**TRUSTS**

A trust is a separate entity for legal and tax purposes, and is established by a trust deed. The trust deed is similar in principle, to a company constitution.

The Trust Deed outlines who the trustees and the beneficiaries are, the name of the trust, how long the trust will operate, how the trust property will be invested, and the rules that are to apply to the trust.

The Deed also normally has a clause giving someone the power to appoint new trustees. (Because over time, trustees may retire or die).

A discretionary trust is one in which trustees have the power, (discretion), to pick and choose among many beneficiaries, each time they make a decision to distribute money or property from the trust property. The beneficiaries only have a right to be considered in respect of any such distribution.

A trust comprises four components;

* ***The Settlor***.

A settlor must be appointed, who is effectively the person settling the trust and who decides what goes in the trust deed. The settlor appoints trustees, (usually a minimum of 2), to hold the trust fund on behalf of beneficiaries.

The settlor establishes the trust by transferring property to it.

* ***The Trust Property***. This is the property owned by the trust. It can take any form whether land, cash, shares, vehicles, or any other form of property whose ownership can be transferred.
* ***The Trustees***. The persons who hold and control the trust property. Legal title to all trust property is in the trustees’ names.

The trustees appointed are responsible for the carrying out of the business activities of the trust. In a family trust, these are normally the husband and wife, children, spouses, and others at the trustee’s discretion. (Power of appointment of trustees is usually given jointly to the husband and wife, in a family trust situation).

It is recommended that an independent trustee should also be appointed, e.g. a lawyer or accountant. Without an independent trustee, there is a greater risk of the trust being defeated in a challenge by a creditor or by the Inland Revenue, as being a sham. The choosing of an independent trustee should be carefully considered, taking into account the possible future need to remove that trustee. If a friend is appointed, this could create conflict and unnecessary bad feeling. The trustees control the assets of the trust, and determine which beneficiaries benefit from the trust.

* ***The Beneficiaries***. These are the persons for whose benefit the trust is established by the settlor and managed by the trustee. The beneficiaries have certain rights in relation to the trust and trustees. These include:
* the right to have his / her interest protected by the courts
* the right to be considered as a potential beneficiary
* the right to take and enjoy whatever part of the income of the trust the trustees choose to give him/her
* the right to have the trust property properly managed and to have the trustees account for their management of the trust.

The beneficiaries can be anyone you wish; normally yourself, your spouse, children, and any such people or organisation you choose.

Most family trusts are discretionary, with the trustees determining who receives income and capital.

With a discretionary trust, an individual may be named as a beneficiary, or come under a class of beneficiaries. Unless the trustees exercise their discretion in that individual’s favour, the individual will not have any claim to any of the assets of the trust. (Generally the class of discretionary beneficiaries should be kept fairly broad).

Income from the trust can remain as trustee’s income, or be allocated to beneficiaries for taxation purposes.

A trust is usually settled with capacity to run for up to a maximum term of 80 yrs. If the term is shortened to less than 7 yrs, tax implications may arise where any tax benefits have been gained through the use of the trust.

**How do Trusts Acquire Assets*?***

An outright gift of an individual’s assets to a trust was not possible without incurring gift duty. Until Oct 2011 Gift Duty was a tax payable on gifts made by a person exceeding $27,000 in any 12-month period. While $27,000 can be gifted duty free in any 12-month period, any excess is taxable at rates ranging from 5% to 25%. Higher amounts can be gifted but duties will be payable at the given rates. Gift duty has now been removed.

1. *Sale of Assets with debt back*

The most common method of transferring a settlor’s assets to a trust, is for the trust to purchase the assets, with a debt equivalent to the purchase price left owing to the settlor. This debt is in the form of a loan by the settlor to the trust and is documented in a “Deed of Acknowledgement of Debt”.

The loan is recorded as:

* Repayable on demand; and
* With interest payable at the current prevailing market rate but only if demanded by a specified annual date. If no demand for interest is made by the specified date, the interest liability for that interest period lapses.

1. *Advantages of a loan*

Another advantage of selling assets to a trust with a loan back is the flexibility it creates for the lender (i.e. the settlor). The loan can be repaid in instalments, which are not taxable. These instalments can be regular or random depending on the wishes of the lender. The lender could require that interest be paid if and when needed by the lender. These options ensure that the settlor has some control over the operation of the trust, he or she has set up.

1. *Forgiveness of debt*

In family trust situations the debt can be progressively written off by the implementation of a gifting programme.

Periodically a gift can be made by the settlor to the trust, by the completion of an annual “Deed of Forgiveness of Debt”.

Changes have been made to sections 2(2) and 61 of the Estate and Gift Duties Act so that gifts made on or after 1 October 2011 are no longer liable for gift duty and you no longer need to file any documents with IRD. The donor or agent remains responsible for keeping and maintaining records of the amount of debt that has been forgiven.

# Taxation of Trusts

Qualifying Trusts are trusts that are based in New Zealand for taxation purposes because the trustees are New Zealand residents and they pay New Zealand income tax on trustee income.

The typical New Zealand family trust, of the type we have discussed previously, is usually classified as a Qualifying Trust.

All the income of a trust is taxable. For taxation purposes a trust’s income is classified as **Trustee Income**, **Beneficiary Income** or a **Taxable Distribution**. This classification determines at what rate tax is payable.

* Trustee Income is any income of the trust that is derived by the trustees and not distributed to beneficiaries within the income year or within 6 months from the end of that income year. Trustee Income for all trusts is taxed at a flat rate of 33%. The great benefit of Trustee Income is that once tax of 33% has been paid on it, it can later be paid to the beneficiaries tax free. Beneficiary Income is any income of the trust which is distributed to a beneficiary in an income year, or is paid or used by the trustee to or for the benefit of the beneficiary during the income year or within 6 months after the end of the income year. In other words, Beneficiary Income is all income that is not retained in the Trust as Trustee Income.

Beneficiary income is taxed at the beneficiary’s personal tax rate. If a beneficiary’s personal tax rate is 21%, then an income tax saving would be achieved if trust income was distributed as Beneficiary Income rather than as Trustee Income.

The trustees (i.e. the trust) pay tax on Beneficiary Income, on behalf of the beneficiary.

# Advantages of Trusts

* Taxation*.* Trusts are perhaps the most effective of estate planning tools, due to their flexibility and the nature of their taxation treatment. Trustees income is taxed at a flat rate of 33%. Income allocated to beneficiaries is generally included in their individual tax returns, and taxed at the individuals own rate.
* The setting up of a discretionary family trust and the subsequent transfer of assets to that trust through an on-going gifting program, can assist the individual to meet the objectives of estate planning.

Protection of assets from Government policies such as; rest home subsidies, death duties, superannuation surcharges, etc., can be effectively achieved. Asset ownership can be transferred from an individual’s own right into a family trust.

* Protecting your assets against matrimonial property claims, including that of a future spouse or partner, and also the interests of your children against claims by their spouses. (Trust assets do not form part of an individual personal matrimonial property).
* Trusts are widely used in conjunction with Wills, as this allows more flexibility in the protection of assets upon death.
* Special arrangements can be put into place for second marriages and stepchildren.
* If death duties, or some form of capital gains tax is introduced in the future, a trust is likely to offer some protection.

# Disadvantages of Trusts

* Setting up costs. Extra compliance costs and time.
* A trust is similar to a company. After the formation of a trust there will be ongoing maintenance required, i.e. Regular meetings of trustees to oversee the ongoing management of the trust property; the keeping of detailed minutes, records, and accounts; separate tax returns for the trust and for infant beneficiaries of the trust.
* Increased accountancy fees. (Financial accounts and extra taxation work).
* The winding up of a Trust should be done with expert legal advice to avoid undesirable taxation consequences.
* Assets transferred into a Family Trust no longer form part of any matrimonial property agreement.
* Livestock valuation scheme options may be limited.
* Often difficult to understand.
* Possible loss of some control (Not so much in family trust as trustees own the assets.). Family Trusts have recently gained in popularity, and are mainly used for asset ownership and protection, rather than for business trading. Farm ownership by trusts is common, but sharemilkers or contract milkers should be careful in the way they use trusts.

The majority of farming trusts are passive investors where the trust owns the farm and maybe the herd; the assets are leased back to the farmers who conduct the farming business. The main reason for this is creditor protection as the business operation and risk is still undertaken by the farmers but the assets are not owned by them.

In some cases, trusts are used as the trading entity. However, it is critical that the trust deed is drafted carefully if it is to be used for trading because of the risk of personal liability for the trustees. (It is usual to have a trustee company with no assets as the trustee to minimise this risk.)

Alternatively, the family trust may be used to hold shares in a company which owns the assets and trades as the farmer, rather than the farmer personally. The advantages of the flexibility of the company are then available in conjunction with the trust.

**Types of trust**

The two most common types of discretionary family trust are;

* Joint
* Parallel

A **joint family trust** is where both partners settle their assets into one trust. They both become trustees usually with another independent. Both partners hold the power of appointment and are preferred beneficiaries. The beneficiaries are:

* The couple
* Their children
* Their grandchildren
* Trusts for any other of the above
* Others if named.

A **modern parallel trust** is where each settles a separate trust.

Her trust

Settlor - Her

Trustees - Her and possibly him

- plus independent person

Power of appointment - Her

Preferred beneficiaries - Her

- him

- their children

- their grandchildren

- others named by her

- trusts for the benefit of the above.

His trust

Settlor - him

Trustees - him and possibly her

- plus independent person

Power of appointment - Him

Preferred beneficiaries - Him

- her

- children

- grandchildren

- etc.

There are clear advantages of having two trusts, particularly after one of the parties dies or in the event of separation.