



## Family Trusts

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# 1. Introduction: Family trusts and their benefits

People have been putting money and other assets into trusts for centuries. They're a way of you keeping property safe from others, or holding onto property so it can be used by your children or other people.

By setting up a trust and transferring your home and other major assets to it, you cease to be the legal owner of those assets but can still continue to use and control them through the trust.

Many New Zealanders have family trusts for a range of different reasons.

## ***What are the benefits?***

Family trusts can –

- protect your assets for the future
- protect your assets against creditors
- provide for your family
- provide tax savings
- help protect against income- and asset-testing
- protect against possible changes to capital gains and death taxes
- prevent claims against your estate (your property) when you die.

## ***How can a family trust protect me from asset-testing for rest-home subsidies?***

Older people in particular often want their assets to be in a family trust so they will qualify for subsidised rest-home care (the Residential Care Subsidy) if they need it.

From 1 July 2005, to qualify for the rest-home subsidy you cannot have assets worth more than –

- \$150,000, if you are not married or in a civil union
- \$150,000, if you are married or in a civil union and your spouse or partner is also in care
- \$55,000 (not including the house and car) in combined assets, if you are a married or civil union couple and only one of you is in care. You can choose to instead be governed by the \$150,000 threshold, **but** your house and car will then be included when your assets are assessed.

On 1 July 2006, those asset thresholds will each increase by \$10,000, and will increase by \$10,000 on 1 July each year after that.

Assets do not include personal belongings like clothing and jewellery. The assessment of your assets also excludes up to \$10,000 in a pre-paid funeral scheme. The family house, furniture and car are also excluded if a spouse, civil union partner or dependent child lives in the family home.

Many people put their assets into family trusts in the hope that they will be eligible for rest-home subsidies in the future. However, you need to have finished “gifting” (giving) all but \$25,000 of your assets to the trust at least **five years** before you apply for a rest-home subsidy (you can gift up to \$5,000 for each of those last five years without this money being included in the assets test). Gifting is explained later in this Infosheet.



## ***How can a family trust provide tax benefits?***

You cannot set up a trust solely for the purpose of avoiding tax. There must be another reason – for example, ensuring your business survives after your death, protecting your assets, or succession planning.

But if you do have a family trust, any income that comes into the trust and that is not distributed to beneficiaries will be taxed at a flat rate of 33%, whereas the top personal tax rate is 39%.

The trust income can also be paid to beneficiaries, such as family members, who may earn little or no other income, and they may therefore be liable to pay tax at a rate lower than the 33 percent trust rate.

## ***How can a family trust protect my assets?***

### **Protection from creditors**

People sometimes put their family home or other assets into a trust so that they're protected if their business fails. However, trusts that are designed to protect assets from creditors need to be very carefully structured. Further, if a person shifts assets into a family trust when they are already in financial trouble, the Official Assignee can later set aside the transaction.

### **Relationship property**

A family trust can also protect your assets from a former partner who decides to dispute a matrimonial or relationship property agreement the two of you have made and instead apply for your relationship property to be divided between you under the Property (Relationships) Act 1976. By putting the assets you received from the settlement into a trust, you put them one step further away from your former partner if they decide to dispute the settlement.

If you're getting involved with a new partner, you may also wish to put your assets in a trust so that if that relationship breaks up, these assets won't be available to be divided as relationship property.

However, there are limits to the protection that family trusts can provide in relationship property disputes. If property is transferred to a trust during a relationship and this has the effect of defeating the claim or rights of one of the spouses or partners under the Property (Relationships) Act, the Act empowers the Court to take that property into account in dividing the relationship property. The property can't be transferred back out of the trust, but the Court can order compensation for the affected spouse or partner –

- by altering the shares in the relationship property, or
- by ordering payment out of the other spouse's or partner's separate property, or
- as a last resort, by ordering payment out of the trust income.

Separating couples who can't agree on how their assets should be distributed sometimes put some of their joint assets in a trust for their children.

## 2. The structure of family trusts

### *How do family trusts work?*

Family trusts are a way of not owning your assets but retaining some control over how they are managed. When you set up a family trust, you “gift” (give) your assets, like your home, to the trust. This means they aren’t yours anymore – they now belong to the trust.

### *Who’s involved in a family trust?*

When you establish a family trust and put your assets into it, you are called the **settlor**. Your assets are looked after by the **trustees**, who are the legal owners of the trust’s property and the people who are legally responsible for the debt the trust owes you.

The trustees are not like any other owners of property, however. They have a special duty (a “fiduciary” duty) to manage the trust for the benefit of the people named in the original trust deed as the **beneficiaries** of the trust.

A trust can have more than one trustee. You, the settlor, can also be a trustee. However, if you decide to be a trustee, it’s important to also have another trustee who is independent or not a relative so that the trust is not seen as a sham.

A settlor can even be a beneficiary of the trust. However, it is important to get good advice about the impact of being a beneficiary.

As settlor, you may also be the **appointer** of trustees under the trust. This means you can appoint new trustees and beneficiaries at any time. When you die, the executor of your estate becomes the appointer for the trust.

### *Who benefits from a family trust?*

If you’re setting up a trust, you decide who will benefit from it. The beneficiaries could include you, your family, friends or charities. Anyone can be a beneficiary, but the trust’s tax status can be affected by your choice of beneficiary.

You can say that you want your grandchildren to be beneficiaries, even if you are yet to have grandchildren.

### *What property can go into a family trust?*

Just about any type of asset can go into a family trust. Trusts are particularly helpful in protecting major assets like your house and your investments.

It’s not a good idea to include assets that fall in value – like cars, boats and furniture. This is because, for the purpose of your gifting programme to the trust, you will still have to gift the original value of those assets, even if the value goes down.

### *Gifting your assets and avoiding gift duty*

If you simply give all your assets to the trust in one go, you will owe the government gift duty. To avoid gift duty, people usually sell their assets to the trust and then “gift” the money the trust owes them in stages until the debt is eliminated.

To completely avoid gift duty, you can gift no more than \$27,000 to the trust each year. This means that if you and your partner owned your assets equally and then set up a trust together, you could gift \$54,000 together every year to the trust.

### **3. Setting up a family trust**

#### ***How do I set up a family trust?***

You will definitely need the help of a lawyer or trust company to set up a family trust. They'll prepare the trust deed, which will say exactly how you want the trust to operate.

The trust is initially set up by giving it a small amount of money, say \$100, to get it started, and then by selling other assets to it, leaving the trust owing you the value of the assets. Then you gradually gift the debt back to the trust.

When you set up a family trust, make sure you change your will to take account of the new arrangement.

#### ***What's the best time to set up a family trust?***

If you want to set up a trust for future asset-testing purposes, you should do it as soon as possible. This is because, if you want to divest yourself of your assets for the purposes of the Residential Care Subsidy, you must have gifted all but \$25,000 of your assets to the trust by at least five years before you apply for the subsidy (you can gift up to \$5,000 for each of those last five years without this being included in the asset test for the subsidy).

Further, your assets – particularly if they include real estate – are probably going up in value, so the longer you take to set up the trust, the greater the value of your assets and the longer it will take for you to gift the assets to the trust.

For example, if –

- you're single
- have assets worth \$295,000, and
- want to set up a family trust so that you can receive a rest-home subsidy,

it will take you 10 years to gift \$270,000 to the family trust, and you can then apply for the Residential Care Subsidy five years after that, gifting the remaining \$25,000 over those last five years.

#### ***How are my assets valued?***

Most people want to transfer their assets to the family trust at the lowest possible value so that the debt the trust owes them is low. But be careful not to undervalue your assets, as at some point it could be found that you in fact partially gifted your assets. That would partially undo the benefits of having a family trust. You should get your property valued to make sure you transfer it to the trust at a fair value.

You can exclude chattels like curtains, carpets, dishwasher and light fittings from the value. Those aren't included in the council rating valuation (formerly called government valuation) anyway. You can also deduct the amount that you would have paid to a real estate agent if you had sold the house.

Another way of reducing the value of your house is by entering into a lease for life with your trust. Because this guarantees you the right to live in your house for the rest of your life, it dramatically brings down the current value of your house. However, to avoid the family trust paying tax, you must enter into this lease before you set up the trust. It would be between you as owner and you as tenant.

To find out the value of jewellery, antiques or art, get a written valuation from a dealer.

### ***How much will it cost to set up the trust?***

Setting up a family trust and transferring your family home to it could cost from \$2-3,000.

When you ask a lawyer or trust company to set up a family trust for you, ask them to tell you exactly how much it will cost, including GST and any “disbursements”. These are costs they may need to pay to other people, for example to search for your house title. You should also tell your lawyer or trust company that you want to know immediately if any unexpected costs arise.

## **4. Trusting a family trust: How trusts are controlled and managed**

### ***How much say can I have in the family trust?***

When you set up a trust you can decide exactly what sort of trust you want and how you'd like it to work for your family. You'll have to make decisions about –

- what powers the trustees should have
- what the trust will be called
- how long the trust should run for.

These guidelines form part of the **trust deed**, which is a legal document describing how the trust will operate. It's not easy to change this deed.

Also, if you're the appointer, you can choose who the trustees are and fire them if you don't like the decisions they're making.

You might also want to write a **Memorandum of Wishes**, which says what you'd like to happen with your assets. For example, you might say that you'd like your house to stay in the family forever or that you would like each of your children to benefit equally. It's a bit like a will, except that it operates while you're alive as well as dead.

The trustees don't have to obey your wishes. But they're likely to take them into account if you put them into the Memorandum.

### ***What do the trustees do?***

The trustees make sure that the trust is run as set out in the trust deed. They decide what sort of investments the trust makes and how any money is distributed to the beneficiaries.

The trustees have a lot of control over the trust and it's therefore important that you choose trustees who you trust. You can be a trustee yourself, but it's not a good idea to be a sole trustee.

## ***How do I choose my trustees?***

Anyone can be a trustee, so long as they are over 20 and have normal mental capacity. They may be individual people or corporate bodies.

The most important thing is to choose people who you trust to carry out your wishes. They also need to be capable of managing the trust. This may not require special expertise if the trust only owns your family home; but if you have more complex investments the trustees will need to be people who can manage them well, particularly if you want the trust to continue after your death.

Most trusts have two trustees. You could appoint yourself or a close friend, as well as a professional who knows how trusts work, such as a lawyer, accountant, trust company or financial adviser. The professional will make sure that all the paperwork is completed properly and that the gifting statements are filed with IRD.

## ***How do I choose a professional trustee?***

If you don't know a lawyer or accountant who you trust, ask for a recommendation from a friend.

You could also try a trustee company. Professional trustees will charge you for their services, so make sure you understand what their charges will be. If the trust owns only your family house, the charges should be only a few hundred dollars a year while the gifting is occurring.

## ***Can I keep living in my house?***

Even though the trust owns your house you can keep living in it, so long as the trustees don't sell it. One way to guard against this is to make a "lease for life" agreement before transferring your house to the trust. This guarantees you the right to live in the house for the rest of your life.

## ***Can I sell my home if it's in a family trust?***

Yes, the trust simply sells the old one and buys a new one of your choice. Typically you, the settler, will make all the arrangements and the trustees will need to sign the documents.

## ***What if I want to put more assets into the trust?***

You can sell more assets to the trust whenever you want. However, the trust will then owe you money for them and this will increase the gifting period.

## ***What if I want to close down a family trust?***

Trusts can't continue for more than 80 years and can usually be closed down before then. It's just a matter of the trustees deciding to close them down and distributing the assets.

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Printed: 9 October 2009

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