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FAMILY TRUSTS

ARE THEY FOR ME?



property / trusts / estates / business / employment / litigation / debt resolution / relationship property

1.0 What Risk is my Family Home/Assets at?

1.1 There are four main ways whereby your assets are placed at risk:

- 1.2 (a) **Inheritance Protection** - Since the passing of the Property Relationships Act 1976, the rules relating to marital splits are also applicable to de facto relationships. If you leave your estate through your will, then whatever your children receive will be at risk of property claims by de facto partners/spouses in the eventuality of a relationship/marital breakdown.
- (b) **Creditors** - if you become bankrupt then all of your personal property will automatically vest in the official assignee.
- (c) **New Zealand Super/Resthomes** - should you have a stroke (or some other permanent illness) and are required to reside permanently in a private hospital then depending on your level of incapacity this will cost you somewhere between \$700 and \$1,500 per week. Keep in mind that the current New Zealand Super payment is approximately \$348.92 (single person) per week. The Government will subsidise the difference provided your assets are under the following limits:

	Current Allowable Asset Level as at 1 July 2011
Single person Married couple <i>(where both are in long-term residential care)</i>	\$210,000 of assets \$210,000 of assets
Married couple <i>(where only one is in long term residential care)</i>	\$115,000 of assets PLUS house and car or a total asset level of \$210,000.00

The value of assets you can retain while still qualifying for Government financial assistance increases by \$10,000 per year.

If you are unsure as to how the asset testing will affect you, you can call the **Ministry of Health Information Line on 0800 737 777** or alternatively you can obtain information from their website at moh@govt.nz /[assettesting](http://moh.govt.nz/assettesting).

By assets they mean things such as:

- (i) cash or savings;
- (ii) investments, shares or stocks;
- (iii) loans made to others (including loans to family trusts);
- (iv) your house, chattels and car if you live alone.

Assets they will not include are:

- (i) your house, chattels, or car if your partner or dependent child still lives at home;
- (ii) personal belongings such as clothing and jewellery;
- (iii) pre-paid funeral expenses for you and your partner of up to \$10,000 each.
- (d) **Relationship Property Claims** - should you be entering a marriage or de facto relationship and are taking into that marriage or relationship a disproportionate value in assets, then they may be at risk should that marriage or relationship fail.
- (e) **Family Protection Claims** - upon death your Will can always be challenged by members of your family. You may wish to avoid this.

1.2 There are a number of legal mechanisms available to you whereby you can protect such personal assets and they include:

- (a) The formation of a Family Trust or Trusts.
- (b) Joint Family Home Application - This applies to the matrimonial home only.
- (c) Property Agreement pursuant to Section 21 of the Property (Relationships) Act 1976.
- (d) The formation of a Limited Liability Company.

2.0 Family Trusts

2.1 In order for you to understand what is involved in setting up Family Trusts, and the mechanics of transferring your assets, we have set out a number of questions and answers which we hope will be of assistance. Of course there are many other issues involved, however, we believe this paragraph will cover the main ones.

Q. What is a Family Trust?

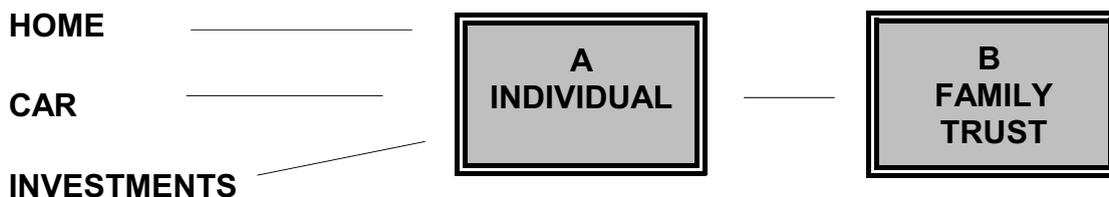
A. A Family Trust is a separate legal entity which is recognised by the law. As such it can sell and purchase property. The Family Trust itself has three main components:

- (a) The Settlor - the person setting up the Trust;
- (b) The Trustees - the persons who are the legal owners of the Trust property;
- (c) The Beneficiaries - those class of persons who are entitled to receive income and/or capital of the Trust.

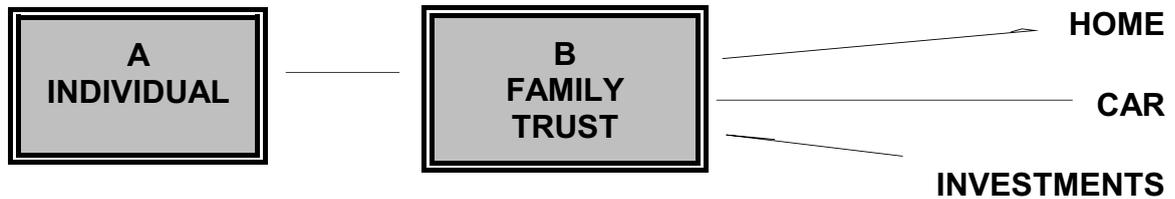
Q. How can a Family Trust be of assistance to me?

A. The Family Trust, being a separate legal entity, is a vehicle that you can use to own all your assets rather than owning them individually. Any assets you own in your own name will be under threat by Government means testing, creditors and matrimonial property claims etc. As a general rule, if you do not own any assets then you would not have any assets to lose. This can be best explained in diagrammatic form:

EXAMPLE 1 - WHEN INDIVIDUAL OWNS ALL ASSETS



EXAMPLE 2 - WHERE A FAMILY TRUST OWNS YOUR ASSETS



In example 1, if A, being the individual, has a stroke then his/her home, car and investments would be subject to asset testing and would have to be declared to Work and Income New Zealand (“WINZ”). But in example 2, if A, being the individual, does not own any assets and, as such, would not have to declare those assets to WINZ while retaining, via the family trust, the benefit of still having the use of the family home, car and investments.

Q. What if I want to sell my home?

A. Then that is not a problem. The Family Trust can do whatever you can do as an individual. It can sell your property tomorrow and purchase a new one for you.

Q. Is this an overnight solution?

A. No it is not. It is important that any assets you own as at today are transferred to your Family Trust at market value. Gift duty was abolished in New Zealand as at 1 October 2011. However, WINZ have reiterated their policy in terms of qualifying for an accommodation allowance (see para 1.2(c) hereof). WINZ have further stated that if you gift more than \$27,000.00 in a twelve month period (individual or couple), then any excess will be treated as an asset and you may not qualify for an accommodation allowance if you require full time care. Although there is no gift duty payable on a gift in excess of \$27,000.00, as far as WINZ are concerned if you do gift in excess of \$27,000.00 in a twelve month period, this will certainly affect your eligibility. WINZ have further said they will go back and audit as many years at their discretion. Further, any gifts made in the five years prior to the application for full time care will need to be declared and treated as an asset. The allowable gift of \$27,000.00 per twelve month period will only be applicable if it was made in excess of five years or more prior to the date of application for the accommodation allowance.

Q. If I transfer my family home into a Trust have I lost control of it? Would my children be able to take over my assets?

A. No not at all. The Trust Deed contains a controlling clause which reserves in your favour the right to hire and fire your trustees at any time. You will have total control over the assets at all times until the day you die because it is the Trustees who have the discretion to distribute property belonging to the Trust. All we are talking about here is paper work, so that your next door neighbour and children do not have to know anything about it, if that is your wish.

Q. What if I own a business and it runs into cashflow difficulties - would my home be protected?

A. The same principle applies in the situation of Government asset testing. If you do not own any assets then, on bankruptcy, you have no assets to lose.

Q. What happens if after the setting up of the Family Trust I separate from my spouse?

A. Obviously you would want to be careful to preserve the rights you have at the moment under the Property (Relationships) Act 1976 ie. a 50/50 split in the event that your marriage/ de facto relationship comes to an end. This situation can be easily resolved by setting up a Trust each and transferring the matrimonial home to the Trusts 50/50. You should also note that S44A of the Property (Relationships) Act 1976 allows the Family Court to make orders against the Trustees where relationship property has been transferred into a Trust during the course of the marriage or de facto relationship and such transfer has had the effect of defeating a claimant's claim under the Act. If you have already entered into a de facto relationship and it is your wish to retain such assets transferred as separate property at all times, then it would also be prudent to enter into a Contracting Out Agreement under S21 of the Property (Relationships) Act 1976 at the same time as the transfer of assets to the Trust.

Q. What about the costs of setting up a Family Trust and transferring assets?

A. Well obviously this will depend on each individual's circumstances. However, at Collins and May we would give you a fixed fee before commencing any work so you would know at day one how much this was going to cost. We also have a facility to allow the account to be

paid off in equal payments up to a maximum period of three months (*please feel free to discuss this with us*).

Q. What if I want more information about Trusts in addition to what is set out in the pamphlet?

A. Collins and May offer a 20 minute free no obligation consultation where your individual circumstances can be discussed. In addition, we would explain to you in more detail what is involved in setting up Family Trusts and the mechanics of transferring your own assets to the Trust. Please feel free to contact Lloyd Collins or Eugene Collins at our Lower Hutt Office on (04) 566 5775.

3.0 Inheritance Trusts

Q. What is the benefit of having an Inheritance Trust?

A. Most people in a standard family situation leave their assets to their children through their will. The danger is that should any such child enter into a de facto relationship or marry, then those assets are subject to claims in the eventuality of a relationship/marriage breakdown.

Q. What does a de facto partner receive in the eventuality of a relationship/marriage breakdown?

A. Provided the partner of your children is in a de facto relationship for three years/marriage for three years, then half the family home and family chattels (whenever acquired). Such person whom you may have never met yet, would also receive half of any "*relationship property*". Although there are a number of exceptions "*relationship property*" are all assets acquired by either party during the course of the de facto relationship or marriage in addition to the family home and family chattels.

Q. What if the family home is freehold at the time of commencement of the relationship?

A. That does not matter. Provided the partner lives in a de facto relationship with the owner for a minimum of three years, then they will receive half the value of the family home owned at the date of separation. The same rule is applicable to any chattels in the family home and any other relationship property acquired during the relationship or marriage.

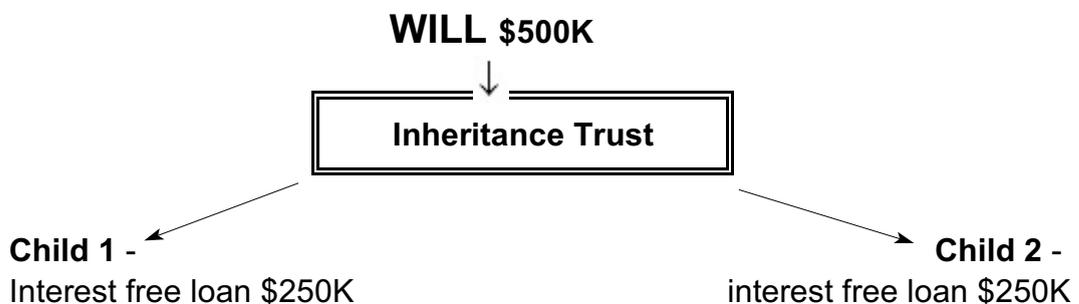
Q. Then how would my inheritance that I leave my children be placed at risk?

- A. From our experience most who inherit usually receive the money and pay off their mortgage etc. Say for example:
- (a) one of your children is in a de facto relationship at the time of death and they receive the inheritance through your will, which is the normal course of events; and
 - (b) say the relationship was to break up six months down the track; then
 - (c) because the mortgage was secured on the family home, half the inheritance has automatically passed to the de facto partner, yet probably the only contribution to that asset that person has made was attend your funeral.

Q. How would a Family Trust help this situation?

- A. What we recommend you do is have an Inheritance Trust. Instead of leaving your assets to children through your will you would simply leave all your assets to your Family Trust. The children can then keep the Family Trust going and leave the capital assets in the Trust and take their inheritance by way of an interest free loan from the Trust. It would work like this:

EG.



Say you have two children and you leave assets of \$500,000.00 then using the above mentioned example, if all the capital was left to the Trust then the Trust would simply advance \$250,000.00 to each of your two children. Instead of this being treated as an asset, which would be the case if you left the same amount through your will, this would now be advanced as a loan which would be repayable in the eventuality that the de facto relationship or marriage was to break down. In that eventuality the Trust would simply make demand for repayment of the loans from the assets of the parties and could be re-advanced once matters were sorted out with the de facto partner/spouse.

Q. So what would happen if the de facto relationship or marriage broke down?

- A. As set out above the Trust would simply demand repayment of the debt. By structuring your inheritance this way the assets you leave at the time of death are then treated as a “*debt*” as opposed to an “*asset*” and therefore not “*relationship property*”. This will ensure that your childrens future partners (*whom you have probably yet to meet*), will be prevented from making a claim against those assets. Because the inheritance has been treated as a debt, then repayment will be required so that your inheritance is preserved. As far as your children are concerned they still have the same use of that capital to pay off the mortgage if that is their wish. From a physical perspective nothing changes . From a legal perspective there is a huge difference in that the assets you leave behind at the time of death are protected from claims under the Property Relationships Act 1976 from people you have not even met yet.

4.0 Joint Family Home

- 4.1 By far the majority of people are of the view that they do have a joint family home. The fact that both names, in respect of a married couple, are listed on the title does not constitute a joint family home pursuant to the Joint Family Homes Act 1964. You must make a separate application and such application must be filed with the appropriate District Land Registrar.
- 4.2 The benefit of such application is that the equity in the family home is protected to a maximum of \$103,000 on one of the spouses becoming bankrupt. This benefit is not available until after two years of the application being filed with the District Land Registrar. The benefit can be attained three months after the lodging of the application should you wish to choose the option of having the application advertised in the public notices of the local newspaper.
- 4.3 The criteria to qualify for the application is as follows:
- (a) Married couples only can apply.
 - (b) Such application can only apply to the matrimonial home (not an investment property).
 - (c) You must be able to make a declaration that at the time of the application you can pay all your debts other than any mortgage secured against the property.
- 4.4 Please note that Section 20B of the Property (Relationships) Act 1976 protects equity in the family home to a maximum of \$103,000 or half the equity whichever is lesser upon bankruptcy of one spouse. It will, therefore,

be of no benefit to you to make application pursuant to the Joint Family Homes Act if your equity exceeds \$103,000.

5.0 Contracting Out Agreements/Court Orders

- 5.1 A Contracting Out Agreement under S21 of the Property (Relationships) Act 1976 or Court Order allows personal assets to be transferred between husband and wife or de facto spouses quickly and easily.
- 5.2 The main advantages of using this vehicle are:
 - (a) Such a transfer can be completed quickly and, therefore, assists the benefit of immediate creditor protection.
 - (b) There can also be certain income tax advantages where one spouse is not earning or earns minimal income.
- 5.3 The main disadvantage of this vehicle is that it remains in place in the event of a marital breakdown or de facto relationship breakdown. Eg. should the family home be transferred to the wife or de facto spouse, then in the event of a marital breakdown or de facto relationship breakdown the transferee spouse will retain sole proprietary rights in the family home. Such agreement/court orders are not revocable other than with the consent of both parties. A Contracting Out Agreement under the new Property (Relationships) Act 1976 can only be set aside provided the claimant can show “*serious injustice*”. Parliament has sent a clear message under the new Act to the Family Court that Contracting Out Agreements are not to be set aside lightly.
- 5.4 The avoidance provisions set out in paragraph 2 will also apply (see *Official Assignee v Smith - High Court Wellington B No. 399/90*). Also Section 47 of the Property (Relationships) Act 1976 provides that where an agreement is voidable but only for a period of two years after the making of the agreement.
- 5.5 This procedure can be very effective especially in the situation where the husband only is forced to give personal guarantees to trading creditors. The family home can then be transferred into the wife’s name only.
- 5.6 Section 20B of the Property (Relationships) Act 1976 will protect equity in the family home to a limit of \$103,000 or half of the equity whichever is the lesser upon the bankruptcy of one of the spouses. This has already been discussed in paragraph 3.4.

6.0 Limited Liability Company

- 6.1 The limited liability company will protect your personal assets from all creditors other than secured creditors and creditors where you have had to give a personal guarantee. The limited liability company provides a shield to personal assets which would not be available to you if not put in place at the time of commencement of business.
- 6.2 Most creditors of a company now require a shareholder/Director guarantee before offering credit to a company. Banks almost always require additional security by way of such a guarantee.
- 6.3 If the company is asset rich, then those assets of the company are susceptible to claims by creditors.
- 6.4 The company, therefore, does not necessarily hold the protection that it once had in respect to your personal assets.

DISCLAIMER

Please note that the enclosed booklet is for information purposes only and is not to be relied upon. Before relying on any of the information set out herein, it is important you consult a solicitor first.

Lloyd Collins or Eugene Collins

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