Setting up a Trust
For hundreds of years trusts have been providing a useful way of structuring asset ownership. If you want to put in place effective asset protection measures, a modern, well drafted trust can provide protection for your assets while also giving you flexibility to deal with changing circumstances.
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What is a Trust?

Normally, the owner of property is also the person or entity who benefits from the property. A trust separates ownership from the right to benefit from the property. Under a trust, ownership of property is in the name of trustees, with the benefits of the property going to beneficiaries.

The law recognises this arrangement, and imposes duties on trustees to act in the best interests of beneficiaries when dealing with trust property.
How a **Trust works**

When you set up a trust, you transfer ownership of the assets from yourself to the trustees.

Because the assets are no longer yours, if someone makes a claim against you, they cannot get to the assets simply because the assets are owned by the trust and not you.

Of course there is no such thing as a free lunch! To enjoy this protection, you need to relinquish ownership of your assets to the trustees.

It is also important to understand that a trust is a ‘living arrangement’, not something to be left gathering dust on the shelves. Even the best trust structure can be ineffective if the trust is not properly managed and administered.

This is especially so with the proposed overhaul of the Law of Trusts following the Law Commission’s review, which will likely see the ongoing management and administration of trusts come under even greater scrutiny.

The key is maintaining thorough records and managing the trust in accordance with good protocols, which we can assist you with.
“The key is maintaining thorough records and managing the trust in accordance with good protocols, which we can assist you with.”
What is the purpose of a Trust?

Why would you want to put your assets (property) into a trust? Generally, to protect those assets for yourself and future generations. Specifically, a trust offers:

1. Better protection of assets from personal or business creditors.
2. Better protection of assets from relationship property claims.
3. Simplifying and reducing the cost of the transfer of assets to others after the death of the owner.
4. Continuity of ownership of certain assets that will not be affected by the death or incapacity of an individual owner.
5. The ability to hold property for those unable to do so.
6. The ability to hold assets for public or charitable purposes.

Let's look at each of these in more detail.

Claims from Creditors

For people in business, a trust can help to “ring fence” assets from business risk. If you or your business became bankrupt or insolvent, assets that have been properly transferred to a trust (and which have not been provided as security for business liabilities) may not be available for your creditors to claim in compensation.

Relationship Property Claims

When a relationship ends either through death or separation, the couple’s relationship property will be divided according to the Property (Relationships) Act 1976. However, property transferred to a trust before the start of the relationship and managed properly once owned by the trust, can be excluded from the property which is available for division.

Sometimes trust ownership alone might not be adequate to protect the asset against a relationship claim. In these cases an agreement with your partner contracting out of the applicable legislation might also be required.

Inheritance

Traditionally, wills have been used to bequeath property after death, but they have limitations. If death is unexpected, beneficiaries may inherit at a time that is not
ideal: they may have creditors of their own, be facing relationship property claims, or not be mature enough to handle an inheritance.

Unlike a will, a trust carries on after death with the trustees managing its assets in the beneficiaries’ best interests until the time is right to distribute the assets to them.

Furthermore, property held in trust might not attract estate duty if it was ever re-introduced in New Zealand.

Holding Property for Those Unable to do so

Trustees can hold property for people who can't legally hold it themselves, or who can't manage their own financial affairs; for example, children or someone seriously ill or disabled.

Holding Property for other Purposes

A trust can be established to provide for public purposes or charities.
Decisions relating to the activities of the trust must be documented and signed by way of a resolution.
What makes a Trust a Trust?

A trust doesn’t have a separate legal existence like a company or a person; it is merely an arrangement or relationship recognised by law. In order to be recognised, a trust must have the following key elements.

1. The Trust Property

These are the assets, the ownership of which has been transferred into the trust. They can include real estate, shares, money, artwork, jewellery, and other (preferably appreciating) assets. Once ownership has been transferred into the trust, the assets cannot be retrieved by the donor and can only be distributed to the beneficiaries.

2. The Trust Deed

The trust deed is the legal document that sets out the terms of the trust as well as the details of the trustees’ power to act. It governs the way in which the trust will operate, sets out the rights and responsibilities of the trustees, and names the beneficiaries.

The trust deed is vital to the ongoing management of the trust and all trustees must familiarise themselves with its terms.

3. Resolutions

Decisions relating to the activities of the trust must be documented and signed by way of a resolution. The resolutions must be held in safekeeping with the trust deed.
The People

The Settlor

This is the person who establishes the trust by transferring or gifting money or property into it. There can be more than one settlor.

The Trustees

The appointed trustees legally own the property held in the trust. The trustees are responsible for managing and administering the trust and investing, divesting and distributing the trust property. Unless the trust deed provides otherwise, decisions affecting the trust property must be made by all the trustees unanimously.

A trustee can be any person who can legally hold property. There is no specific legal requirement about the number of trustees but usually there are at least two. The trustees have a duty to act in the best interests of the beneficiaries and in accordance with the trust deed. Further rights and obligations of trustees are contained in the Trustee Act and other statutes such as the Income Tax Act.

Independent Trustee

We recommend that one of the trustees is independent; that is, someone who cannot benefit from the trust. Many trusts appoint a professional person (such as a lawyer or accountant) or entity to act in this role. Having an independent trustee ensures the trust assets can be easily distinguished from the personal assets of the settlor(s). It also gives greater credibility to the trust and promotes robust trust management.

Corporate Trustees

A company can be a sole trustee or one of two or more trustees. It is known as a corporate trustee and offers a number of benefits.

For example, having one or more directors responsible for administering the trusteeship on behalf of the company means if one of the directors is unavailable, then another may sign as the company’s representative, preventing delays. It is also simpler and cheaper to change directors than to change personal trustees, such as if (for example) your lawyer was to retire.
For those managing the trust, a corporate trustee also offers more protection from creditors. Let’s say creditors make a successful claim against the trust, and the trust’s assets are insufficient to cover the claim. In this case, all the trustees are personally liable, unless their liability has been limited by previous agreement with the creditor.

By being one step removed from the actual trusteeship, however, the directors of a corporate trustee company have an added level of protection. That is why corporate trustees are becoming the norm for lawyers providing independent trusteeship – including those at Morrison Kent.

Consider a recent case, where a trust’s taxes were not paid and over several years attracted significant penalties. As it happened one of the two trustees was overseas, and the court then ordered the independent trustee, still in New Zealand, to meet the outstanding taxes and late payment penalties personally. If a corporate trustee had been in place, the company would have been liable but it is likely the individual directors would not have been.

If you have a corporate trustee it is important to know what other trusts the company is corporate trustee for, as “your” trust may be exposed to their activity. For example, unpaid taxes (as in the case above) could see the company struck off the Companies Office register, leaving “your” trust having to appoint a new trustee.

It is our practice to use a general trustee company for clients with “passive” assets, such as the family home, and a trust-specific corporate trustee for clients exposed to tax or other trading risks.

Whether we provide trusteeship personally or via a corporate trustee, there will be a charge. Where there is a corporate trustee company, you can expect to be invoiced for the initial cost of setting up the company, filing the annual return with the Companies Office, filing the annual ‘nil’ tax return with the IRD and related administration. We may sometimes factor in a fee to cover the risk exposure, depending on the activities in which the trust is involved. All fees will first be agreed with you.
Controlling the Trust

This has been a point of contention and, in our view, is often misunderstood. In simple terms, unless the trust deed provides to the contrary, the trust is controlled by all trustees acting unanimously. No single trustee has more (or less) power than the others – all are equal. This is important to understand before you establish the trust structure, because once the assets are transferred to the trust, you no longer have absolute power and control over them – power and control are shared jointly by all trustees.

The People Who Appoint and Remove Trustees

The trust deed will specify who can appoint and remove trustees. This may be the person who established the trust or one or more of the trustees. Although this person, often called the appointor, has the power to decide who the trustees will be, it would be wrong, in our view, to suggest that the appointor controls the trust. No matter who is appointed by the appointor to be a trustee, the trustees still have to act unanimously and in accordance with the terms of the trust deed.

The Beneficiaries

The beneficiaries are the people who benefit from the trust. Under current trust law, the settlor, any of the trustees and the person with the power to appoint and remove trustees may all be named as beneficiaries. The beneficiaries can be referred to by name or as a class of people (for example, the settlor’s children, XYZ Charity).

There are two types of beneficiaries: “discretionary” and “residual”. Discretionary beneficiaries have no specific interest in the capital or income of the trust; they depend entirely on the trustees deciding to apply the trust fund in their favour. By contrast, residual (or “final”) beneficiaries do have a more defined interest in the trust capital and income as set out in the trust deed – that is, they have a right as described in the deed to the distribution of the trust fund but only when the trust comes to an end.
“Your lawyer will discuss your circumstances with you and whether a trust is the right structure.”
Setting up a Trust

When considering whether a trust is suitable for you, think about:

- Your purpose for the trust
- Which assets should be protected by it
- Who will manage it
- Who will benefit from it

If you get the structure and management of a trust right, you can help prevent someone who has a claim against you personally from making a successful claim to property held in the trust.

Your lawyer will discuss your circumstances with you and whether a trust is the right structure. Once the options are decided, the lawyer will prepare the trust deed and documents required to transfer the assets you wish the trust to hold. The costs will include the initial setup of the trust and then the costs of transferring the assets through gifting or sale of the assets from you to the trust at market value. There is often a family home to be transferred which will require conveyancing and could include refinancing and insurance.
Life after Setting up a Trust

If you have established a trust and transferred your home and other major assets to it, you’ll need to make some changes to how you manage your assets and financial affairs.

The Family Home

The family home is now owned by the trustees of the trust. Typically, the trust will have granted you and your family a “licence at will” that allows you to continue to live in the home as beneficiaries of the trust.

This licence at will is often as simple as a trustees’ resolution authorising you, as beneficiaries, to live in the home on such terms and conditions as the trustees decide.

Mortgage Repayments

“If you have established a trust and transferred your home and other major assets to it, you’ll need to make some changes to how you manage your assets and financial affairs.”

If the home is mortgaged, the mortgage will need to be transferred into the name of the trustees, as they are the legal owners of the property. The loan from your bank can be either in your name or in that of the trustees.

Unless the trust is earning income, we generally recommend that any personal loans secured by trust property remain in your own name. This is because often the trust won’t have enough income to meet principal and interest repayments. Having the loan in individuals’ names means the trust only has to worry about the principal (upon acquisition or when gifted).
Rates and Insurance
Rates and insurance payments should be treated as advances or gifts to the trust because they are made for the benefit of the trust. Alternatively, it can be a term of the clients’ residing in the property that they meet these types of costs and outgoings.

Renovations
If you pay for renovations to the property or borrow to pay for them, the amount should be treated and recorded as an advance or gift to the trust.

Recording Advances
You should record all advances to the trust so that at the end of each year a simple deed can record the total advanced during the year. This annual total is then added to the existing debt owed to you by the trustees. Part of administering the trust is monitoring exchanges of value to the trust – this is important later on if organisations such as WINZ require information on gifts made to the trust.

Any amounts to be gifted to the trust should be formally documented by your lawyer after discussing whether it is appropriate to make that particular gift.

Investment Properties
If the investment property is likely to make tax losses, it may not be worthwhile for the trust to own it. This is because any resulting tax losses cannot be passed on to an individual taxpayer. If the trust does own an investment property, the trustees should operate a bank account in the name of the trust for all payments in relation to the property. Any borrowings should be in the name of the trust. The trust will need to obtain an IRD number and file annual tax returns.

Other Investments
If the trust owns income-producing investments, the trustees should establish a bank account through which all income and expenses should pass. Again, the trust will need to obtain an IRD number and file annual tax returns.
Any income or any other money that the trust receives and pays to you can be used to reduce the trustees’ debt to you and, if applicable, to reduce your gifting programme, if you have one.

It is also important to understand that any debt left owing to you by the trust constitutes an asset in your name and therefore is vulnerable to recourse by your personal creditors.

Gifting Programmes

Traditionally, in order to avoid gift duty, assets were transferred to the trust at market value and the resulting debt gifted back at the rate of $27,000 per person per year.

The repeal of gift duty in October 2011 allows you to gift as much as you want without paying gift duty. However, there may be a benefit to putting a controlled gifting programme in place, or maintaining an existing gifting programme, particularly if you are planning to qualify for asset testing benefits in the future. In that case, it is important to understand that the maximum gifting permitted per person per year by WINZ may be less than the old gift duty threshold referred to above. Accordingly, it is important to get proper legal advice to ensure the programme achieves your desired outcome.

Intermingling of Trust Assets with Personal Assets

Trust assets and personal assets must remain separate and proper records kept of all transactions between you and the trust. All cash to be placed in the trust must be treated as an advance or a gift and properly documented.

Similarly, when the trust wishes to pay money to you or any other beneficiary, there should be a trustees’ resolution or minute. All trustees must agree before the payment is made.

You should also consider how the arrangement should be structured. For example, money can be paid to a beneficiary as a distribution, advanced to them as a loan, or used to repay debt owed by the trust.
“Any amounts to be gifted to the trust should be formally documented by your lawyer.”
Timing

The sooner the trust is set up and assets transferred to it, the sooner the benefits of the trust begin. There are timeframes that need to expire before maximum protection is available. For example, gifts made to a trust within five years of being adjudged bankrupt can be set aside and ignored.

Your Next Step

Please contact Morrison Kent if you would like to discuss the benefits of a trust to your circumstances and the options available to you.
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