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TRUST PROTECTIONS RELIANT ON GOOD MANAGEMENT

Family trusts have come under the spotlight again in a recent New Zealand Court of Appeal decision involving Dunedin-based litigants. The outcome in this case should be a warning to the many New Zealanders who have used a family trust structure in the management of their affairs but have less appetite for ensuring the ongoing good management of the trust.

There are several reasons why a trust may be an appropriate asset planning structure. A trust is an effective way to keep assets protected for vulnerable individuals or to hold assets in a manner that is more advantageous to them or their family. Vulnerability can arise due to age, capacity, intellectual ability or family circumstances.

For business owners, trusts are particularly effective in ring-fencing family assets from the risks of business ventures. Trusts can isolate assets from creditors as long as the transfer or gifting of assets was not done with the intention to defraud creditors or while the person was insolvent. Gifts made within two years prior to a person being adjudged bankrupt are also able to be challenged.

Another common reason for establishing a trust is to enhance a person's eligibility for a means-tested benefit such as the Residential Care Subsidy. A person who has transferred their family home and other assets to a trust and gifted off the resulting debt over time may still qualify for Residential Care Subsidy provided that the amounts gifted do not exceed the limits specified in the legislation.

Trusts are also used as a mechanism for protecting assets which might otherwise be available to spouses making a claim under the Property Relationships Act. The recent Dunedin case which went to the Court of Appeal involved a claim by a spouse (Ms M) for a share of profits from the sale of an Arrowtown house which had been built her ex-partner (Mr H). Mr H, who is a builder, built the home on land owned by a trust established by him and of which he was trustee (together with his solicitor). Ms M was successful in being awarded the equivalent of a 15% interest in the profit made on the sale of the house based on contributions she made during the relationship.

The important message from this case for trustees of trusts and those contemplating establishing a trust is the importance of good trust administration and all trustees actively turning their minds to matters involving the trust.

The Court criticised the way in which the trust was administered, particularly in relation to the period during which the house was being built. It found that the independent trustee, a solicitor, allowed Mr H to make all the decisions of the trustees alone. He allowed him to bind the trustees to contracts relating to the construction of the house, therefore imposing an obligation on the trust to pay the amounts owing under those contracts. He allowed Mr H to operate the trust bank account as if it were his own including receiving Mr H's salary and paying his living expenses as well as trust expenses. The trust had very few records and there was no documentation for the bank facility required for the building of the house. It appears the independent trustee was unaware of that facility.

In that particular case, the lack of oversight by the independent trustee, and the failure of Mr H to involve the independent trustee, was the chink in the armour which enabled Ms M to succeed in her claim for a share of the profits from the house sale.

Whilst many family trusts are administered by law firms and accountants who may also act as independent trustees, the obligation to ensure that all proposed transactions are properly considered, authorised and documented lies with all trustees. Trustees who continually fail to complete the documentation in a timely manner and to attend trust meetings where necessary are undermining the effectiveness of the trust as an asset planning tool. The moral of the story is, if you are a trustee, make sure your trust is actively managed, and that you ensure all key decisions are discussed by all trustees and appropriately documented.

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This article was published in the Otago Daily Times on Monday 25th August 2014.