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Trust eSpeaking

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Welcome to the Autumn issue of *Trust eSpeaking*. We hope you find the articles both helpful and interesting. If you would like to talk further about any of the material in this newsletter, or about trusts in general, then please don't hesitate to contact us.

In this issue we have articles on:

Division of Trust Assets on Separation

Family Proceedings Act can apply

As a general rule the 50/50 split provisions of the Property (Relationships) Act 1976 do not apply to assets held in a family trust. This creates real problems when a couple separate; one or both may be denied access to trust assets. The issue arose recently in Ward v Ward… *CONTINUE READING*

What Type of Trust do you Have?

Important tax implications

Following the article in the last Trust eSpeaking *(September 2009) outlining how a trust's income is taxed, this article moves on to discuss three types of trust and the taxation implications for each…* *CONTINUE READING*

Advisory Trustees

All care and not the responsibility

When people are establishing their family trusts, they sometimes ask for a friend, family member or professional adviser to be involved in the management and care of a trust, but for them not to have the responsibility that comes from being a trustee…
CONTINUE READING

WARNING: *31 March 2010 is fast approaching. If your trust has a balance date of 31 March then we recommend supplying your trust's accountant with all the information required to enable preparation of financial statements for your trust as soon as possible after 31 March. This is particularly helpful in the event that your trust intends distributing income to beneficiaries prior to 30 September 2010.*

The next issue of Trust eSpeaking *will be published in September 2010.*

Division of Trust Assets on Separation

Family Proceedings Act can apply

As a general rule the 50/50 split provisions of the Property (Relationships) Act 1976 do not apply to assets held in a family trust. This creates real problems when a couple separate; one or both may be denied access to trust assets. The issue arose recently in Ward v Ward[1] *which we discuss below.*

Ward v Ward involved interpretation of s182 in the Family Proceedings Act 1980 which allows the court to vary the terms of pre and post-nuptial trust settlements on the dissolution of a marriage or civil union.

Background

Mr and Mrs Ward married in 1991. They entered into a matrimonial property agreement in 2000 which transferred half of Mr Ward's assets to Mrs Ward. Included in the assets was a farm that had been in Mr Ward's family since 1959. Simultaneously they established a trust and transferred the same assets to the trust. They and their two children were beneficiaries. Mr & Mrs Ward divorced in 2005, and Mrs Ward applied for an order under s182.

The Family Court ordered in Mrs Ward's favour dividing the trust with one half to benefit Mrs Ward and the children, the other to benefit Mr Ward and the children. On appeal, the High Court set aside the judgment deciding the order was precluded by s182(6). In 2009, the Court of Appeal reinstated the Family Court's judgment.

Mr Ward appealed to the Supreme Court, claiming the High Court was correct that s182(6) precluded the order or, alternatively, the order was not properly made as it was too far in Mrs Ward's favour because Mr Ward was the original owner of the assets prior to the matrimonial property agreement and trust settlement.

Section 182

Section 182 does not entitle parties to a 50/50 division of assets on the dissolution of marriage. The court has power to vary the trust. One purpose of s182 is to stop one party benefitting unfairly from the settlement. In assessing a s182 claim the court is required to identify the parties' expectations at the time the settlement was made and compare them with the expectations of the parties at dissolution. If the dissolution has not affected the previous expectations, no order will be made. Section 182 applies if one party's expectations of the settlement have been wholly or partially defeated by the dissolution of the marriage. The order will be to restore those expectations in the best way possible.

However s182(6) prohibits the court from exercising the powers under s182 if that would defeat or vary a matrimonial property agreement made by the parties unless the interests of any children of the marriage require it.

Decision

The Supreme Court decided that s182(6) did not apply. A s182 order reinforced the intention behind the matrimonial property agreement that all the assets were equally owned, it did not defeat those intentions. The settlement of the trust contemplated that the marriage would continue and the parties had expectations of sharing the benefits of the trust equally. This was reinforced by a memorandum of wishes. The dissolution of the marriage changed the implementation of those expectations.

The court ordered the trust be split in half and settled onto two new trusts so that each party could still benefit equally from the trust.

Application

Section 182 only applies on the dissolution of marriages and civil unions; it does not apply to the breakdown of de facto relationships. There is no entitlement to a 50/50 spilt and while a useful guide, the outcome in *Ward* will not be followed in every case.

1 [2009] NZSC 125 1

What Type of Trust do you Have? Important tax implications

Following the article in the last issue of Trust eSpeaking (September 2009) *outlining how a trust's income is taxed, this article moves on to discuss three types of trust and the taxation implications for each.*

Complying trusts (formerly qualifying trusts)

The most common form of trust in NZ; it has been taxed in NZ on all its trustee income since the date it was settled.

Complying trusts include:

- Trusts settled by NZ residents with NZ trustees
- Estates of people who were NZ residents when they died, or
- Other trusts which have elected to become complying trusts.

A trust remains a complying trust if, since the settlement of the trust, the trustees have satisfied all obligations in respect of its income tax liabilities.

A trust is not a complying trust if:

- The only trustee income is non-resident withholding income, or
- The trustees earn foreign-sourced income excluded from the meaning of 'assessable income'.

If a trust ceases to meet the conditions for a complying trust in an income year, for example, if the tax on a complying trust trustee's income is not paid or the trustee has ceased to be a NZ resident, it will no longer be a complying trust. A complying trust will not lose its complying status if there is no tax due on trustee income.

Non-complying trusts (formerly non-qualifying trusts)

This classification is to be avoided as any taxable distribution from this trust type will be taxed at the rate of 0.45 cents in the dollar. A non-complying trust is neither a complying trust nor a foreign trust at the time it makes a distribution. It is generally a trust which has:

- A resident settlor,
- Has been established overseas with non-resident trustee, and
- Has not been liable for NZ income tax since it was first settled.

This classification also includes trusts where trustee income been liable to full NZ tax, but the trustees have not yet paid the tax.

New residents who arrive in NZ may have settled a trust before they arrived in this country. Such a trust would normally be a foreign trust, but it can elect to become a complying trust. To change types, the trust *must* elect to pay NZ income tax on its trustee income within 12 months of the date the settlor first arrives in NZ.

If the trust does not make an election, it will be treated as one of the following:

- A foreign trust, for any distribution that consists of income, capital profits or capital gains derived before the election expiry date, or
- A non-complying trust, for any distribution that consists of income, capital profits or capital gains derived after the election expiry date.

Failing to make an election in time is what caused the taxpayers trouble, in case Y25[2], with very expensive consequences. In this case, the NZ resident beneficiaries received their vested share, and also received a tax bill of $365,214.15 (45% of the distribution) on the death of their surviving parent. The trust was established in 1985 with a US-resident trustee who had not made the appropriate election in time.

Foreign trusts

A trust will be a foreign trust if none of the settlors have been resident in NZ since the later of these dates:

- 17 December 1987, or
- Alternatively the date the trust was first settled.

A trust will cease to be a foreign trust if it makes a distribution after a settlor becomes a NZ resident or if a NZ resident makes a settlement on the trust.

After 10 October 2006, where a foreign trust has one or more NZ tax resident trustees, one of them must make disclosure to the Inland Revenue Department of the key factual data relating to the trust. A form IR607 must be lodged. In addition, the NZ trustee appointed with the task of making disclosure must keep specific financial and other trust records and retain those for seven years.

Failure to comply with these obligations can lead to prosecution for a criminal offence with a sentence and/or a financial penalty. If convicted and there is no professional trustee, the trust can be made liable for NZ tax on its worldwide income until the information is provided.

Being clear about the type of trust you have is imperative as there could be severe penalties or implications for the trustees and, ultimately, the beneficiaries. If you are unsure about what type of trust you have or would like us to review your trust arrangements, please be in touch before 31 March.

2 TRA 012/06 &081/06 (2008) 23 NZTC 13,270 (TRA)

Advisory Trustees

All care and not the responsibility

When people are establishing their family trusts, they sometimes ask for a friend, family member or professional adviser to be involved in the management and care of a trust, but for them not to have the responsibility that comes with being a trustee. This article looks at the appointment of advisory trustees.

Appointing an advisory trustee

An advisory trustee is appointed by a trust's settlor under s49 of the Trustee Act 1956. They can be consulted by the responsible trustee, or they can advise on their own initiative, about anything relating to the trust or the trust property. The 'responsible trustee' is the person named in the trust deed as trustee and who makes all the day-to-day decisions about the trust.

It is not common in modern family discretionary trusts to appoint an advisory trustee as most settlors are responsible trustees themselves, or the responsible trustees are the same people the settlor would appoint as advisory trustees anyway. Appointing an advisory trustee can also add to the complexity, and therefore cost, of managing a trust.

However, an advisory trustee can be a very useful appointment if the settlor wants someone who will fully understand their intentions in setting up the trust and who can represent those intentions if the settlor cannot do it themselves, perhaps through illness, absence overseas or death.

Alternatively, an advisory trustee might be someone with specific expertise in an area that is particularly important to the aims of the trust, perhaps a medical specialist in the field which a charitable trust supports.

The settlor can appoint an advisory trustee when the trust is established, or they can be appointed later by the responsible trustee, anyone with the power to appoint new trustees, by the High Court on application from a beneficiary, trustee or anyone entitled to apply to the court to appoint a new trustee.

Sometimes advisory trustees are paid to undertake their role, but that depends on the terms of the trust deed or any court order relating to the matter.

Having an advisory trustee appointed means that the responsible trustee has no liability for the consequences if they follow the advice of the advisory trustee. This may mean the responsible trustee could be more willing to do something contentious that will better meet the aims of the settlor. An example of this is benefitting a particular family member ahead of others, which the advisory trustee knows the settlor would have wanted had those specific circumstances been present when the trust was established.

Managing advisory trustee advice

Anyone dealing with the responsible trustee can do so without consulting the advisory trustee, and they do not have to check that the advisory trustee is happy with what the responsible trustee is doing.

If a responsible trustee believes that an advisory trustee's advice conflicts with the trust or any rules of law, exposes the responsible trustee to liability, or is objectionable for some other reason, they can apply to the High Court for directions, but they are not required to do this. High Court applications are expensive and a responsible trustee may decide that the cost is not warranted, or may choose not to make the application for some other reason.

Similarly, if there is more than one advisory trustee and their advice conflicts, the responsible trustee can apply to the High Court for directions, but again is not required to do this.

Having an advisory trustee can have advantages for both settlors and beneficiaries, but whether you want or need an advisory trustee for your trust is something that you should discuss with us before appointing anyone to this position.