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The Importance of Completing your Trust Gifting Programme

By Michael Moohan

Bill was a Plumber who was self employed. A friend once suggested that to protect his family assets in case the business went under, he should form a Family Trust and transfer his assets like the family home into it.

Bill thought this was a good idea, set up his Family Trust and transferred his family home into it. The home was valued at $400,000.00 when he sold it to the Trust and so the Trust owed Bill $400,000.00.

Because the Trust had no earning power of its own, Bill's lawyer explained to Bill that once a year he should forgive $27,000.00 (which is the maximum you can give away without incurring gift tax) of that debt so that eventually the Trust would owe him nothing. In the meantime, Bill would retain a benefit in the house, although he would no longer own it or have a legal interest in it once the entire debt was forgiven.

For several years Bill forgave $27,000.00 of the debt each calendar year through the Trust Gifting Programme, until one year he let it lapse. At this stage the Trust still owed Bill $292,000.00 of the original purchase price.

After a while Bill's plumbing business failed with Bill personally owing large debts around town. He thought that even though he was liable to repay the debts, his family home was safe because it was in the Trust. He thought that this meant his creditors wouldn't be able to touch it.

Bill was wrong! You see the Trust still owed Bill $292,000.00 so the creditors could apply to have the Trust ordered to repay Bill so that they (the creditors) could in turn be repaid. Because the Trust had no way of coming up with that sort of money, its only option was to sell the family home and to repay the debt.

This meant that the whole reason that Bill had for creating the Trust in the first place, i.e. to protect the family home in the event his business failed, was for nothing.

This was obviously the worse case scenario for Bill, but even if his business had not failed, and he had eventually retired, consider his position if the Government of the day changed the law on asset testing or the superannuation surcharge. Because Bill's Family Trust still owed him $292,000.00 this would show up as an asset on Bill's account. Even though Bill is not getting any direct benefit from the $292,000.00 owed to him, it would be taken into account when assessing his superannuation benefit or ability to pay for rest home care.

While the superannuation surcharge and asset testing are not in force at present, there is nothing to stop the Government of the day bringing one or both of these back into force. It is for this reason that many family trusts are set up in the first place and it would be a great pity if they failed to protect because the Gifting Programme was not completed.

Once you have transferred assets into your Trust, it is imperative that you set up a Gifting Programme to be completed each calendar year until the debt is forgiven. It is only by doing that, that you can be sure that eventually your Family Trust will no longer owe you anything and its protection will be complete.

If you have any queries at all about Trusts or the Gifting Programme please do not hesitate to give us a call.

Next month Davina writes about the importance of a Will.

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