



What is a trust?

A family trust is essentially a legal way to protect your assets by having your assets owned by someone else (the trustees) for the benefit of others (the beneficiaries).

A trust has three parties to it:

- A **settlor** is the person or persons who will set up the trust and who puts the initial assets into the trust. Once the trust has been created, the settlor has no further say in the trust, other than holding the power to remove and appoint trustees.
- A **trustee** will run the trust and look after any assets put into the trust. Trustees are required to act in the best interests of the beneficiaries and manage the trust's investments prudently. Most trust deeds generally require there to be at least two persons as trustees and it is quite common for the settlor or settlors to also be trustees. While there is no legal requirement to have an independent trustee, it is generally advisable to have an independent trustee such as a professional advisor (for example, your lawyer or accountant). In this way, they can help you to administer the trust properly and add an air of objectivity to any decisions made by the trustees.
- A **beneficiary** is anyone who may derive a benefit from the trust. Beneficiaries can be defined by name or by a class, such as 'the child or the children of the Settlor'. As a trust cannot provide for a beneficiary unless they are included in the trust deed, defining a class will ensure that any beneficiaries that do not exist at the time the trust is created will still be included. Settlers can also be beneficiaries, which is why it is a good idea to have an independent trustee for objectivity. Often, trust deeds will have a clause that allows beneficiaries to be added or removed at a later date.

Why might I need a trust?

Trusts can be set up for a variety of reasons and these can either be private (e.g. to protect your home) or commercial (e.g. to buy investment property). Some of the benefits of having a trust are:

- Protecting your home and other assets for the future
- Providing for your children or grandchildren's education
- Safeguarding your assets against claims from third parties under legislation such as the Property (Relationships) Act and the Family Protection Act and preventing unwelcome claims on your estate
- Protecting your assets from unexpected business debts
- For tax efficiency and having income owned by a trust rather than by yourself
- Preserving assets for retirement and when you might need aged care
- Preparing for the possibility of estate duty or capital gains being reintroduced
- Ease of supporting your favourite charities
- Confidentiality about your financial affairs

Whatever the reasons you choose to set up a trust, you must be sure of your intention to set up the trust in the first place. It cannot be legally enforced if there is no clear intention to set up a trust, or it is not clear what the trust assets are or who the beneficiaries are.

What do the Trustees do?

It is a very important responsibility that a person takes on when they are the Trustee of a trust and so you must choose carefully who you want your Trustees to be. Subject to the terms of the trust deed, Trustees have duties to:

- Carry out the terms of the trust deed
- Treat all beneficiaries fairly and informing beneficiaries of their rights when they come of age
- Identify trust assets and manage them properly keeping their personal assets and income separate from the trust's assets and income
- Keep proper records of the trust's financial activities
- Act with due diligence and prudence
- Act in good faith and responsibly
- Act impartially and in agreement with the other trustees
- Act in their personal capacity – trustee obligations can't be delegated unless allowed by law or under the terms of the trust deed
- Not profit from the trust unless they are a professional advisor and the terms of the trust deed allow them to charge fees as a professional trustee

All Trustees are equally responsible for any decisions made, so all decisions should be unanimous. As a Trustee can be sued for negligence or fraud, so Trustees should take an active role in managing the trust and not just 'rubber stamp' any decisions made. It is very important that all Trustees are actively involved in any and all of the trust's decisions.

Having an independent trustee helps identify personal assets from trust assets. An independent person who has no personal interest in the outcome of a decision is also more likely to act in the best interests of all of the beneficiaries rather than just a single beneficiary. Trusts are a very effective form of asset protection and need to be properly managed to ensure they cannot be challenged. There are two situations which need to be protected against. – a sham trust or an alter ego trust. A court will undo a trust if it is found to be either a sham trust or an alter ego trust, thereby making the assets of the trust available to third parties.

A sham trust may have the correct form of a trust, but the actions of the parties concerned lack the substance necessary to establish a genuine trust, or the actions of the parties negate the trust. In other words, it is a trust in name only.

An alter ego trust arises when assets are settled on a trust, yet the trustees of the trust are mere puppets doing whatever they are instructed to do, or where trust property is treated as if it were personally owned, instead of belonging to the trust.

The best way to avoid either of these situations arising is for all trustees to be involved in the decision-making process and to take external advice from appropriately qualified parties as required. That includes talking with fellow trustees in the lead up to making a decision, and not presenting them with a fait accompli where they just have to sign a document. While this can slow down the decision making process (and this shouldn't slow things down overly), it will generally mean that a better quality decision is made in the long run.

What goes into a trust?

The sorts of things that go into a trust are generally assets that increase in value over time and one of the primary assets to look at transferring into a family trust is your home, and depending on the value of the home, sooner rather than later.

Any assets transferred into a trust must be done at current market value, and so for a home, a registered valuation of less than six months old will be needed to establish the market value. When the house is transferred into the trust, instead of receiving a cash payment as you would when selling the house to a third party, a deed of acknowledgement of debt is entered into between the settlor (the person who owned the house) and the trustees (the people who now own the house on behalf of the trust).

A deed of acknowledgement of debt shows that the trust now owes the settlor the market value of the home and will include provisions for the debt to be repaid at any time and whether interest will be charged. From that point on, any increase in value will be attributed to the trust, not the settlor. The longer you leave an asset to be transferred, potentially the higher value it will be and this will lengthen the time of your gifting programme.

This debt, now held by the settlor, is then reduced progressively over time by way of a gift to the trustees called a forgiveness of debt. Under current legislation, a gift may be made of up to \$27,000 in any 365 day period without attractive gift duty. If more than \$27,000 is gifted, it attracts gift duty on a graduation scale up to 25% of any gifts totalling more than \$72,000 in any 365 day period. The debt is therefore reduced by \$27,000 per year free of gift duty until such time that the gift has been entirely forgiven.

Disclaimer

Every reasonable effort has been made to ensure the accuracy of the information in this report and to the best of our knowledge, it was accurate at the time of printing. This information is of a general nature only and professional advice should be sought in relation to your specific situation.