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MACKINTOSH BRADLEY & PRICE Level 5, State Insurance Building, 88 Division Street, P.O Box 8364, Riccarton, Christchurch 8440
Ph: 03-343 5880 | Fax: 03-343 5888 | E-mail: partners@mbp.co.nz | Web: www.mbp.co.nz

Welcome to the Autumn issue of *Trust eSpeaking*. In this issue we focus on the October 2011 abolition of gift duty and its implications. We also have an article on the Law Commission's review of trusts.

If you would like to talk further about any of the stories in *Trust eSpeaking*, or about trusts in general, please do not hesitate to contact us.

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The next issue of *Trust eSpeaking* will be published in September 2011.

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Copyright, NZ LAW Limited, 2011. Editor: Adrienne Olsen. E-mail: adrienne@adroite.co.nz. Ph: 04-496 5513.

Gift Duty Abolition

From 1 October 2011

The government has announced it will abolish gift duty from 1 October 2011 citing the cost of gift duty compliance (estimated to be \$70 million pa) significantly outweighs government revenue (\$1.6 million in 2009-2010).

Gift duty was intended to stop people giving away property before they died to avoid paying estate duty. Although estate duty was removed in New Zealand in 1992, the government retained gift duty. The disappearance of gift duty will affect nearly every person in New Zealand who has a trust. Gift duty is currently payable for gifts more than \$27,000 in any 12 month period.

Currently where a trust does not have the funds to purchase an asset outright, the trustees provide the vendor with an acknowledgement of debt as consideration for the transfer of the assets. The vendor forgives \$27,000 per year until the debt has been extinguished. Depending on the value of the assets transferred to the trust, the gifting programme could have taken years to complete. With the abolition of gift duty, gifting programmes will be a thing of the past, making the trust administration easier.

Transferring assets to a trust post-1 October 2011

After 1 October 2011, those with existing trusts can complete a deed of gift, completely forgiving the remaining balance of the debt owed to them by the trust.

For those who are contemplating the transfer of assets to a trust, there will be no requirement for consideration, and therefore no debt back to the vendor will be needed and assets will not need to be valued prior to the transfer. Deeds of gift and trustee resolutions should still be completed for an accurate recording of transactions. There can also be tax implications, so we recommend professional advice.

It is worth considering there may be good reasons not to forgive a debt. For example, the trustees may want to distribute capital to a beneficiary and debt repayment may be a good way to do this.

Implications of abolishing gift duty

People may be able to avoid potential claims under the Family Protection Act 1955 by giving assets to a trust while alive. This will leave nothing in the estate to claim against and in particular there will be no debt back from the trust (which up until now has been treated as an estate asset).

Relationship property claims could be defeated by one person in the relationship transferring their assets to a trust or company. Up until now the debt back to the vendor was a potential asset for a relationship property claim. After 1 October 2011 that may no longer be so in many cases (Read more on the implications of relationship property on Page 3 in 'Rush to Trust – or Maybe Not?').

If a person has debts, particularly business liabilities, and transfers all his or her assets to a trust and then fails to meet obligations to creditors, the transfer could be set aside under the Insolvency Act 2006. The test is whether the person who transfers the assets is unable to pay all their debts as they fall due from assets other than those disposed of. This has been described as a cash-flow test rather than balance sheet insolvency. One commentator has suggested that clients should complete a list of assets and liabilities at the time of transferring assets to a trust to negate subsequent suggestions of insolvency.

The timing of the transfer will be an important factor. If assets are transferred to a trust well before problems arise, the risk of having the transaction set aside will be reduced.

Our recommendation

The abolition of gift duty will make it quicker and simpler to transfer assets to trusts and the reasons for doing so remain as valid as ever. However we cannot emphasise enough the importance of talking with us *before 30 September* so we can give you the best advice for your particular circumstances.

Rush to Trust – or Maybe Not?

Careful on relationship property issues

With the abolition of gift duty taking place on 1 October 2011, commentators are already predicting there will be a rush to transfer assets into trust, or to complete any established gifting programme, see our story on Page 2.

The purpose of this article, however, is to suggest that there may be reason to pause and consider whether that will actually achieve the desired outcomes, at least in the area of protection against relationship property claims. Under s44 of the Property (Relationships) Act 1976 (PRA), the Family Court can set aside any transfer of property to a trust if it was done with the intention of defeating the rights of a relationship partner.

Under the PRA it generally only takes three years for a relationship partner to have an equal claim to certain assets owned by the other, such as the family home. Under the existing gift duty rules, however, it can take several years to transfer the full value of a property to a trust. With that mismatch in timing, it has been difficult for people to prevent an established partner from enforcing PRA rights.

The proceeds of a relationship property sale are itself relationship property. Proceeds of sale include any debt back owed by a trust for the price. Transferring a home that is already relationship property to a trust does not stop a partner making a claim against the debt back or from making an application under s44 to have the transfer reversed and then making a claim against the property itself.

It is frequently suggested that the s44 provisions do not apply where property is transferred into trust before a couple's three year anniversary; the property is not yet relationship property. This is incorrect as the judgments of the Supreme Court in *Regal Castings v Lightbody*¹ and in the High Court in *Ryan v Unkovich*² have made clear.

The courts held that 'knowledge of a consequence can be equated with an intention to bring it about'. If you know that a transfer could defeat your partner's PRA rights, even if that was not in fact your primary motive, you are still held to have intended that outcome, and s44 will apply.

Retrospective

The PRA applies in retrospect; it applies to actions that took place before the legislation was passed. This means that any transfer to a trust that was intended to defeat the rights of a de facto partner will be subject to s44, even if the transfer took place before the PRA came into effect (1 February 2002). The PRA also applies to actions of a couple that took place before they have been together for three years. Therefore both existing PRA rights and also potential PRA rights are protected by s44.

John and Mary

To illustrate how this works, let us look at John and Mary who live in John's house. Mary will have a full PRA claim to half the house once they have been together for three years. At year two she only has a potential PRA claim to a half share. If John transfers his house to a trust at year two, then it appears that in year three he has defeated Mary's potential PRA claim to a half share.

As the PRA is retrospective, and following *Regal Castings* and *Ryan*, it is now clear that John knew that would be the result, and so s44 will apply.

Speeding up John's gifting programme is not going to fix his problem. Whether John can transfer the house to his trust in one step, or does it over several years at \$27,000 pa as currently, does not alter the effect of s44.

In conclusion, any assumption that an immediate transfer of the whole value of a property into trust is sufficient to provide relationship property protection will frequently be wrong. Transferring assets to a trust before the commencement of a relationship is the safest course of action.

¹ *Regal Castings v Lightbody* [2008] NZSC 87; [2009] 2 NZLR 433

² *Ryan v Unkovich* [2010] 1 NZLR 434; [2009] NZFLR 948

What Might Happen With Future Trusts Legislation?

The Law Commission has embarked on a lengthy review of trust law in New Zealand. This is an in-depth and lengthy process: the first issues paper was released in November 2010 (62 pages), the second in December 2010 (69 pages), and a further five papers are to be released between now and the end of the year³.

Even before getting down to recommending any changes, there are the underlying principles to be decided as to whether any legislation should be on a default basis (rules to apply where a matter is not covered within a trust deed) and/or mandatory (will apply to all trusts regardless of whether or not they are covered in the trust deed and cannot be contracted out of) rules. The United States' uniform trust code provides an example of a statute that includes mandatory rules that cannot be overridden by a trust deed. Like the New Zealand Trustee Act, the code contains both default and mandatory rules.

The Commission's present indication is that it is likely to have legislation with provisions that apply by default and some provisions which are mandatory. Mandatory provisions in the USA uniform trust code include:

- » The requirements for creating a trust
- » The duty of a trustee to act in good faith in accordance with the terms and purpose of the trust and the interests of beneficiaries
- » The requirement that a trust and its terms be for the benefit of its beneficiaries and that the trust has a purpose that is lawful, not contrary to public policy and possible to achieve, and
- » A duty to notify qualified beneficiaries of an irrevocable trust, who have attained 25 years of age, of the existence of the trust, of the trustee's identity and of their right to request trustee's reports.

If the last mandatory provision was adopted in New Zealand it is likely to create excitement with settlors and trustees who wish to preserve secrecy.

The common options being considered by the Law Commission are:

- » **OPTION 1:** A statute that covers the same ground as the present Trustee Act but modernises it, leaving it to the common law to define fundamental elements of trust law.
- » **OPTION 2:** Legislation that includes more of the core principles of trust law and that is wider in scope than the current legislation (similar to the US and India's statutes)
- » **OPTION 3:** A mixture of mandatory and default provisions
- » **OPTION 4:** A combination of options 2 and 3 that include more core principles of trust law and having more mandatory provisions.

The second issues paper (December 2010) deals with problems with the use of trusts, including relationship property, creditor protection and sham trusts.

The Commission sees two distinct issues regarding the use of trusts. The first is whether any fundamental issues with the trust should mean the trust itself is invalid. Should there be limits on the purpose for which trusts can be used and what requirements should be for a trust to be invalidated as a sham or for any other reason? In recent times trusts have received bad press, for example, the situation with Rod Petricevic and Bridgecorp. Trusts are sometimes perceived as a means by which people shelter their true wealth and avoid liabilities.

The second issue is whether there are circumstances where valid trusts should be ignored or where dispositions to trusts should be set aside to give effect to settlor obligations. This revolves around the issues such as making assets available to creditors, and avoiding the equal sharing regime of the Property (Relationships) Act 1976 where the courts have viewed the outcome of the use of a trust as unfair.

It is clear policy decisions will be made which will impact on the future use of trusts and their effectiveness; we will keep you up to date on the debate.

³ See www.lawcom.govt.nz to download the issue papers in full.