CavellLeitch

Do you still need a trust?

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Trusts used to be very popular and every man and their dog had one. New legal developments, including the introduction of the Trusts Act, has made people question the need to have or retain a trust.

Our trusts experts will discuss the common reasons for setting up a trust, and for those who already have a trust, the pros and cons for retaining or winding it up.

Creditor protection

Business risk and personal liability

Many people use trusts to protect themselves from creditors if they are in business or if they work in fields which expose them to risk. By moving assets out of your personal name and into the name of a trust, you are more likely to protect those assets from "attack" by third parties such as creditors. This is because a trust, like a company, is a separate legal entity from you. Without a trust, your family assets could be vulnerable.

Personal guarantees and director liability

Business owners could be subject to personal liability from claims brought by creditors if the company cannot pay its debts. Often, directors may be asked to provide *personal* guarantees under terms of trade or leases. This means that any assets owned in your personal name could be sold to pay off the company debts. However, trust assets are not personal assets, so can be excluded and therefore protected from any personal claims.

Directors are increasingly coming under scrutiny and it is more commonplace for directors to attract personal liability. This may arise through compliance issues, such as actions against directors personally under the Health and Safety Act (which cannot be contracted out of). Another possibility is where an action is taken against directors or senior management of a company for mismanagement. A recent example of this is the Mainzeal case where the former directors were found to be personally liable for reckless trading and originally ordered to pay $36 million in penalties. From their perspective, one would hope, that they had longstanding, well maintained trusts in place before becoming directors of Mainzeal.

Transfer assets on a 'blue sky day' and stay on top of full gifting

As with anything, trusts are not bullet proof and cannot always protect you from personal risk. It is important that assets are transferred into the trust on a 'blue sky day', meaning that there is no litigation on the horizon, you are still solvent, and you are not transferring the assets to defeat a creditor. If assets are transferred on non bona fide terms, then some assets could be clawed back if issues arise within a certain period of the business experiencing difficulties. Often 5 years is benchmark for this.

So if you are in business, or looking to go into business, or even if you are thinking of becoming a director or senior manager of a company, then it is important to get the trust structure set up beforehand if possible, or as soon as possible, while business is going well.

It is also important if you are in business to stay on top of your gifting so that the trust doesn't owe you large sums of money, as any debts which the trust may owe you form part of your personal assets and are therefore subject to creditor claims.

If you are in business, we would always recommend full gifting for this reason, which means you won't be eligible for a care subsidy, but that is not your focus when you are in business. The focus of your trust is to keep a roof over your head while you are in business.

Longevity of trusts and proper management

Trusts can exist for up to 125 years in some cases. However, if you have a trust for business reasons, and then retire or cease trading it could be wound up. We often say that a trust is like a Will; it should be reviewed regularly and as life changes, you need to check if it still works for you. Often we have clients who will retire and sell their business. If they don't need the trust for any of the other reasons discussed here, then they may wind up the trust if the cost of maintaining the trust outweighs any perceived benefits which the trust is giving them. This does not take away from the protection it gave them during the years they were in business.

So in summary, trusts are a great way to reduce your personal assets which may otherwise be subject to attack from creditors, provided the assets are put into the trust at the right time and the trust is managed properly. Robust trusts are ones which are regularly maintained and managed.

Relationship property considerations

Property (Relationships) Act 1976 – relationship property vs separate property and 50/50 presumption

The Property (Relationships) Act regulates the status of assets owned by a couple who are married, in a civil union or in a de facto relationship. A de facto relationship is usually one of three or more years duration, though it can be less in certain circumstances. The Act divides assets into two categories: separate property, and relationship property. *Separate property* is deemed to be your own, and is not subject to a claim in the event of death or separation, e.g. an inheritance that is kept totally separate. However, the Act has a presumption of 50/50 division of *relationship property* in the event of a separation. Most assets will, over the course of a relationship, be used for the relationship and therefore deemed to be relationship property.

Trusts created prior to relationships may offer some protection but a constructive trust is still possible

Assets transferred to a trust *before* a relationship may constitute the separate property of one party and will therefore not be subject to the 50/50 presumption in the event of separation or death. This is often great for couples who set up a trust together for the benefit of themselves and their children, one partner later dies and the survivor enters into a new relationship. If the trust was longstanding and established before the new relationship, it could ringfence the trust assets as separate property rather than relationship property, thereby protecting the original couple's assets for the children against the new partner.

Nonetheless, case law has developed over time and has eroded the protection that trusts once provided in a relationship property context. There have been various cases where if the partner who is not party to the trust adds any value to the trust assets, such as painting the house, providing gardening or landscaping services, etc then they have a constructive trust themselves and can look to the trust for compensation. It may not be the full 50/50 but it is a claim nonetheless.

Trusts created after a relationship provide little protection and should be done in conjunction with Contracting Out Agreements

It is important to note that once a relationship has started, if assets are transferred into a trust, such assets could still be clawed back if the effect of that transfer is to defeat the rights of the partner. This is the case even if the assets are transferred early in the relationship before the parties are deemed de facto.

Trusts are therefore no longer a great vehicle for protecting yourself against relationship property claims. While they provide some protection if set up before a relationship, the strongest protection from relationship property claims is to enter into a contracting out agreement with your partner, either instead of or in conjunction with a trust, depending on your other legal needs. Contracting out agreements are known colloquially as 'pre-nups' but they can be done at any time in a relationship and there is no requirement to get married.

So to conclude, a trust can provide some protection from relationship property claims, but the circumstances are now limited and a contracting out agreement should always be considered either in tandem with or in lieu of a trust depending on your individual circumstances.

Protection for vulnerable family members

Factors to consider

Many families have a member who is vulnerable and who would benefit from the implementation of asset protection strategies.

The family member may be a minor child (under the age of 18), have a physical or intellectual disability or a substance addiction, they may be poor money managers or they may be in a relationship which is at risk of breaking down or where there is undue influence from a person seeking to access their assets.

In these circumstances, holding assets in a family trust, managed by properly qualified and independent trustees can offer significant asset protection. The trust is able to pay expenses, or pay an allowance to a vulnerable beneficiary without the beneficiary having access to the capital held in the trust.

How will the trust operate?

It is important that the settlors provide clear instructions to the trustees as to the type and level of support to be provided to the vulnerable beneficiary, particularly when the vulnerable beneficiary is one of several beneficiaries of the trust. Issues to cover include whether the vulnerable beneficiary is to have priority over other beneficiaries, whether capital is to be retained for the use of the vulnerable beneficiary and whether capital can be distributed to other beneficiaries, which may result in reduced income for the vulnerable beneficiary.

This protection is not fool proof as it is possible for all of the beneficiaries, where they are all of age (over 20 years of age) and with full mental capacity to instruct the trustees to wind up the trust. This used to be referred to as the *Rule in Saunder v Vaultier* and has now been codified in section 121 of the Trusts Act 2019. Where a beneficiary lacks capacity, the Court may approve the winding up or variation or resettlement of the trust (section 124 of the Trust Act 2019).

Where the vulnerable beneficiary may object to the trust holding assets for his or her benefit, it is important that they understand why the settlors have put the protections in place and that they are consulted when significant decisions need to be made that affect them. The trustees need to carefully balance the persons interests with undue control by keeping up to date with the vulnerable beneficiary's personal circumstances and adapt to the beneficiary's changing needs.

Maintaining the trust long term – costs vs value of trust fund

Another point to consider is the cost of maintaining a trust long term, taking into consideration the value of the trust assets. Where trust assets are significant, the cost of maintaining the trust is more easily justified but where the value of the trust fund is comparatively small, any income generated may need to be applied to trust administration rather than to the beneficiaries.

Where the settlors are elderly, and there is a need to retain the trust for the benefit of vulnerable beneficiaries, consideration needs to be given to succession planning:

- Who will take over as trustees as the settlors age?
- What processes have been put in place, or need to be put in place to ensure a smooth transition to new trustees when the time comes?
- Are trustees losing mental capacity?
- Should independent professional trustees be appointed or should the trustees be family members, or a combination of the two?
- Are there funds available to pay an independent trustee if the trust deed allows for it?
- How long will the trust operate for? and;
- What happens to the trust assets when the vulnerable beneficiary dies?

Other options available

If you decide that retaining your family trust is not a viable option, but you still want to provide for vulnerable family members there are other options available. These options include testamentary trusts, where a trust is created by Will and does not come into effect until you die, or careful wording of gifts given by will which enable the recipient of the gift to nominate a trust as the beneficiary of the gift rather than receiving the gift personally. This option enables a beneficiary to consider their personal circumstances at the time the gift is made and to meet their own costs for setting up and administering a trust if that is the path they choose to take.

Need to balance persons interest with undue control

While settlors often, with the best of intentions, wish to protect a vulnerable family member or protect funds received by him or her, it is very important to carefully tread the fine line between protecting the vulnerable persons interests and unduly controlling the person's life.

Residential Care Costs

The Ministry of Social Development subsidises the costs of residential care in a hospital or rest home for people who are aged 65 or over and have assets assessed as being at or below the relevant threshold. However, the Ministry's policy is that if a person has the means to pay for their own care, then they should be responsible for doing so. Accordingly, the Ministry is taking a hard line when applications are made for residential care subsidy.

How does a care subsidy work?

If a person is eligible for a Residential Care Subsidy, they must contribute any New Zealand Superannuation or other benefit they receive, less a personal allowance, toward the cost of their care.

Eligibility is determined through a two-stage process:

1. Asset test: First, the Ministry will assess your assets. If you do not pass the asset test, then you will not be able to apply for a subsidy until such time as your assets have reduced to the appropriate level. If you pass the asset test because your assets are below the required limits, then there will then be an income test.

2. Income test: The Ministry will then assess your income to ensure it is below the required limits. How they work this out is different for each type of income. If you are earning income, then the Ministry will work out how much of your income you should contribute towards your care costs, and then they may subsidise the balance.

Gifting limits and over gifting considerations

Until 2011 it was common to establish a trust to minimise exposure to residential care costs.

In 2011 the law around gifting limits was clarified. This clarification said that the allowable limit for gifting in any one year under the Social Security Act is $27,000 per single person and only $27,000 per couple ($13,500.00 each). As a result of the clarification, many settlors had been gifting at twice the allowable limit for residential care purposes prior to the clarification. Any over gifting is added back into the asset assessment for a residential care subsidy, as the clarification was applied retrospectively.

The Ministry of Social development is able to go back to the date the trust was established when undertaking an assessment.

The Ministry of Social Development is also able to consider distributions from a trust when assessing a person's eligibility for a residential care subsidy. Where a trust has made "regular" distributions to a beneficiary, those distributions can be treated as regular income and included in any income assessment. "Regular" distributions can be as infrequently as once a year.

Occupation Rights Agreements and Trusts

Where a trust property is sold and the settlor / beneficiaries decide to purchase a Licence to occupy a villa in a retirement village, it is important that any funds advanced to the beneficiaries are recorded as a loan from the trust as a trust cannot be party to the Licence. If the transaction is not clearly recorded as a loan which is repayable upon the termination of the occupation licence, it is open for the Ministry of Social Development to treat the funds as a distribution from the trust and require that the funds be applied to residential care costs. It is always easier to record a loan at the time the funds are advanced than to retrospectively prove the funds were not a gift.

Will a trust help me get a subsidy?

It is generally accepted that trusts established for the sole purpose of avoiding residential care costs are unlikely to be successful, however we believe that each trust should be assessed on a case by case basis.

Existing trusts may still provide protection

If you are concerned that your trust may not protect against residential care costs, it is worth undertaking a trust review to assess the trusts exposure. If it is found that the trust will not offer the desired level of protection against residential care costs there may be alternative asset protection structures available.

Succession

Long term ownership of family property

A trust can be beneficial in succession planning for many families. A trust allows for property to be held within one entity beyond one generation with flexibility in the use and management of that property.

Without a trust, family properties, such as a bach or a farm would be divided up or sold following the death of the parents. However, if it is owned in a trust, it can continue beyond the parents' death.

It is essential that if you establish a trust for the purpose of holding a specific property over generations, you hold in-depth discussions with your family and consider a bespoke trust deed or surrounding documents that cover off matters such as exclusive use, payment of costs, the ability for family members to cash out, what happens if one person contributes more than another either financially or in maintaining the property, and what happens in the event that the property is damaged.

With respect to a property such as a farm, there are a number of options available to ensure the property is kept together while allowing for other family members to benefit or cash out, and our rural team are experts in this area.

Trusts can be used to grow family wealth

For those of you with more wealth than the average person, trusts can be a great vehicle for growing wealth. This is primarily the purpose of a family trust overseas. If your wealth is retained over a number of generations, that wealth will continue to grow at a greater rate than if it is divided up continuously throughout the generations. Trusts allow for various family members to take part in the management of the trust as trustees, as well as having independent trustees to assist in decision-making.

Trusts can protect individuals from predatory friends or colleagues. For that reason, trusts are often recommended to lotto winners so an independent trustee has to approve the release of funds, and the lotto winner won't feel obliged to help everyone that comes out of the woodwork.

Educating the family is essential for the trust to continue over generations

If you want your trust to continue beyond your death then this needs to be discussed with your children so they do not immediately wind up the trust on your death. Some matters you need to consider include whether your children can work together, and do they have the requisite understanding of trusts to make it work?

Estate claims

Moral obligations under the Family Protection Act 1955

Trusts can be beneficial if you wish to provide more for one or more children over another, or not provide for a child at all.

New Zealand is unique in that the Family Protection Act provides that every person has a moral duty to provide for their dependent children and other family members. The Courts have taken this further and provide that independent adult children still have a right to be recognised for their familial relationships. That means that if you do not provide for your children or certain other family members (not necessarily an equal provision) then that child or family member can make a claim against your Estate.

Testamentary freedom to dispose of assets during Will maker's lifetime

Despite this you do still have some testamentary freedom to dispose of your assets as you see fit, both during your lifetime and on your death.

If you do wish to disinherit certain family members to whom you owe a duty to provide for, one option you have is to set up a trust of which they are not a beneficiary and settle all of your personal assets on that trust. Remember to forgive any debt which might arise from that transfer, then on your death your Estate will have no assets to be claimed against.

The Family Protection Act technically does not have any claw back provisions, therefore any gifts you make in your lifetime cannot be reversed back to your personal estate under this Act.

There has, however, been a recent attempt to attack this in the Courts. In this instance the deceased set up a trust with the intention of disinheriting his daughters. The daughters claimed, and the Court found that in fact the deceased had abused them and therefore he had a greater fiduciary duty to provide for them. The gifts to the trust were deemed invalid.

Although this case is narrow given its set of facts, there is room for further cases to be brought against people who make gifts in their lifetime in an attempt to defeat their moral obligations under the Family Protection Act. In the meantime, we are still setting up trusts for this purpose and they are still serving that purpose.

Possible succession law changes

You might have seen in the news the new succession laws that the government is considering. These will have a massive impact on your testamentary freedom, or your ability to make a claim against an estate. Until that law is finalised, we won't know how that will affect current trust structures, and at that point, if you set up your trust for this purpose, we can review it and decide if it is still necessary.

Trusts still serve a purpose for those that need them. Whether a trust is right for you must be assessed on a case by case basis. If you no longer need your trust then we can consider winding it up. If the trust has any income earning assets or a family bach then you need to discuss the tax implications with your accountant. For example, transferring a property out of a trust may cause the Brightline Test to start again. There will also be costs involved in winding up the trust including potentially new bank documents or guarantees.

If you decide to form a trust or retain your existing trust, then you must ensure you meet your trustee obligations and administer your trust correctly. Otherwise it might not be worth the paper it is written on.

Our Trusts and Estates Experts

We're one of the South Island's largest trusts and estates teams. This means we're experienced in handling even the most complex situations, and guiding you every step of the way.

We approach your needs with compassion and understanding. Talk to us about estate planning, powers of attorney, trusts, Wills and resolving family disputes.

Don't hesitate to reach out to our trusts and estates team, they are happy to assist you with any of your trusts and estates matters.

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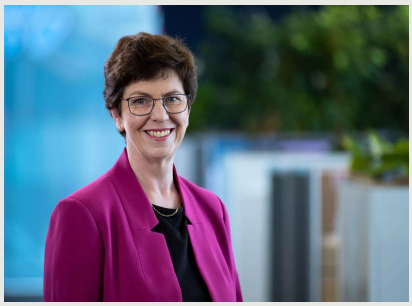

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