

## THE ROLE OF FAMILY TRUSTS

A trust is a separate legal entity documented by a Trust Deed.

It involves three parties:

- A Settlor who provides money or other assets to be held for certain purposes.
- The trustees who take charge of the trust property and administer them in accordance with the Trust Deed and the Trustee Act 1956.
- The beneficiaries who receive the income and or capital in terms of the Trust Deed and the trustees' decisions.

### **Why Create a Trust?**

Benefits of Trusts include the following which is by no means an exhaustive list:

- Asset protection from creditors and the State
- Income tax savings from ability to split income
- Avoidance of superannuation surcharge
- Protection from matrimonial asset claims
- Providing for education of children
- Charitable donations made tax deductible
- Estate planning during one's life-time

### **What are the Characteristics of a Good Trust?**

The prime requirements are that:

- It should be specifically arranged to suit the circumstances of the Settlor and his or her family.
- It should be extremely flexible so that as circumstances change, or the unexpected occurs, it can be adapted to meet the new situation.

### **What Assets are Suitable to Settle in a Trust?**

Ideal assets are those of a "permanent" nature, which are likely to grow in value and/or to generate income.

Examples of permanent assets include land and buildings, publicly listed company shares, and fixed term deposits.

While the Settlor's own home is often included as Trust Property it should not be an automatic settlement as problems can arise if the Trust Deed is incorrectly structured.

## **Flexible Provisions in the Deed:**

### *Settlement*

Provision should be made for an initial settlement, together with any later settlements either by the original Settlor or others.

### *Trustees*

It is common for the Settlor and spouse to be trustees and it is advantageous to have a third, perhaps a professional adviser or a family friend. This overcomes problems which may arise at the death of the Settlor if the spouse were left as the sole trustee, since a sole trustee cannot allocate income or capital to themselves.

The Settlor should have the right to appoint new trustees during his or her lifetime, and the executors or the Settlor's estate may be given that right after the Settlor's death.

### *Term of the Trust*

The maximum period allowed by law i.e. 80 years with the Trustees have power to shorten the term.

### *Beneficiaries – Income*

One normally thinks in terms of the Settlor, spouse and children.

In practice it has proved advantageous to set up a "pool" of beneficiaries and give the trustees an absolute discretion to select from among them in dealing with income year by year.

Such a "pool" might consist of:

- The Settlor, spouse and any future spouse,
- Present and future children, and their husbands and wives,
- Grandchildren and their husbands and wives,
- Any charitable organisation anywhere in the world.

However in the event Estate Duty or a similar tax is reintroduced it is important that there is power to re-settle the Trust. This should enable any potential problems that may arise if a settler is also a beneficiary.

### *Capital*

- In order that the spouse is cared for after the death of the Settlor it is important that not only the income but also the capital of the trust can be made available.
- It is normal practice to have the capital at final distribution go evenly to the children, or in the event of the prior death of any child, that the children of the deceased receive their parent's share.
- The trustees have power to make an election as to the allocation of capital prior to date of final distribution.
- Ideally the trustees should have the same discretions as to capital as they have for income. This sometimes gives the opportunity to skip a generation if that proves desirable.

### *Administration*

- It is highly desirable that proper accounts are kept for a trust by someone who is familiar with this type of work.
- All decisions of the trustees must be documented by written resolution and kept in a Minute Book.
- If in the future any questions arise the records will answer them.

### ***Taxation Returns***

- Each trust must have a tax return prepared and lodged each year.
- Income allocated and paid out to or on behalf of a beneficiary is taxed in the hands of the trustees as agents for the beneficiary as though that income were the beneficiary's only income. If the beneficiary has other income the trust income must be included in the beneficiary's personal tax return and a credit claimed for the tax paid on it by the trustees. The Settlor should have the right to appoint new trustees during his or her lifetime, and the executors or the Settlor's estate may be given that right after the Settlor's death.
- Income not taxable as beneficiaries' income - e.g. income retained and added to capital, is taxed as trustees' income at 33%.
- If the trust income includes New Zealand dividends with imputation credits special care is needed in making the allocation to beneficiaries so as to ensure that imputation credits are not lost or wasted
- Where the same person is preparing the tax returns for both the trust and the beneficiaries the Inland Revenue Department may allow beneficiaries' income to be taxed directly in the personal returns. This much simplifies both the trust tax return and the Financial Statements.
- Where charities are included as beneficiaries income allocated and paid out to a charity escapes income tax altogether.

### ***Handling the Income***

- Ideally a trust should have its own Bank or Savings Bank Account through which income is received and payments are made.
- Alternatively transactions may take place through the accounts of a company or through a lawyer's or accountant's trust account.

## **SUMMARY OF DESIRABLE FEATURES IN A FAMILY TRUST**

### **Most Trusts:**

- A wide pool of beneficiaries including the Settlor, spouse, children, children's husbands and wives, grandchildren and their husbands and wives, plus any charity.
- The maximum period allowable by law i.e. 80 years but the trustees having the power to shorten the term.
- The trustees having an absolute discretion as regards the allocation of income, with any income not allocated accumulating and adding to capital.
- The trustees having an absolute discretion as regards capital including previously accumulated income.
- Wide powers of investment
- Power to vest and pay out an interest of any beneficiary in the capital of the Trust, without regard to any other beneficiaries and to carry on the residue of the Trust for the remaining beneficiaries.
- Power of resettlement.
- Power to acquire property and make available for use by the beneficiaries.
- Power to pay professional trustees for their professional services.
- Trustees: Settlor and Spouse and a Professional.

### **Additional Considerations:**

- Include as beneficiaries
- Any company in which any of the named beneficiaries holds at least 25% of the capital.
- The trustees of any superannuation fund in which any of the named beneficiaries is a member.
- The trustees of any trust in which any of the named beneficiaries is a beneficiary.
- Include the power to appoint further beneficiaries.
- Include the power to dismiss a trustee.



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