Information on *family trusts.*

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What is a trust?

A trust is a legal relationship in which a person(s) holds an interest in property for the benefit of another person(s) or for a specified object or purpose. There are 3 categories of persons involved in a trust relationship:

The Settlor

The person who creates the trust by transferring property into the trust initially or at later times.

The Trustee(s)

The person(s) who becomes the owner of the property transferred to the trust (subject to the specified purposes of the trust) and whose name(s) appears on the documents of title or ownership.

The Beneficiary(ies)

The person(s) who benefits from the trust relationship by receiving income and/or capital during the term of the trust or upon final distribution of the trust assets.

Use of a trust.

There are a number of reasons to form a family trust and potential benefits that arise from doing so. These include:

Asset Protection

Assets in a trust will often be safe from claims by creditors in the event of personal bankruptcy or the insolvency of a company in which a person is a shareholder or director. (Please note that there are some exceptions to this which we can discuss with you in more detail if necessary).

Continuity

Trusts can continue to operate after the death of the settlor without any immediate need to sell any assets to distribute among beneficiaries. Progressive release of funds to beneficiaries can occur and distribution to vulnerable beneficiaries can be delayed until appropriate.

Relationship Property

Property transferred to a trust prior to a relationship is not likely to be at risk in the event of a subsequent marriage or relationship break up. However, the Property (Relationships) Act 1976 gives to the Courts mechanisms to address any imbalance caused by a transfer of assets to a trust during the relationship, (although a trust, especially when combined with a proper contracting out agreement, can still be an effective form of protecting certain assets from the consequences of a marriage break up). A trust can also still protect family heirlooms and inherited property.

Family Protection Act

Assets in a trust are generally safe from family protection claims by disgruntled family members who disagree with the provisions of a deceased person's will. This becomes even more important now that, under the Property (Relationships) Act 1976 and associated legislation, de facto partners (and in some instances their children) may be able to make family protection claims to challenge your will.

Protection in Old Age

Trusts reduce the risk that an elderly person will lose family assets through an unwise marriage late in life and a subsequent matrimonial settlement. Trusts can also protect against the undue influence of other family members or from poor financial decisions.

Irresponsible Children or Their Spouses

Assets can be protected from being wasted by children if they receive assets in the will of their parent at an age when they are still immature and not financially responsible. Income can be made available but capital retained until children reach a specified age.

Income Spreading

Income earned by the trust can be spread among any one or more of the beneficiaries so as to take advantage of their personal lower tax rates, ie: spouses, partners, children and grandchildren.

Cost Effective Estate Administration

The costs of winding up your estate may be substantially reduced or eliminated altogether.

How does it work?

Assets are sold or gifted by the settlor at market value to the trustees. The trustees have an obligation to deal with this property for the benefit of the beneficiaries.

These assets can be, for example, your home, bank investments, shares, chattels or life policies. These can be transferred all at once or progressively as appropriate.

Income generated by the trust, and capital comprising the property owned by the trust, can be distributed to the beneficiaries as specified by the settlor or at the discretion of the trustees. The trustees also have the power to make distributions to individual beneficiaries to the exclusion of other beneficiaries although this needs to be done with care. The beneficiaries under a discretionary trust have no power to require the trustees to make any distribution to benefit them.

Income which is retained in the trust is taxable to the trustees at a rate of 33%, whilst income which is distributed to beneficiaries is taxable at their personal rates. This enables trusts to be used as a tax efficient vehicle by distributing income to beneficiaries at the lower tax rates.

Trusts can operate for limited periods, but have a maximum life of 125 years. Most trusts enable the trustees to terminate the trust at any earlier date they so determine.

Different types of discretionary trusts.

Sole Settled Trusts

A settlor can create a trust for the benefit of a range of beneficiaries including himself or herself. In this situation there is an independent trustee and the beneficiaries usually comprise a wide class of persons and/or organisations.

Joint Settled Trusts

Joint settlors such as husband and wife or partners can create a trust in which they are trustees jointly with or without an independent trustee. These types of trusts best suit people who are in stable committed relationships of some duration.

Parallel Trusts

Two trusts are created, one by each spouse or partner, in the same form as joint settled trusts. The beneficiaries are the same in each of the trusts but only one spouse is a trustee. The right to appoint and remove trustees is given exclusively to one spouse or partner for one of the trusts. This format is particularly suitable where there are blended families or where the couple have a desire to keep the assets which each spouse or partner transfers to their separate trusts, separate.

Mirror Trusts

These comprise two separate trusts. One is created by a husband for the benefit of his wife and children and any others as discretionary beneficiaries. The other is created by the wife for the benefit of her husband and children and others as discretionary beneficiaries. The husband and wife transfer their property respectively into the trust in which they are not a beneficiary. This results in the property being owned in equal shares by the two trusts, the income and capital of which can then be distributed to the husband and/or children, or to the wife and/or children, respectively.

This type of trust was used extensively when death duty was in place and is now less frequently used due to the fact that, upon the death of one spouse, the survivor loses potential access to capital and income of assets in the trust established by the survivor.

Memorandum of guidance.

The settlor usually provides a signed note to trustees (to be used in the event of the death of the settlor) indicating how the settlor wishes the trustees to manage the assets of the trust, for example for the benefit of infant beneficiaries. The memorandum is purpose designed for the settlor and can be likened to a will for the trust.

Relationship of will to trust.

In your will, it may be appropriate to leave personal effects, chattels and motor cars to your spouse or partner and leave the rest of your personal estate direct to the trust. This avoids the need for the survivor to subsequently gift into the trust the assets received as a legacy from the deceased. The same benefit is derived from assigning life policies to the trust; upon the death of the Life Assured, the insurance moneys go direct to the trust.

General.

Trustee Duties

Trustees have mandatory duties they must observe as set out in the Trusts Act 2019 to:

- know the terms of the trust
- act in accordance with the terms of the trust
- act honestly and in good faith
- act for the benefit of the beneficiaries, and
- exercise your powers for a proper purpose
- keep trust documents

Further duties apply by default if the terms of the trust do not say otherwise:

- general duty of care in administering a trust
- to invest prudently
- not to exercise power for your own benefit
- to actively and regularly consider exercising trustee powers
- not to bind or commit trustees to future exercise or non-exercise of discretion
- to avoid conflict
- to act impartially toward all beneficiaries. However, this does not mean treating beneficiaries equally
- not to profit from being a trustee
- to act for no reward (other than to be reimbursed for legitimate expenses
- to act unanimously

Trustee's Liability

A trustee's role is a serious one. People approached to be an independent trustee should give consideration to their personal liability and take advice. Careful provision should be made to ensure that the trustee's liability to third parties is limited to the assets of the trust. When the trust borrows from a bank, for example, then a clause can be inserted in the bank's mortgage recording the fact that the independent trustee's liability is limited to the assets of the trust. Provided regular meetings of the trustees are held (for example once every six or 12 months) and appropriate resolutions made, all matters affecting the trust are easily monitored and there should be no major concerns regarding liability.

Trustee Obligations to Disclose Information

One of the changes in the Trusts Act to the historical operation of trusts is the disclosure of basic trust information by the trustees to all qualifying beneficiaries of the trust (a qualifying beneficiary is any beneficiary the trustees believe the settlor intended to have a realistic possibility of receiving trust property). Discretionary beneficiaries of a trust are already entitled to certain information regarding the trust. The Trusts Act extends that right to notifying beneficiaries that they are beneficiaries of the trust, that they have a right to request a copy of the trust deed and/or other trust information (i.e. details of the trust assets and liabilities) and the names and contact details of all trustees.

Costs of Forming a Trust

The costs of forming a trust include the initial legal set up costs, an annual fee where Davenports Law is an independent trustee of your trust, and modest annual administrative costs usually in relation to succinct reviews of any changes to personal circumstances and any developments in trust law and practice. You will also need to have any further advances made to the trust recorded by way of deed of acknowledgement of debt and trustee resolution. If a trust generates any income it must become a registered tax payer, file tax returns, complete annual accounts and may need to be GST registered.

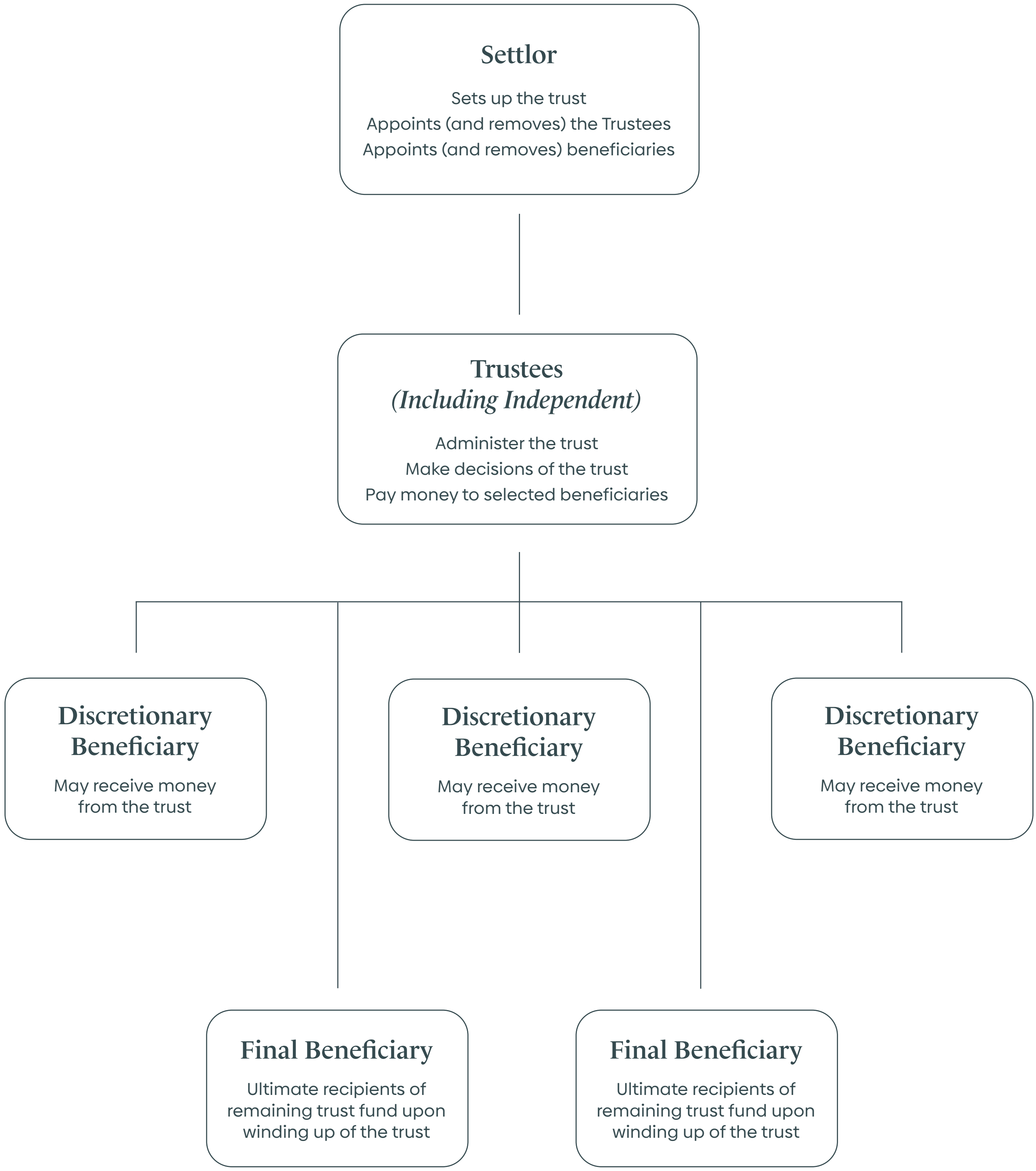
Advice on Formation

Significant legal issues are involved in the formation of a trust and transfer of assets to it. There is a need to harmonise your property ownership mode, your wills, the memorandum of guidance and the trust set up. Accordingly, it is vital to take legal advice from the Davenports Law trust team members who are extremely experienced in this area of work. Each person or couple's personal circumstances are different and at Davenports Law we see our role as providing advice and legal structures that suit your situation, life goals and needs – "crafted for you", you could say rather than "off the shelf".

In order to fully understand your personal circumstances and the issues involved in setting up a trust for you, we offer a free consultation with our trust team.

Disclaimer: We have taken every care to ensure that the information given is accurate, however it is intended for general guidance only and it should not be relied upon in individual cases. Professional advice should always be sought before any decision or action is taken.

Family trust structure.



Property ownership.

Joint Tenancy

Both own all the property and the survivor takes all.

Tenancy in Common

Each owner owns a share of the property and can leave it by their will to whomever they decide (reserving a life occupancy right, if so wished, to the survivor).

Income allocation to beneficiaries.

Trust

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Earns income of $3,000 (taxable at 33%)

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Trustees decide which beneficiaries should receive the income

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Trustees must decide within 12 months of the end of the tax year to either:

- tax the income within the trust as "trustee income" at 33%; or
- allocate the income to beneficiaries

e.g.,

$1,000	$1,500	$500
A	B	C

A, B and **C** show the money earned as income in their tax returns.

If a beneficiary's total income (from all sources including the trust) falls within one of the lower tax brackets then all income (including the money from the trust) is taxed at that beneficiary's lower tax rate.