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FAMILY TRUSTS

Information for Clients

Why Form a Family Trust?

The following are the most common reasons.

1. People may be able to position their assets in such a way that if they have to go into a rest home, they may be able to attain a rest home fees subsidy earlier than what they would otherwise have been able to do.
2. If you are self-employed and are exposed to potential commercial risks you may be able to protect some of your assets in the event of a financial calamity.
3. If you have survived a relationship break up you may want to protect your remaining assets against this situation re-occurring or you may want to make sure that some or all of your assets at your death are left for your children or divided between your children and your partner, according to your wishes.
4. You may have a substantial family asset such as a farm, which you want independent people to be able to control and deal with for the benefit of your family, after your death.
5. Less commonly, you may wish to pass on your assets for the benefit of some of your family members to the exclusion of others, and you want to ensure that your wishes cannot be contested. The provisions of a Will can be contested whereas a trust distribution cannot.

What is a Family Trust?

1. Family trusts have been in existence for several hundred years. They began in England in the feudal period when freed men would lease their farming allotments from the Lord of the Manor. If they died, their land would revert back to the Lord of the Manor and their widow and children would be left homeless. To avoid this they would transfer their lease to two trusted friends to hold it on behalf of themselves, their wife and their children. Their friends thereby became their trustees to hold the title to the land "on trust".

2. Much of the law relating to trusts has evolved through decided cases, over the centuries. Only part of it is set out in the Trustee Act 1956. This is why parts of the law of trusts are uncertain and why "best practice" has evolved but failing to follow "best practice" may not be fatal.
3. A family trust is set up by way of a Trust Deed which sets out who the parties to the trust are, what the rules of the trust are and also sets out the initial cash settlement.
4. The parties to a trust are:-
 - (i) The settlor – the person who sets up the trust.
 - (ii) The trustees – the people who look after the assets of the trust
 - (iii) The beneficiaries – the people who are to benefit from the trust.
5. Historically it was considered that if one person had two or more roles, that the Trust could be considered to be a sham or simply the alter ego of that person. Now it is commonly accepted that one person or a couple can be the settlors, the trustees and the primary beneficiaries of a trust.
6. Best practice is certainly that an independent professional trustee should be one of the trustees to avoid the trust being labelled a sham or the alter ego of the settlors.
7. The trustees must constantly remind themselves that the assets which have been transferred to the Trust are no longer the property of the original owner. The trustees must always be careful to properly account for the assets of the trust and observe the rules of the trust. Failure to do so can have serious consequences for the trustees.

How are Assets Transferred to a Family Trust?

Traditionally, apart from the initial cash donation, assets were sold to the family trust at market value. The purchase price was then loaned to the trustees by the vendor or transferor. A loan acknowledgement was entered into recording the amount of the loan and then the loan was reduced by the vendor or transferor making annual gifts of \$27,000 (or \$54,000 for a couple) in reduction of the loan.

This is called a "gifting programme".

The gift is recorded in a legal document called a deed of gift. The sum of \$27,000 was selected because prior to 1st October 2011 a person making gifts in excess of \$27,000 in any one year was required to pay a tax on the excess (called gift duty).

Gift duty was abolished on 1st October 2011.

The Form of the Deed of Trust

- (i) Most family trusts are “discretionary” family trusts as they provide wide discretionary powers to the trustees to distribute capital and income as they see fit.
- (ii) The list of potential beneficiaries is also usually reasonably extensive and trust deeds generally include a power for the trustees to add to the list of potential beneficiaries if they see fit.
- (iii) The decisions of the trustees are usually unfettered and they have the power to do as they see fit provided that they do not act illegally.
- (iv) It is common practice for the persons who set up the trust to provide a Memorandum of Wishes for their trustees setting out what they would like to happen to the trust assets on their deaths. This memorandum may also set out who they would like to be appointed as additional trustees until such time as the trust is wound up.

A Memorandum of Wishes is not designed to be binding on the trustees. If it were it may impugn the integrity of the trust and could lead to suggestions that the trust was a sham or the settlor’s alter ego.

Further Information

Please let us know if you would like a copy of the pamphlet “Memorandum Regarding Trust Information” which goes into this subject in slightly greater details and gives a more in-depth explanation of the jargon.

Rest Home Fees Subsidy

If you are interested in how the use of a family trust may assist with the payment of rest home fees please read our pamphlet on the Rest Home Fees Subsidy Scheme.