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REVIEWING YOUR FAMILY TRUST - WHY DO YOU HAVE ONE?

The website **sorted.org.nz** lists four benefits of a family trust:

- Protect assets against claims, creditors & business failure.
- Set aside money for special reasons, such as a child's education.
- Ensure your children, not their partners, keep their inheritances.
- Avoid unwanted claims on your estate – such as from a former partner.

In our experience clients seldom articulate or record their reasons for setting up a family trust. Here, based on our work across 40 years of legal practice, are the reasons why we meet New Zealanders who still want to hold property in family trusts.

CREDITOR PROTECTION

Trade Creditor Protection: Business and professional people want their family assets protected from potential creditor claims. Their concern may diminish after retirement but the risk does not abate immediately. Instant creditor protection is never available and several years of gifting is required for an effective programme. The Official Assignee in Bankruptcy can set aside prior transactions going back 5 years where the effect has been to reduce the amount available for creditors. Fraudulent transactions to defeat creditors can be set aside any time, and while no fraud may be intended, people who transfer all of their property to trusts risk the fraud allegation.

Creditor protection is often also important in relation to children. Trust property may pass to children for their use, while staying in "trust solution". In this way, and with careful administration, the property will not become available to your child's unproven partner or creditors.

SPECIAL PURPOSES

Trusts have always been used to provide for future generations and vulnerable family members. Wills often pass income to the surviving spouse or partner and capital later for the children. A special purpose trust may provide for a child or grandchild's education, or for a person with a disability. A discretionary trust may mean that there is a nest-egg available for housing or other need that can be lawfully administered without a beneficiary losing other entitlements. Special purpose trusts can also be used to benefit one branch of a family, separating property specially marked for eventual transfer to particular people. The existence of such a trust may leave the settlor free to make a simple will leaving residue to spouse and children of two families, or to include stepchildren from a later marriage.

RELATIONSHIP PROPERTY PROTECTION

In our opinion the cultural change in property ownership and entitlement engendered since 2001 by the Property (Relationships) Act 1976 is now the foremost reason for the settlement of family trusts in New Zealand. Masquerading as an amendment of 1976 matrimonial property law, this Act made the application of equal sharing principles available to de facto and same-sex couples alike. It also extended the rules past the death of a partner, so the survivor now must elect to take either what is available through normal estate administration, or half the combined property.

Using a trust for relationship property protection may involve two generations:

Relationship Property Protection (settlor generation) : People use trusts for protection against future claims, arising out of their own possible future relationships. This applies to presently single people as well as those in relationships. There may be no current claimants but the protection is against future partners of the survivor. We occasionally receive instructions to protect assets from a present or intended spouse. This must be done in conjunction with a pre-nup section 21 contracting-out agreement completed in total co-operation with the spouse.

Relationship Property Protection (your children's generation) This is nearly always a material consideration. With a trust, used with care, the benefits that pass to children may stay in "trust solution" and remain separate from in-law claims. Clients should understand that property claims by relatives are regarded sympathetically by the courts, especially where the claimant has fewer resources or income than the controller of the property. Bear this in mind as you read our paper *Relationship & Kindred Challenges to Family Trust Property*.

THE SUNSET YEARS - BENEFIT ENTITLEMENT

A common reason for placing assets in a trust was to preserve the settlor's entitlement to State support – most particularly the residential care subsidy for the elderly. This is less likely to prompt a trust settlement today than formerly when New Zealand residents in rest homes were systematically stripped of their assets. It remains a factor in certain circumstances however, and must be associated with careful and moderate transactions in each particular year.

It is widely believed that the residential care subsidy will only be declined if applicants have divested themselves of assets in the five years immediately preceding their application for state support. This is not correct. The law does not impose a time limit on the asset and means test and the State is entitled to investigate an applicant's affairs far earlier than the five year period preceding the application. Scrutiny is intense now and will intensify in the future as an aging population compels the State to arm itself with even more draconian powers of investigation and disallowance.

However trust set up to preserve a person's entitlement to state support may succeed for some people under present policies. The result will depend on policy current at the time, the amount of property owned, the history of gifts made by all applicants, and careful documentation.

THE TAX EFFECT

The ability to spread income is a natural incident of a discretionary trust, and in some cases may have the effect of attracting tax at lower rates. Income can no longer be easily allocated with this effect to minor beneficiaries. Trusts also operated to avoid estate duty (abolished 1993).

Some people perceive a need to **hedge against a future capital gains tax**. Without knowing the outline of such a tax, it is not possible to structure one's affairs to avoid its future its impact.

It is possible that a family trust may provide a **hedge against future inheritance-type tax** imposed at the moment of death**.** A trust is likely to be effective in preventing the impact of an inheritance tax on property passing to another person on the death of the property owner. New Zealand family trusts are certainly intended to hold property to ensure that the death of the former family owner is not a trigger for any taxation effect, and the death will not capriciously establish or date any acquisition, or disposition event.

DELEGATION OF MANAGEMENT

A trust may be set up against the possibility that the settlor may in future experience a loss of capacity. The trust deed can usefully assist in defining investment policy and who is intended to benefit. Whether or not funds are professionally managed a trust is potentially useful in these circumstances. Even where an enduring attorney is appointed, the loss of mental capacity reduces the ability to provide significant gratuitous special assistance or gifts, but the terms of a trust instrument would normally allow such assistance to continue.

WHAT SHOULD YOU DO?

You should consider whether any of the above considerations apply to your family and whether the trust you may already have effectively safeguards your family property. We suggest you read our other papers as well. New Zealanders have used trusts for years preserve cultural and family obligations in respect of their property. The law of the land is not always in synch with such objectives, and it is true that some have taken the road of property protection too far, forcing the recognition of beneficiary and claimant rights. If you would like more information on anything here, or if you think that your present family trust may no longer be set up to achieve what you want, please call us.

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