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Family Trusts

Why would I set up a family trust?

A trust comes into existence when individuals transfer ownership of assets to the trustees to be held on trust for certain persons (called the beneficiaries).

The trustees own and manage those assets for the benefit of the beneficiaries of the trust and will be bound by the terms of the trust deed. On the eventual winding up of the trust, the trust assets are distributed under the provisions of the trust deed.

The trustees are therefore the named owners of those assets, but they have a legal obligation to deal with them in the manner set out in the trust deed and for the benefit of the beneficiaries.

We usually suggest you consider setting up a trust to include three trustees, with at least one independent trustee, who will hold the assets of the trust as trustees for the beneficiaries you nominate. All or any of these beneficiaries could benefit as to income and capital from the trust during its term.

Benefits of a family trust

One of the main advantages of using a trust is that it has a separate existence distinct from you. Therefore, it may;

(a) Provide you with a convenient vehicle through which to distribute your wealth to children and grandchildren.

(b) Guard against potential business claims and/or director's liability if you are self-employed.

(c) Protect against possible future problems with creditors.

(d) If you are not currently in a relationship, provide protection from future partners.

(e) Ensure that assets earmarked for children do not get caught up in relationship property disputes with their husbands, wives, civil union partners or de facto partners.

The advantages of using a trust over a will for distributing wealth are the trust may continue after your death, distributions cannot be contested in the same way that gifts under a will may be challenged under the Family Protection Act 1955 and trusts can be a useful way of providing for future generations.

Disadvantages of a family trust

There is no advantage in having a family trust if you do not need one. Your particular situation will need to be analysed to see if a trust is beneficial for you.

Some of the disadvantages of trusts are as follows:

(a) Assets transferred to a trust are no longer your assets, meaning you cannot deal with these assets as your own — you will have surrendered personal ownership and control over those assets to the trust.

(b) The trustees must manage the trust's assets prudently for the beneficiaries and carry out the terms of the trust deed. They may be personally accountable to the beneficiaries if they fail to do this.

(c) The trustees need to agree on any decisions about the management of the trust's assets and the distribution of any income from the trust. This means that the trustees, including any independent trustees, must agree on decisions made for the trust.

(d) Setting up and maintaining a trust costs. These costs will depend on the complexity of your particular situation.

(e) You will need to have separate records and accounts for the trust, in addition to any records you have for your personal assets and business dealings.

All these possible disadvantages must be balanced against the potential benefits of a trust.

How is a trust structured?

We first need to determine what sort of trust structure is suitable for your needs and then settle on the form of the trust documents themselves. We will need to discuss the following issues with you.

The Trustees

You will need to decide who to appoint as trustees. Having trustees who have no relationship with the beneficiaries provides the ultimate protection against the trust being attacked, but it results in a loss of control to those independent trustees.

There is no reason why you cannot be a trustee of the trust which you intend to establish. If there is a law change in the future which might change this, your trust deed should be flexible enough that you could resign and appoint replacement trustees.

In addition to appointing yourself as a trustee, we would recommend that you appoint at least one independent trustee who will help with situations where a trustee is put in a position of conflict and specifically where a trustee may want to exercise their discretion to confer a benefit on themselves as a beneficiary.

Beneficiaries
Anyone who will, or may, derive a benefit under the trust is a beneficiary.

The trustees have the discretion to distribute income or capital to any of the discretionary beneficiaries during the term of the trust. Once the trust is wound up, the assets are distributed among the final beneficiaries, who will be named separately in the Trust Deed.

It is also our practice to include a direction to the trustees as to whose needs should be considered as first priority among the beneficiaries. We do this by appointing primary beneficiaries, who are generally the people who have transferred assets to the trust in the first instance.

Powers of Appointment
It is important that someone has the ability to appoint and remove trustees. Our practice is normally to reserve that power for the person who established the Trust. Where that is a couple, the power would be exercised jointly.

These powers are quite significant as they allow you to retain a degree of control over who will be involved with the management of the trust over time.

Distribution
The trust will be wound up and the assets distributed on the 'Date of Distribution,' which will be defined in the Trust Deed. A trust cannot continue for more than eighty years. We can also include a direction to the trustees as to when they may wish to consider winding up the trust early.

We often include in the Trust Deed that the trustees consider winding the trust up when the primary beneficiaries are no longer in need of any of the trust's assets and when the final beneficiaries have reached a certain age, such as 25 years.

What property should go into a trust?
There are very few limits on the types of assets you can put into trust but you would generally only include assets which are likely to increase in value.

The most common asset transferred to a trust is the family home. Some people will transfer their holiday home or rental properties, shares, superannuation schemes or insurance proceeds.

It is worth thinking about the extent of the ongoing record-keeping that must be done by a trust in relation to specific assets when deciding what assets are to be transferred. For example, if a trust holds cash, the trustees should record every decision to withdraw funds or when more funds are advanced. Sometimes the potential advantages of having a trust own specific property is outweighed by the administration costs of dealing with those assets.

We suggest that you retain the contents of your home, jewellery and other personal items and possibly cars and boats unless they are of significant value and need to be protected.

How is property transferred into a trust?
Our practice is that the property is sold to the trust which results in a debt owed to you personally.

A market valuation should be obtained for the property, which is used to specify a purchase price. Since the trust will not have the funds to purchase those assets from you, the trust will borrow from you and acknowledge a debt for the value of the assets purchased. Therefore the assets transferred to the trust are in effect exchanged for a debt back.

Depending on the reason for establishing the trust, you may then be able to forgive the entire debt owed to you by the trust. However, there are reasons why you might want to forgive the resulting debt at a reduced rate. We will discuss these further with you.

If you are selling your family home, any lending which is secured by mortgage over it will remain in place. The trustees will sign a guarantee to your bank and the loans will remain in your name, with you continuing to make the repayments.

What can ARL Lawyers do for you?
We're experienced in dealing with all aspects of trust administration and general property and estate planning matters. If you would like to know more about setting up a trust or acting as a trustee, we are available to assist.

In many cases we support and advise trustees by acting as an independent trustee for the trust through a trustee company established solely for the trust.

When establishing a trust or reviewing an existing one, we will make sure that it fits with your needs and complements any existing structures you may already have put in place. For further information please contact our Personal Planning and Business Solutions Team.