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**ASSET PLANNING:  
SOME BACKGROUND READING**

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**MBP**

**MACKINTOSH BRADLEY & PRICE**

**Barristers & Solicitors**

5th Floor, State Insurance Building  
88 Division Street  
PO Box 8364, Riccarton  
**CHRISTCHURCH**

**Ph: (03) 3435-880 Fax: (03) 3435-888**

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## INTRODUCTION

### **This booklet**

If you are reading this it is likely that you are considering your assets with a view to managing them in the way that best meets the needs of yourself and your extended family. You will want to know what your options are, and what impact your choices will have on the way you use and enjoy your assets in the future.

This booklet is intended to provide some brief background reading on the subject of asset planning. To do full justice to the whole topic of asset planning would require volumes of detailed academic writing since "asset planning" actually encompasses the subjects of property ownership, contract, trusts and wills, matrimonial and defacto property, taxation, and insolvency law, to name just a few.

Our purpose now is just to provide you with an overview of the factors that you might consider, of possible options that you may have, and of the likely impact of choices you may make, so that you have a framework of understanding within which to think about your own situation, to discuss it with us and to consider any advice that we may give you.

### **Other reading**

As well as academic texts, there are books generally available which go into more depth and which are designed for lay persons. You may care to read one or more of those as well. However, in our view, each person's situation is so individual, and there are so many varying factors to take into account, that a booklet such as this or even a fuller published book cannot take our own place as your legal adviser in helping you to review your situation and then in assisting you to make the most appropriate decision for you. No written material can possibly hope to cover all possible factors and situations that may arise, so please, in reading this booklet do remember that it is intended to be only a brief and very generalised overview – it is not designed to constitute advice to you on the decisions you should be making .

### **Our approach to costing**

If you pass this booklet on to friends or other family members please mention that we are happy to spend half an hour or so with clients, or potential clients, to discuss these topics in a general way on the basis that if they don't proceed further there will no charge but that if they do decide to proceed the work should come to us. In saying that, we should also make the point that in assisting you to make decisions in this area we are careful not to be influenced by the work that might be generated for us but rather by what is in your own best interests. We prefer to take the long term view that confident and satisfied clients are a better investment than a quick return on unnecessary work.

In terms of dollar cost, we charge generally on the basis of time actually spent on a transaction with adjustments for urgency or unusual risk factors. We will attempt to give you an estimate of likely costs either at the beginning of a transaction or as further decisions are taken, but in this area these can only be estimates as we cannot always foresee what decisions will be made along the way, what further information may be given to us that will alter those decisions, and thus just what will be involved in any transaction before it is finally complete.

## OBJECTIVES

Before making asset planning decisions it is important to determine which (if any) of the objectives listed below you are trying to achieve as this may affect the choices you make and the methods and speed with which you choose to implement those choices. You may also have other objectives not listed, and those should be noted and discussed with us in due course.

- *To provide financial security for yourself and your family*  
This includes the maximising of income and saving for retirement as well as the minimisation of losses which can of course result from any current or previous business activity.
- *To provide for your children's and grandchildren's education*  
Bearing in mind the increasing cost of education you may well be called upon or wish to assist with your grandchildren's as well as your children's education expenses. For people without dependants this may apply instead to nieces and nephews or the children of friends.
- *To provide for succession of assets to your family or friends*  
Subject to the primary responsibility to look after yourself, you may like to think that you would ultimately have something left over to leave to your children, other family, friends or charity.
- *To provide for any special needs of members of your family*  
If any member of your family has special needs it may be appropriate to establish a trust to hold and manage that person's share in your estate, rather than leave it to them outright.
- *To ensure that assets built up by your current relationship will go to the children of that relationship rather than to a second partner*  
By putting assets into a trust you are of course preventing them being left by the survivor of you (assuming you are a couple) to any second partner, rather than to your own children. For the survivor, you are also avoiding the possibility of embarrassment or disagreement with a second partner of having to ask for a pre-nuptial or de facto property agreement.
- *To protect family assets from claims by your children's partners*  
Leaving the family bach (or other important family asset) outright to your children can make it vulnerable in the event of a relationship break-up between your child and his or her significant other. We do not say "spouse" here because of course de facto partners may have a good claim on family assets.
- *To endeavour to ensure that assets are not available to creditors*  
As New Zealand becomes an increasingly litigious society everyone, and more particularly those who are or have been in business for themselves, are subject to possible claims from creditors. If your assets are held in trust then they are almost certainly not available to creditors unless you face insolvency within 2 years of transferring the assets or if you transferred them with intent to defraud creditors.

- *To attempt to avoid (not evade!) future estate duties or capital gains tax or capital transfer tax*  
While there are currently no estate duties, capital taxes are of course mooted from time to time by our politicians and are therefore a possibility.
- *To avoid claims on your estate*  
The Family Protection Act allows claims from family or dependent others who feel they have not been adequately provided for, while the Law Reform (Testamentary Promises) Act allows claims from those who believe they were promised that provision would be made for them in a will and did work for the deceased relying on that promise. Both Acts can only apply to assets forming part of the estate of a deceased person so assets given away during the deceased's lifetime are not subject to a claim under these Acts.  
  
Moreover, a testamentary capacity challenge to a will has no affect on prior gifts to a trust made during full capacity. Such gifts made at an early stage which have stood for some years are also far less open to other legal challenges, such as undue influence.
- *To obtain government assistance as soon as possible*  
While this is not acceptable to the applicable authorities as a primary reason for reorganising asset holdings it is perfectly permissible for this to occur as a consequence of actions which are being taken for other more important reasons.
- *To obtain taxation advantages*  
Similarly, so long as reducing the incidence of income and other taxes is merely incidental to the primary objectives of asset planning it can be an acceptable result as far as the IRD is concerned.

## **FACTORS TO CONSIDER**

### **Attitude to Risk**

In considering your objectives one issue that has to be considered is your attitude to risk. We each individually have a different attitude to the risks which could eat into our capital investments. At one end of the spectrum there will be people who take the view that in the New Zealand environment the chance of capital duties or taxes being introduced are unlikely or that the chances of business or other losses being made are slim; and that keeping things simple and having control of their own assets is of major importance. On the other hand there will be some people who are so fearful of capital taxes or losses that they would take active steps to reduce the assets in their own names to virtually nothing.

Many people fall between these two extremes and feel most comfortable in contemplating a middle course, of putting some assets (such as their house) into a trust or other protective structure but retaining their other assets in their own name so that those assets are not under the control of the trustees.

### **Speed of action**

If you decide to start transferring assets out of your own name into a trust or other protective structure the question arises as to how quickly that is to be done. In considering that issue there are some points to take into account:

- New Zealand must be virtually alone as a jurisdiction which has no capital gains or capital transfer taxes.
- New Zealand is becoming a more litigious society.
- Assets cannot be transferred to defraud your creditors.
- Your age or state of health are factors which may encourage some speeding up of the process.
- That where a claim lies in tort - (eg negligence) rather than contract the time limit for bringing any action is six years following the discovery of the act or omission complained of. That does mean that even in retirement you could have a claim made against you for an act or omission during your working life. This is a matter that is particularly applicable to professional advisers.

### **Gift Duty**

One is able to gift a total of \$27,000 per 12 months per person making the gift without incurring gift duty. Thereafter duty is charged at the rate of 5% on the next \$9,000 (from \$27,000 to \$36,000), 10% on the next \$18,000 (up to \$54,000), 20% on the next 18,000 (up to \$72,000) and 25% over that. Incidentally the 12 month period is not a calendar year or a tax year but any 12 month period.

If a quick gifting programme is required for any reason it is common to elect to gift up to \$36,000 per annum and pay the 5% gift duty which amounts to \$450 on the full extra \$9,000. For a couple this means an extra \$18,000 per annum at a cost of \$900, which is often considered worth while.

Other methods are also available to speed up gifting programmes depending on the final asset owning structure that is chosen. Those are discussed later in this booklet.

## WHAT IS POSSIBLE? THE ASSET PLANNER'S 'TOOLKIT'

Having identified your objectives and priorities we have the technical role of putting together a course of action to achieve them. There are number of "tools" which can be used.

### **Ownership**

Assets may be owned:

- in the name of a single individual, or
- jointly by two or more people (technically called a "joint tenancy\*") - where the survivor takes automatically rather than under the deceased's will, or
- in specified shares by two or more people (technically called a "tenancy\* in common" and which can be in equal or unequal shares) - where the assets get distributed according to the provisions of the deceased's will, or
- as a Joint Family Home - which is a particular type of joint tenancy\* of the family home, available only to married couples, which protects part of the equity in the home (\$103,000 as at May 2004) from creditors in certain circumstances.

*\*"Tenancy" here does not imply a lease.*

### **Relationship Property Agreements**

A relationship property agreement can be completed between married couples, de facto couples (within the meaning of the Property (Relationships) Act 1976), or people contemplating entering into such a relationship. A transfer of assets by way of a relationship property agreement is not subject to gift duty so long as the transfer does not result in more than 50% of the assets which are legally classed as relationship property being owned by the person receiving the property. This can be used to equalise asset ownership between the parties or to transfer, for example, the professional practice to the professional and the house to their partner.

### **Non-Relationship Property Agreements**

Some people buy property together without necessarily contemplating that they will ever marry or be in a de facto relationship. In that event they may enter into a type of property agreement which is similar to but not exactly the same as a relationship property agreement. While these don't have the gift duty benefits of a relationship property agreement they can be used to achieve certainty of outcome in several circumstances, for example, on the death of one of the parties or dissolution of the relationship. They might also be used to provide a right of first refusal for the other in case either party wishes to sell.

## Trusts

A trust is an obligation placed on *trustees* to hold assets donated by a *settlor* for the benefit of the *beneficiaries*.

### *Settlor:*

Any person who has legal capacity can be a settlor. The person who originally establishes the trust is generally named as settlor in the trust document, but any person who subsequently gives assets to a trust will be deemed also to be a settlor for tax and some other purposes.

### *Trustees:*

Any person who has legal capacity can be a trustee. You may appoint one or more trustees. In a standard family trust it is normal to have at least two trustees. Trustees must act unanimously unless the trust document provides otherwise.

It is possible for a husband and wife to be the trustees of their own family trust, to be settlors of that trust and to be beneficiaries under it. However, all three categories must not be completely identical and accordingly, in such a case, there must also be other beneficiaries or another trustee or the trust would be invalid.

In practice we would normally recommend that there should be a third independent trustee who could be a close friend or a professional adviser. Reasons for suggesting this are that it provides an independent view on matters relating to the trust's administration and may provide benefits from a tax point of view in ensuring that the settlors of the trust have not retained absolute control of the trust assets themselves. Retention of absolute control can also lead to the court treating the trust as a sham and therefore unenforceable.

A trust documents may provide for the appointment or removal of trustees by the settlors or other named person at times in the future but this must be carefully considered in case it amounts to retaining too much control over the trust.

### *Beneficiaries:*

Any person may be a beneficiary, and the class of beneficiaries may of course include one or more charities. It is possible for a trust document to provide for the addition or removal of beneficiaries at times in the future.

Under the Perpetuities Act 1964, the trust property must ultimately vest in the beneficiaries within 80 years, and it follows that the beneficiaries cannot be too distant.

It is not uncommon to name one set of beneficiaries who receive the income (such as parents and children), and a different set of beneficiaries who ultimately receive the capital (such as children and grandchildren).

### *Sham Trusts & Invalid Trusts:*

Although we have already made these points we want to stress two important factors about trusts:

- *There does have to be some difference between the settlor, the trustees and the beneficiaries.* They cannot all be exactly the same person or persons, otherwise there is actually no trust at all, whatever the documents may say on the face of them.

Because anyone who gives to a trust after its creation becomes a settlor of that trust it is not possible to define the settlor with the same accuracy as the trustees and

beneficiaries. To avoid this problem it is therefore normal to add another trustee since adding another beneficiary of course means giving that person something they would not otherwise have received.

- *The settlors cannot retain absolute control of the trust assets.* They do need to view and treat the assets as belonging to the trust rather than themselves so as to avoid the trust being seen by the courts and IRD as a sham. This means that:
  - they need to consider the interests of the final beneficiaries in the trust property. That may include themselves but is also likely to include other people such as their children and grandchildren.
  - The trust needs to be run with proper accounting and tax records kept and decisions recorded in a formal and organised way. In a complex trust that may require the services of a chartered accountant, but for a simple trust it may be possible for the trustees to do it themselves if they are willing to be disciplined about doing it properly.

#### *Discretionary Trusts:*

A discretionary trust gives the trustees the power to distribute either the income or the capital, or both, at the discretion of the trustees rather than according to fixed provisions in the trust deed. While a discretionary trust is obviously flexible, and that can have its advantages, it does place something of a burden on the trustees who, in exercising their discretion, may have to choose between various beneficiaries.

#### *Income Tax*

The trust's income is taxed in the hands of the trustees at 33 cents in the dollar. Income distributed to a beneficiary during a tax year, or within 6 months after the end of the tax year, is taxed at that beneficiary's marginal tax rates (unless s/he is "a minor", that is for these purposes, under the age of 17 years, when special rules apply - which generally mean such income is taxed at 33 cents in the dollar).

#### *Powers and obligations of trustees*

Powers and obligations of trustees are set out partly in the trust deed and partly in statute and case law. For example, the Trustee Act provides that in exercising their powers of investment the trustees must follow the 'prudent person rule', but the trust deed can exclude or amend that requirement.

The Trustee Act sets out a number of matters to which trustees should have regard in exercising their powers of investment. These are set out in the later chapter of this booklet dealing with the duties and responsibilities of trustees.

### **Trading Trusts**

A trading trust is set up to own and/or operate a trading or business activity rather than to somewhat passively hold assets as many family trusts do. A trading trust has a settlor, trustees and beneficiaries as do other trusts and must obey the same laws of trusts and taxation as family and other trusts. However, trading trusts are subject to the same risks as other business entities. It can be unwise therefore to attempt to use a single trust both to hold important family assets as well as to operate the family business. It is common practice for a trading trust to have a single corporate (company) trustee.

A trading trust is often used to spread income or to get assets out of the name of the original settlors and in other situations where a company would be inappropriate.

### **Companies**

A company structure may be used where a fragmented form of ownership is required (among several people, especially if the shares are not equal), or where there is likely to be a pattern of ownership change. The transfer of company shares can be an easier and often cheaper process than other forms of transferring assets, especially where the ownership is of odd fractions. The 'loss attributing qualifying companies' tax regime (LAQC) also provides some asset planning opportunities.

When using a company structure to own family business assets it is important to bear in mind the increased liabilities that being a director these days may attract. It may be better for the family as a whole if only one member is appointed a director so that the other(s) can hold other assets in their own name(s) safe from claims against any who are company directors.

### **Partnerships**

These are sometimes required for tax purposes but are not frequently used in general asset planning. What can be achieved by way of the partnership agreement can usually also be achieved by way of a relationship property agreement or non-relationship property agreement.

### **Transferring Assets**

#### *Sale agreements:*

Rather than have a person gift a house or other asset to a trust (or other person) it is desirable for the trust or other recipient instead to purchase the asset from the owner at market value with the purchase price left owing interest free and repayable upon demand. That then allows the owner to forgive the debt year by year and take advantage of the present gift duty exemption of \$27,000 per annum. Otherwise gift duty would be payable on the whole asset at once at the levels listed previously (including 25% on any amount over \$72,000).

#### *Marshall clauses:*

More often than not we actually provide these days that the debt is left owing on "Marshall clause" terms rather than simply interest free and repayable on demand. This means that the loan is for a fixed term and that interest can be charged each year if desired by the lender but if not desired it can be waived without any tax or gift duty implication. This gives greater flexibility to lenders who may not want to commit themselves to a no interest loan for years into the future and it also gives the trust or other recipient more certainty because such loans are generally for a certain length of time (usually between 7 and 20 years) rather than repayable on demand.

#### *Capital gains and delayed transfers:*

There can be some benefit in transferring an asset immediately even if you are not ready to commence a gifting programme because by transferring ownership future capital gain is captured in the trust or other recipient. This is particularly important in times of high inflation because the difference in the level of gifting eventually required can be quite enormous if the transfer is left for even a year or two. For example, a house with a current market value of \$250,000 can be transferred at that price now with the debt then fixed at \$250,000, and if the

value increases to \$400,000 in two years time the debt is still only \$250,000 and the gifting programme which is started then only needs to deal with that level of debt. If however, the transfer is left for the two years until you were able to start the gifting programme the house would have to be transferred at its new value of \$400,000 and the gifting programme would have to go on for that much longer and be that much more expensive to complete.

### **Gifting programmes**

A gifting programme is generally set up so that a gift of \$27,000 is made every 366 days (1 year and 1 day, but not a calendar or tax year) until such time as the debt has been fully written off. For a married couple that is \$54,000 every 12 months.

It is rare of course for a programme to run so exactly to specifications and we generally find that while the level of gifting is kept to \$27,000 / \$54,000 the timing runs a little longer so that there may be 13 or 14 months between gifts rather than the 12 months and one day that is the minimum requirement. However, it is usually important in achieving the objectives stated when an asset planning exercise is started to try and keep delays to a minimum. We do endeavour to remind you each year just before a gift is due but of course the responsibility does ultimately lie with you to ensure that it is completed.

It is possible to stop a gifting programme at any time. If you decide now to transfer your home to a trust and you do so, thereby creating the debt which has to be progressively written off year by year, and if you at the same time complete the first gift, then next year when the time rolls around for the second gift you may decide that you don't want to reduce the debt any further (e.g. you might want to retain the right to call for money from the trust by way of repayment of your debt so that the trustees cannot refuse or do not have to make a distribution from the trust). In that case you simply don't complete the second gift. Then in a few years you may decide to pick the programme up again and to carry on where you left off.

Generally you would amend your will to ensure that if you die during the course of a gifting programme it is completed under your will after your death. In that case there is no gift duty payable no matter how much is gifted.

We also refer you to the earlier chapter in this booklet entitled "Factors to Consider" for further information on the rates of gift duty and possibilities for speeding up gifting programmes.

### **Lease for Life**

If it is particularly important for some reason to speed up the gifting programme as it relates to a home (or sometimes other real estate) it is possible to create a 'lease for life'. This is a lease back to the owner which provides that s/he can remain in the property at a peppercorn rental (a nominal sum) for the remainder of his/her life. That obviously reduces the market value of the property because who would want to buy a property subject to such a lease? In fact the IRD accepts a reduction in market value of the property calculated in accordance with the schedules in the Estate and Gift Duties Act which are based on the life expectancy of the youngest of the life tenants. A forty year old would achieve a reduction of over half the value of the property; someone in their mid to late sixties over a quarter.

Although at first glance leases for life appear to be a good idea, they do have their fish-hooks. They can be difficult to register at the Land Transfer Office, especially over cross lease or ownership flat titles, they may have an adverse effect in the advent of the re-introduction of estate duty (as a reservation of an interest) unless true market rent is paid, and there is some argument that they do have residual value themselves, even if they are strictly personal to the tenant who is therefore unable to transfer them or rent them out to obtain an income. Accordingly, although we do use them where a speeding up of the gifting process warrants the acceptance of these "risks" we also avoid them if possible.

## **Wills**

There are basically two types of will:

- One where all assets are left outright to named beneficiaries, and
- Another where a 'life interest' in the assets is left to a named person with a provision that after that person's death the assets go outright to other named beneficiaries. Having a 'life interest' means either that you get the income from the assets or that you are able to use them (eg live in a house) for the rest of your life or until a certain event occurs (eg you remarry).

Some wills are a combination of the two, perhaps leaving the house subject to a life interest and specific items or the residue of the estate (all investments, chattels etc) outright to either the life tenant or other people.

This 'combination' type of will is often used where a couple may not want the expense and complexity of a trust but would still like to achieve at least some or part of the objectives which a trust would obtain for them in full. They may, for example, split the ownership of their home so that they own it as tenants in common in equal shares (half each rather than jointly) and then leave each other just a life interest in their half. The survivor then ends up owning only half the house with only the right to continue using the other half without ownership of it, and in that way if they need, say, a rest home subsidy only half the house is available to be taken before the subsidy kicks in.

## **Intestacy**

It is of course an option for you to choose deliberately not to have a will. If you die intestate then your estate is distributed in accordance with the Administration Act 1969. This may not be in accordance with what you would expect, for example, if you have children then your spouse takes only the first \$120,000 (currently) of your estate plus a further 1/3<sup>rd</sup> while your children get the other 2/3rds. That may seem generous now (or not) but the property boom of 2003, when real estate went up in some areas by over 20% in one year, shows how easily you assets can outstrip the protection given to spouses by the Administration Act provisions.

If you have no spouse or children or grandchildren who survive you then your estate is distributed amongst more distant relatives in equal shares per class (e.g. all nieces and nephews would get the same amount). So on an intestacy you have no ability to benefit certain people ahead of other because of their need or to reward assistance they have provided you during your lifetime.

You can be intestate as to only part of your estate by omitting mention of that asset or class of assets in your will. In that case the Administration Act applies only to that part of your estate.

**Enduring Powers of Attorney**

In the same way that you appoint executors in your will to look after your assets when you die, it makes sense to grant an 'enduring power of attorney' to someone to look after your affairs if you become incapacitated through a stroke or suffer a car accident or the like. An enduring power of attorney in respect of property allows you to do this, while an enduring power of attorney in respect of personal care and welfare allows you to appoint someone to make medical decisions for you if you are mentally incapable of making them for yourself.

We consider that having enduring powers of attorney in place is a "basic legal health" issue and should be completed by everyone, from youngsters of 18 years right on through. Like insurance, it is too late to arrange it once you need it, and the alternative, an application to the court for a welfare guardian or property manager's appointment, is thousands of dollars more expensive and time consuming. It also involves annual reporting to the court and Public Trust (with annual fee) and a need to renew the appointment at regular intervals.

**Financial Planning**

Financial planning is a modern process covering retirement planning, investment management, as well as asset planning and risk management. Each impinges on the other. We would encourage all our clients to seriously consider an holistic approach to their financial planning and would be happy to discuss the whole topic with you in greater depth.

## HOW DO YOU CHOOSE?

It is not a case of just choosing one of the possibilities listed in the previous chapter. Your own individual asset plan may well incorporate several of the possible 'tools', with a combination of part of one and part of another plus several others as well. So how do you choose? What are your options?

- *The first option is to do nothing*  
That has the advantage of keepings things simple with control of your assets squarely in your own hands. However, it is true to say that it would not help you to achieve a number of the objectives listed in a previous chapter of this booklet.
- *To establish a trust and give away all your assets to that trust*  
That might be a rather extreme form of asset planning but would be the preferred option if you took the view that you wanted to accept the minimal risk possible. Certainly you would achieve most of your objectives previously outlined but at the cost of some loss of control over your assets. It is fashionable for some commentators on trusts to say that settlors do not need to lose any control if they are appointed as trustees. We do not subscribe to that view. The role of the trustee is different from an individual. Assets owned by an individual can be spent in any way that person chooses, whereas assets belonging to a trust can only be handled in accordance with the terms of the trust deed and the Trustee Act.
- *To take a middle road by establishing a trust and transferring only some of your assets to it*  
You could for instance transfer only your house property to a trust. As time goes by you could make the decision from time to time to transfer other assets to the trust, or then again you might not.
- *To take a lower road again by simply splitting the ownership of your assets and leaving each other a life interest (assuming you are a couple)*  
That would involve you splitting your assets so that you each owned half in your own right, and then remaking your wills leaving a life interest to the survivor with the capital ultimately going to your children (or whoever you name). That would achieve some of your objectives but not others. This option is significantly different from establishing a trust in that:
  - it can be reversed more easily
  - it really only protects one half of your joint assets
  - it does not offer any protection against creditors and, if you are cancelling a Joint Family Home registration to achieve it, in fact reduces that protection
  - there is unlikely to be a significant gifting programme or asset transfer involved and so the costs are likely to be substantially lower
  - it is very important to complete your wills correctly because an old will might leave all assets in your sole name to someone other than your spouse (and your half of the home is in your sole name), or if you die without a will (intestate) then in some circumstances your partner might not inherit the whole of your estate because, for example, under the Administration Act a spouse only gets the first \$121,500 (as at May 2004) plus 1/3 of the balance with the rest going to your children, and any de facto partner takes an equal share in the spousal portion.

- *Relationship Property Agreement (for married or recognised de facto couples)*  
 If your assets are owned unequally between you there is value in considering the use of a Relationship Property Agreement to equalise the ownership of your assets before embarking on the establishment of a trust or other protective structure. This in itself would achieve some of the objectives outlined earlier in that since we don't know which of you will die first we can't assume it will be the one with the greater or lesser assets. It therefore "hedges your bets" in that it makes it irrelevant to your overall planning which of you dies first. As far as the one with the greater assets now is concerned it does in itself give you some protection against possible estate duty, it offers some protection against creditors, it may enable you to obtain government assistance as early as possible, and for you both it also helps to ensure that at least half your joint assets are passed on to your family.
- *Lease for Life*  
 You do have the option if you want to speed up the gifting process of creating a 'Lease for Life' as explained in a previous chapter.
- *Greater Gifting Amounts*  
 As previously discussed, many people consider it acceptable to pay gift duty of 5% to enable them to gift up to a further \$9,000 each 12 months above the standard \$27,000 which can be gifted free of duty. Duty on \$9,000 extra is \$450.
- *Joint Family Home (for married couples, not available to de facto couples)*  
 Even if you do nothing else, if you are in business and married, then your house should probably be registered as a Joint Family Home. For a cost of about \$400 you obtain protection of \$103,000 (as at May 2004) of your equity against creditors in most circumstances.

If you are married and the house is only in one name then again, registration of a Joint Family Home is the cheapest way to equalise the asset ownership and there is no gift duty payable on the transfer of half the interest in the house to the other spouse.
- *Non-Relationship Property Sharing Agreement*  
 Certainly all unmarried or non-recognised de facto couples sharing ownership of a property or living together in a property owned by only one of them (whether long term flatmates or in some other relationship such as parent and child or just friends) should be seriously considering a non-relationship property sharing agreement. To rely on the rather uncertain outcomes of the common law (made by the courts) and legislation is leaving a lot to chance which could be fairly easily settled by you in writing at the outset. While the relationship is happy and stable it is also by far the best time to achieve an agreement that is likely to be fair to you both/all.
- *Wills and Enduring Powers of Attorney*  
 It need hardly be said that we believe that everyone from age 18 onwards should have a will and enduring powers of attorney. They are so simple and inexpensive to obtain but can save so much expense and difficulty when needed.

## TYPES OF TRUST

### **Discretionary**

Discretionary trusts usually provide trustees with a discretion as to the distribution of both income and capital among a defined group of beneficiaries up to the point in time when the trust is to be finally distributed. At that point capital may be distributed either on a discretionary basis to defined beneficiaries or on a fixed basis to certain beneficiaries, usually with a gift over to their children and/or grandchildren.

Under this heading when dealing with a family trust there are, generally speaking, three types of trust:

*Cross Trusts or Mirror Trusts* - an arrangement by which each partner (usually a spouse) establishes a discretionary trust under which the other spouse plus their children, grandchildren etc are beneficiaries, but not the spouse establishing the trust. Each of the spouses has recourse to the income and assets of the trust in which he or she is a discretionary beneficiary, subject of course to the consent of the trustees.

This form of trust was used to overcome 'reservation of interest' provisions under the Estate and Gift Duties Act when it was in force, or upon its anticipated re-introduction. They have certain advantages but also some disadvantages, not least of which is that when one of the partners dies neither partner is then a beneficiary under one of the trusts which can leave the children rather well off! Since the abolition of estate duties mirror trusts are no longer the common choice they once were.

*Parallel Trusts* - are similar to mirror trusts except that the husband and wife settlors are both included as discretionary beneficiaries under both trusts - this overcomes some of the disadvantages of mirror trusts in that each spouse has a discretionary right to benefit under both trusts. If a power to exclude beneficiaries is included then this could be used to overcome the estate duty disadvantages so that generally speaking, parallel trusts are preferred.

*A Single Discretionary Trust* - where both husband and wife are settlors and beneficiaries of a single trust. These are increasingly the preferred option, given their comparative simplicity of administration, smaller tax and other compliance costs, and fewer disadvantages.

### **Non-Discretionary or Restrictive Trusts**

In the case of a "non-discretionary" or "restrictive trust" assets are transferred to a trust where the income beneficiaries are defined and income is distributed annually; and where the capital beneficiaries are defined and on distribution of the trust the capital goes to those beneficiaries usually with substitutionary provisions. The trustees here have no discretion as to who receives income and/or capital. This naturally lacks flexibility. This could be partially overcome by including a power to include and remove beneficiaries, although that in itself is not always a good idea.

**Trading Trusts**

Trading trusts usually take the form of a single discretionary trust with a corporate trustee. They have some advantages in that they provide commercial flexibility, the ability to make payments to relatives and associated parties without tax implications, so that they allow some income splitting and they do provide some limitation of liability. However their disadvantages are that the tax anti-avoidance provisions may be brought to bear, and also creditors of the trustee company would have rights of subrogation to the trustee's right of indemnity from the assets of trust (that is to say the creditors could step into the shoes of the trustees so as to recover any personal losses arising out of administration of the trust from the trust assets).

**Charitable Trusts**

Charitable trusts must be for charitable purposes as defined by law. That is to say to advance religion or education, for the relief of poverty or for the benefit of the community. Charitable Trusts cannot be confined to one's own family or friends but must be "public" in some way.

One needs to be aware of the application of section CB4 of the Income Tax Act - the exemption for business income of a charity is not available where a person associated (eg Settlor, Trustee or shareholder) receives income or some benefit from the charity and is able to determine or materially influence any decision by which that benefit or advantage is granted. A mere capacity to arrange the benefit is sufficient. So you can't set up a charity to employ yourself or family.

## **DUTIES AND RESPONSIBILITIES OF TRUSTEES**

### **Introduction**

Historically it could be said that the most important duty of the trustee was to obey the directions of the settlor (the person creating the trust). Trust instruments were previously tightly drawn and closely defined the settlor's intentions. Today major emphasis is on the efficient management of the trust fund and the welfare of the beneficiaries. It is now usual for trust deeds to include very broad administrative powers and discretions in favour of trustees. This of course places considerable authority in the hands of trustees which, naturally, correspondingly increases their responsibility.

In addition, people generally are now better informed regarding trusts and their rights as beneficiaries; and persons acting as trustees are becoming subject to closer scrutiny. The result is that trustees are more likely in the future, to become subject to claims made by beneficiaries who feel that they have not been properly treated, or that the trust has not been properly administered for their benefit. Bear in mind that a trustee may become personally liable not only for his or her own acts or omissions but also for those of any co-trustee.

For these reasons it is important that a person acting as a trustee should be aware of his or her obligations and of practical steps which can be taken regarding the administration of the trust to protect both himself or herself and the interests of the beneficiaries that he or she serves as trustee.

The following comments are therefore provided as a basic guide for a person acting as a trustee both in relation to the understanding of his or her duties and as to some practical steps which may be implemented to assist in properly carrying out those duties.

### **Fiduciary Duties**

A person who is acting as a trustee of a trust is acting in a fiduciary capacity. As a fiduciary a trustee has a wide range of responsibilities which could be summarised as follows:

- *The duty to preserve the trust property*  
This is the primary duty of the trustee and requires the trustee to take title to the assets of the trust, ensure that any documents of title are secure, that the assets are invested in appropriate and authorised forms of investment; and monitoring, managing and preserving the assets and investments of the trust with the standard of skill, prudence, diligence and care that the law requires.
- *The duty of loyalty*  
This requires the trustee to give effect to the settlor's intentions as expressed in the trust document for the economic well being of the trust and the personal welfare of all the beneficiaries. Essentially, as a fiduciary, a trustee must put aside all personal interests and consider the overall interests of the beneficiaries. The obligation is similar to that of a company director who must always act in the best interests of the company.

- *The duty to keep accounts and provide those details to beneficiaries*  
This means the trustee is under a duty to keep and render to the beneficiaries a full and candid record of his or her stewardship, including all appropriate financial accounts.
- *The duty to act personally*  
This carries with it the important rule that subject to any specific provision in the trust document, a trustee must act personally in carrying out or executing his or her trust powers and discretions. This rule is also modified to an extent by section 31 of the Trustee Act 1956, which enables a trustee who is out of New Zealand, or about to leave New Zealand, or who, because of physical infirmity, is incapable of performing his duties as a trustee, to delegate all or any of his trusts, powers, authorities and discretions by power of attorney, to another person.
- *The duty to consider*  
While a Court will not often second guess discretionary decisions made by trustees it will ensure that trustees have considered whether they should act or not; and may require them to act if they have not.

### **Duties as to Investment**

One of the most significant duties imposed on trustees relates to the investment of trust Funds. Subject to any contrary intention contained in the trust document or in any Act, a trustee now has the power to invest any trust funds in any property whatsoever. However, in exercising that power a trustee must exercise the care, diligence and skill that a prudent person of business would exercise in managing the affairs of others. Also, where a trustee has special skills by reason of his or her profession, employment or business, the standard of care is extended to that which a prudent person engaged in that profession, employment or business, would exercise in managing the affairs of others.

Section 13E of the Trustee Act 1956 provides assistance to trustees by detailing matters which may be considered when exercising a power of investment. Those matters are as follows:

- ◆ The desirability of diversifying trust investments;
- ◆ The nature of existing trust investments and other trust property;
- ◆ The need to maintain the real value of the capital or income of the trust;
- ◆ The risk of capital loss or depreciation;
- ◆ The potential for capital appreciation;
- ◆ The likely income return;
- ◆ The length of the term of the proposed investment;
- ◆ The probable duration of the trust;
- ◆ The marketability of the proposed investment during, and on the determination of, the term of the proposed investment.
- ◆ The aggregate value of the trust estate;

- ◆ The effect of the proposed investment in relation to the tax liability of the trust;
- ◆ The likelihood of inflation affecting the value of the proposed investment or other trust property.

Section 13F of the Trustee Act 1956 preserves the trustees' duties at law in respect of all rules and principles which impose any duty on a trustee exercising a power of investment, including, but not limited to those which impose:

- (a) Any duty to exercise the powers of a trustee in the best interests of all present and future beneficiaries of the trust;
- (b) Any duty to act impartially towards beneficiaries and between different classes of beneficiaries;
- (c) Any duty to take advice.

Again these duties are subject to any contrary intention expressed in the trust document or in any Act.

Discussion of a trustee's obligations relating to the investment of trust funds would not be complete without some reference to what is known as "modern portfolio theory". Key features of this theory have been summarised by one commentator as follows:

*"At the heart of portfolio theory are a number of key principles. First, the measure of a person's wealth is the value of her portfolio looked at as a whole. Second, the security of the investor's fund can be enhanced by diversifying it across a range of counter-reacting ("negatively co-related") investment vehicles. Third, decisions as to which investment vehicles ought to be included in a portfolio cannot be made in isolation, they must be made in light of the nature of the other elements of the portfolio. Thus, investment vehicles which might be thought speculative when considered in isolation, may not be speculative when considered in the context of a portfolio's overall holdings. Fourth, the return on a portfolio reflects both income and capital returns and to separate the two is an artificial exercise ..."*

The same commentator later states *"the key difference between portfolio theory and the individual investment approach is that the former sees the investment fund as an organic whole."* ... and *"The investment community in New Zealand has adopted portfolio management in the trust area and ... it may well be that if the courts are convinced that the Act (meaning the Trustee Act 1956) is really pro-portfolio, then trustees will have an obligation to make investment decisions in line with the tenets of portfolio theory."*

In recent cases both here and overseas, Judges have by their comments indicated that modern portfolio theory may have its place when consideration is being given to the investment of trust funds. It seems that it is certainly one of the approaches to investment which should be considered by trustees in relation to their duty to act prudently as previously outlined. Because it involves a field of particular expertise, it is likely that trustees would employ as an agent, an experienced financial and investment planner to provide both investment advice in

this area and to arrange the actual investment of trust funds pursuant to the instructions of trustees.

It follows from the comments regarding investment referred to above, that a trustee's obligations in this respect are wide reaching and that a lay-person acting as a trustee would be unwise to make investment decisions without taking professional advice. Reference is made to this later when dealing with the trustee's power to employ agents to assist in the administration of the trust. Trustees should also bear in mind that it may sometimes be appropriate to canvass the views and obtain the approval of beneficiaries who are adult and of full legal capacity, to major investment proposals or strategies.

### **Practical Issues**

In terms of the practical management of the operations of a trust, trustees should:

- (a) Upon accepting office as trustee, acquaint themselves thoroughly with the terms of the trust deed and all other relevant trust documents e.g. the accounts, the minute book, the list of trust assets and any other documents, including correspondence relevant to the administration of the trust.
- (b) Become familiar with the names, ages and situations in life of the beneficiaries of the trust.
- (c) Ensure that the titles to trust assets are registered in the names of the trustees as joint tenants particularly following a change of trustees; and that those documents and the assets themselves, are safeguarded against improper use.
- (d) Ensure that the trust has in place certain measures to facilitate the proper day to day management of the trust. In this respect the following are suggested as basic requirements:
  - (1) The trustees should meet regularly as required and certainly not less than annually. The most appropriate time for an annual meeting would be after the accounts become available, at which time the accounts could be discussed, the investments of the trust could be reviewed and the question of distributions to beneficiaries and matters relating to maintenance, repair etc of trust assets could be considered. It must be remembered that for tax reasons any proposed distribution to a beneficiary must be completed within 6 months of balance date to be effective for the preceding income year.
  - (2) The trustees should keep a minute book in which all resolutions of trustees should be recorded. It is not usual to record the reasons for the resolutions as these are regarded as confidential to the trustees. Indeed, modern trust deeds may contain a provision requiring confidentiality in this respect by trustees.
  - (3) Trustees should maintain a file containing documents connected with the trust, such as a true copy of the trust deed, past accounts, copies of contracts entered into by the trustees, details of beneficiaries, and copies of all correspondence.

- (4) Trustees should maintain a list of trust property, including details of all assets owned and where appropriate, details of all liabilities, including copies of all relevant documents.
- (5) The trust should have a separate bank account which should be clearly identified as such on the face of documentation such as the cheque book and in the records of the bank itself. Care should be taken to ensure that only trust transactions are conducted through the bank account. Naturally, trust investments should not be intermingled with personal investments and care should be taken in this respect when buying and selling trust securities.
- (6) An efficient diary system should be maintained drawing attention to matters which require regular action e.g. payment of income to beneficiaries, furtherance of a gifting programme, reminders for preparation and filing of annual returns, income and other tax returns etc.
- (7) Keep a record of agents employed by the trustees to carry out specialist tasks such as preparing accounts and carrying out the trustee's instructions in relation to the administration of the trust, or the investment of trust assets.

### Using Agents

While the duty to keep and render accounts and to arrange for the investment and reinvestment of trust funds are duties imposed on trustees personally, it is likely that on many occasions trustees will not have the necessary skills to deal with these matters themselves. Section 29 of the Trustee Act 1956 recognises this and authorises the trustee to engage agents to assist in the administration of the trust in a wide range of fields.

Amongst other things that section includes the following provisions ...

*“A trustee may, instead of acting personally employ and pay an agent, whether a solicitor, accountant, bank, trustee corporation, stock broker or other person, to transact any business or do any act required to be transacted or done in the execution of the trust or the administration of the trust property, including the receipt and payment of money, and the keeping and audit of trust accounts, and shall be entitled to be allowed and paid all charges and expenses so incurred, and shall not be responsible for the default of any such agent if employed in good faith.”*

When employing an agent, particularly in relation to the investment of trust funds, it is suggested that as a matter of practice a trustee should have regard to the following:

- (1) Check and retain documentary evidence of the credentials of the agent employed. A Trustee will need to have taken reasonable steps to ensure that the agent concerned has the ability to provide the service sought.
- (2) Where the agent is employed on a continuing basis, carefully supervise and regularly monitor that agent's performance. Obtain regular reports.
- (3) Where an agent e.g. a financial planner, is employed to provide investment advice and to arrange for investment of trust funds then:

- a. Provide written instructions, including details of assets, beneficiaries' ages and likely needs regarding distribution of assets and making specific reference to the trustee's obligations in respect of preserving a balance between income and capital growth.
- b. Set out the trustees' needs regarding investment reviews, particularly bearing in mind the nature of the investments owned by the trust.
- c. Specify the trustees' obligations particularly in terms of modern portfolio theory, as to the diversification of trust investments and the use of unit trusts and funds in this respect.

### **Conflicts of Interest**

Another matter of which trustees should be aware is that relating to conflict of interest. Generally speaking, as a fiduciary, a trustee should not personally be involved in the sale to or purchase from the trust of any assets. Nor should a trustee be so involved indirectly e.g. as shareholder or director of a company, or trustee or beneficiary of a trust with which the trust has dealings. These obligations arise wherever the trustee's personal needs or wishes could conflict with those of the trust.

However, it is common in modern trust documents to include provisions enabling a trustee to have dealings with the trust whether directly or indirectly notwithstanding his or her personal interest. This is usually subject to the need to make full and prompt disclosure of that interest and to take no part in the decision making process. Trustees should also ensure that the trust is independently advised in respect of any such transaction. Notwithstanding any specific provision to that effect in the trust document it is however wise for a trustee to avoid situations where a conflict of interest may arise.

As mentioned previously the foregoing comments are only a basic guide. Clearly in today's world a trustee should be conscious of the need to seek advice in respect of any matter relating to his or her obligations as a trustee and of course in respect of any particular situation where there may be legal considerations to be taken into account. For simplicity's sake the following will provide a short checklist for a trustee :-

- a. Know all about the trust documents, the trust assets and the beneficiaries to whom you are responsible.
- b. Act promptly, honestly and fairly, bearing in mind the nature of the trust and its assets and the differing needs and expectations of the beneficiaries.
- c. Act prudently when dealing with or investing the assets of the trust fund.
- d. If you employ an agent to assist you, take care in his selection and carefully monitor his performance.
- e. Keep your personal affairs and those of the trust completely separate. Avoid conflicts of interest.
- f. Seek and act upon proper professional advice when appropriate.
- g. Take effective action to properly administer the trust, meet regularly, keep records and account fully and regularly to the beneficiaries.

## **SOME TECHNICAL CONSIDERATIONS**

### **Future Capital Tax**

Planning with any accuracy for a future capital tax is clearly not possible until the content of the legislation imposing the tax is known. It could take any form. However, there are some basic arrangements that could be worthwhile:

1. There could be a threshold below which the tax will not apply (eg. When we had estate duties they only applied on assets over \$450,000.00).
2. It might apply only on transfers of assets. If so, to transfer assets out of your names now may be worthwhile.
3. Transfers to a discretionary trust, where the group of beneficiaries may be named but the share they obtain left to the discretion of the trustees may not be desirable. It is at least possible that a capital transfer tax will catch distributions to beneficiaries of a discretionary trust.

### **Inflation**

An advantage in transferring growth assets to a trust is that the growth then accrues to the trust. It has in the past been a convenient way to "peg" the value of assets, and that was particularly important when we had an estate duties regime. But there is a disadvantage. In times of high inflation the transferor of the asset is left with a debt owing and the dollar value of the debt will be eroded. It follows that over a number of years of high inflation, transferors can move from a position of wealth to a parlous financial state because they transferred too much too soon.

A gifting programme, reducing the debt owing on the sale of the assets, can accelerate that effect. In times of dropping asset values the debt can be higher than the value of the asset originally purchased.

### **Control**

We have previously referred to the reservation of control by the trustees over assets which have been settled on the trust. Usually the trustees of a discretionary family trust have the power to decide who receives the income of the trust and in what shares and also who receives the capital of the trust and the shares in which they receive it. It is the reservation of the power to control the disposition of the capital of the trust fund which is important for income tax purposes and as mentioned it is in our view preferable to provide for the appointment of a third independent trustee in order to overcome any difficulty in this respect. Alternatively if a husband and wife wish to be the only trustees of their family trust a provision can be included in the trust deed whereby any disposition of capital from the trust requires the appointment of an independent third trustee before that disposition is made. Historically this was important in order to avoid the tax implications of short term assignments of income. Although those provisions have now been repealed the general anti-avoidance provisions of the Act still remain and the question of control is still an important matter to be considered when preparing the trust documents.

## Sheltering Assets

There are a number of statutory provisions which affect clients ability to transfer their assets out of the potential reach of others. For instance the Property (Relationships) Act 1976 empowers the court to set aside dispositions of property made to defeat the claim or rights of any persons under the Act.

Of somewhat greater interest these days are the statutory provisions which empower creditors to recover assets.

- Sections 54 to 58 Insolvency Act 1967 deal with gifts, securities etc which are voidable against the Official Assignee in bankruptcy. Generally such gifts, transfers, or securities may be avoided if made within two years from adjudication of bankruptcy but in some situations that period can be extended to 5 years.
- The particular provision which is most difficult to understand is Section 60 Property Law Act 1952 which relates to the alienation of property with intent to defraud creditors. It states:

*"Alienation With Intent To Defraud Creditors*

1. *Save as provided by this section, every alienation of property with intent to defraud creditors shall be voidable at the instance of the person thereby prejudiced.*
2. *This section does not affect the law of bankruptcy for the time being in force.*
3. *This section does not extend to any estate or interest in property alienated to a purchaser in good faith not having, at the time of the alienation, notice of the intention to defraud creditors."*

From the section you will note:-

1. There must be an alienation of property
2. It must be with intent to defraud creditors
3. The party seeking to avoid the transaction must be a person who is prejudiced.

It is (2) which is the difficult element. The courts have evolved a number of indications of fraud including:-

- A. The initiating, or even likelihood, of litigation against the debtor.
- B. The entry by the debtor into "hazardous activity" soon after the disposition.
- C. Where the disposition comprises all or substantially all of the settlor's assets.
- D. Where the disposition is made in secret.
- E. Where it is made "pendente lite" (when court action is underway).
- F. Where there is a trust between the parties for the debtors benefit.
- G. Where the deed contains unusual statements such as that the disposition was made honestly, truly and bona fide.
- H. Where the deed grants the settlor a general power of revocation.
- I. Where the deed contains false statements as to the consideration etc.
- J. When the consideration is grossly inadequate.

Clients wishing to transfer amounts to shelter them from creditors should be warned of the risk of assets being recovered to pay creditors.

## THE PROCESS

The process of asset planning generally follows four distinct steps:

### **The initial inquiry**

Which you have probably already made and after which we provide you with this booklet.

### **A detailed examination of your situation.**

This is probably the most important step in the whole process because it enables us to help you review and record your objectives. It often takes a session of 60 to 90 minutes and we follow it up with a letter recording the issues discussed, itemising our recommendations and setting out the decisions then to be made.

It is helpful if before that session is held you have written out a schedule of your assets and major liabilities (eg mortgages), with their approximate current value, and in the case of a couple, marking whose name each asset or liability is in. In doing this don't forget to note any future potential inheritances from your parents or other family. A note of the full names, ages, dates of birth and special needs (if any) of you and your family is also useful.

### **Making the decision**

Making the decision to proceed to change the ownership of your assets, deciding the format of any documentation that needs to be prepared, preparing that documentation, arranging for it to be signed and arranging for assets to be transferred.

As the process can take some months we like to set a timetable which we would probably do when the decision to proceed is first made. In complex cases, where completing the documentation and transfer of assets can take longer than normal, we render an interim account at the end of each month with payment due within 21 days

We will give you an estimate of the cost of the exercise at the outset but it commonly costs between \$1,500 - \$2,500 including GST.

Any disbursements, such as registration fees on the transfer of properties would of course be extra.

### **The gifting programme**

Often the process calls for the actioning of annual gifts over a number of years. The cost of that is generally around \$400 per annum including GST plus any gift duty you have chosen to pay to speed up the process.

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So that's it. A great deal of reading and some of it quite complex. If you have any questions, and we hope you have a lot, please contact us to discuss them. Criticisms and compliments on this booklet both gratefully received.

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**Disclaimer** – The information contained in this booklet is of a general nature and should be used as a guide only. It should not be used or relied upon as a substitute for detailed advice or as a basis for formulating decisions. Before acting, clients should consult a partner of this firm.