiary. Normally, two classes of beneficiary are used in a family trust, being "Discretionary Beneficiaries" and "Final Beneficiaries".

- (a) Discretionary Beneficiaries are those to whom the trustees have the discretion to distribute income or capital to during the term of the trust.
- (b) The Final Beneficiaries, on the other hand, are those to whom the trust's assets would be distributed on the final winding up of the trust.

6.4 Ineligible Appointees: You may wish to designate certain individuals who may not be appointed as beneficiaries. We will discuss with you whether this may apply to your situation for any reason.

6.5 Powers of Appointment: We would normally reserve to you the power to appoint and remove trustees. These powers are quite significant as they allow you to retain a degree of control over who will be involved with the management of the trust over time.

6.6 Vesting Day: The trust will be wound up on the vesting day, which will be defined in the trust deed.

This definition normally has two parts:

- (a) first, it states that it is a specific date, being up to a maximum of 80 years after the date of the trust deed (since legally a trust cannot run on indefinitely); and
- (b) secondly, the definition gives the trustees the discretion to nominate a vesting day sooner than the date fixed above, although a sole trustee cannot exercise this power if that trustee is also a beneficiary under the trust.

On this date, the trustees must distribute all remaining assets of the trust to the persons you have noted as your “Final Beneficiaries”.

7. TRUST STRUCTURE OPTIONS

7.1 Single/Umbrella or Parallel/Mirror Trusts: Essentially there are two trust structures which may be suitable in establishing your asset planning.

Single/Umbrella Trust

- (a) The “umbrella trust” is where one trust is established and assets are transferred into that trust. The major advantage with this structure is that the assets effectively go into one pool which allows relatively straightforward administration.
- (b) However, if the assets are pooled in this way for one family group and the need arises to split the trust’s assets between two or more groups of beneficiaries, it may be necessary to resetttle the umbrella trust assets on two or more new trusts.
- (c) Furthermore, with umbrella trusts, when one of the settlors dies, the surviving settlor may be left with the power to unilaterally remove existing beneficiaries and substitute as yet unknown beneficiaries.

Parallel/Mirror Trusts

- (a) “Parallel trusts” and “mirror trusts” involve each settlor transferring assets to a different trust for which each holds certain powers (ie powers of appointment of beneficiaries and trustees), even though each trust may be established for the benefit of the same family group.

- (b) With parallel trusts, the settlor of each trust is normally also included in the list of beneficiaries, in addition to his or her husband, wife or de facto partner. With mirror trusts, the settlor of each trust is excluded from the list of beneficiaries, with only the settlor of the other trust (and normally also the children) being beneficiaries of each trust.
- (c) Mirror trusts provided a way of avoiding death duty, which was imposed on a person who settled assets on a trust of which he or she was also a beneficiary. As this aspect of the law has now been abolished in New Zealand, mirror trusts are less in favour, with parallel trusts providing the preferred model for those who require two trusts.
- (d) Parallel trusts also have the advantage of resolving two potential problems with the mirror trust model – first, on the death of one settlor in the mirror trust scenario, the survivor would be left with an interest in only half of the family assets held by the two trusts; secondly, if the relationship between the settlors broke down, the potential existed for one settlor to refuse to distribute the trust assets to the other party, if that settlor was in a position where he or she did not need to receive the assets from the other party's trust.
- (e) The main advantage of the parallel trust structure is that, if it is necessary to provide for two separate groups of beneficiaries at some time in the future, or if estate duty is reintroduced in its previous form, this structure can be more readily adapted to fit changes in circumstances.

7.2 Fixed Purpose Trusts: You may wish to create a trust to hold assets for a special purpose or need. For example, you may wish to:

- (a) provide for the welfare of a child with special needs;
- (b) create a trust for a charitable purpose; or
- (c) create a trust specifically to provide for the education of one or more persons.

This is an area that we will discuss with you in further detail to determine what trust structure(s) are appropriate to meet your needs.

8. TRUST PROPERTY ACQUISITIONS AND GIFTING

8.1 Sale of Assets to a Trust: There are very few limits on the types of assets you can put into trust. Generally speaking though, it is desirable that you retain personal ownership of your amenity assets such as:

- (a) the contents of your home;
- (b) jewellery; or
- (c) other personal items and possibly cars and boats unless they are of significant value and need to be protected from creditors.

The essence of asset planning using a trust is that you would sell appropriate assets to the trust. Since the trust will not have the funds to purchase those assets from you, the trust will borrow from you and acknowledge a debt for the value of the assets purchased. Therefore the assets transferred to the trust are in effect exchanged for a debt back.

- 8.2 Gifting:** While the trust owes the debt to you the value of the debt will remain part of your personal estates potentially available to creditors. Accordingly, you may then reduce the debt that the trust owes you by cash gifts or forgiving up to \$27,000 per person per year by way of gift (as at 1 December 2005, this is the maximum amount, which a person can gift per year without being liable to pay gift duty). If both of you sell assets to the trust and gift off the debt together, then together you can gift up to \$54,000 per year without being assessed for gift duty.