FAMILY TRUSTS

Is a trust right for you?

There are a number of potential benefits – and some responsibilities – that come with a family trust. Is a trust the right fit for your family? How would it work for you, in your circumstances? We look at some of the common reasons why people choose to establish a family trust.

Creditor protection

One of the most popular reasons for establishing a family trust in New Zealand is protection against potential creditor claims. This is particularly significant for the many New Zealanders who are self-employed or own small to medium enterprises, who may be personally liable for their business debts. Assets held in a family trust are ordinarily protected from any claims by personal creditors of the beneficiaries. This does not apply in the case of assets that are settled on a trust with the intention of defrauding creditors.

Setting aside income or assets for specific purposes

A family trust can be a good way to set aside money or assets for a specific purpose, such as a child's future education. One of the benefits of this arrangement is that the beneficiary does not have control over the trust assets, which are instead managed by the trustees for the purposes of the trust. This can be important if you have concerns about your child's ability to manage their own affairs, whether due to their age or any other vulnerability. A trust may also provide a useful vehicle for protecting specific assets, such as a family home, holiday home or other heirlooms, to ensure these can be passed down through the generations.

Protecting property against estate claims

Family trusts can be useful as a way to protect against estate claims after your death. Assets that you hold in your own name at the time of your death can be the subject of a claim by your family under the Family Protection Act 1955, which empowers a court to make orders overturning the effect of your will. However, there is no power for a court under that legislation to rewrite the terms of a trust.

Can trusts prevent relationship property claims?

In many cases, no. Historically, there was a perception that using a family trust would protect your property from a relationship property claim. However, the law has evolved rapidly in recent years and courts are significantly more willing to engage in 'trust busting' in the relationship property context. Anyone seeking to use a family trust for this purpose would be well advised to consult a relationship property specialist before taking any further action.

Sharing income between family members

Assets held by a trust can be a source of income, which can be shared among the beneficiaries of a trust at the discretion of the trustees. Income derived in a tax year that is distributed to adult beneficiaries within the timeframe to be treated as beneficiary income for tax purposes is taxable at the beneficiary's marginal tax rate rather than at the trustee rate of 33%. This can be especially beneficial where the beneficiaries of the trust include people who have little or no income. (Income paid to minor beneficiaries is always taxed at the trustee rate however.)

Currently, the top personal tax rate is the same as the trustee rate (33% in both cases), which limits the impact of income splitting through a family trust. However, the balance could shift when a new top personal tax rate of 39% is introduced in April 2021. In that case, there could be significant benefits for high income earners in ensuring that key income-earning assets (such as investment properties and shares) are held in a family trust rather than in their personal capacity.

Alongside the new top personal tax rate, the bill will require the trust to provide more information to the IRD about the financial position of the trust and any settlements and distributions relating to the trust. The government has indicated it will be on the watch for abuse of trusts, however taxpayers who engage in legitimate income sharing arrangements, should have little cause for concern.

Note that income splitting through a trust structure is only possible for income derived from assets. Salary and wage earners are unable to use a trust structure for this purpose.

These benefits are illustrated on the following page.

CASE STUDY

Aroha owns 100% of the shares in a company that runs a manufacturing business and earns a market-rate salary of $180,000 from her job as CEO. Brian has a voluntary role with a charity and the couple have an adult child, Charlotte, at university with no other sources of income.

SHARES ARE HELD BY AROHA PERSONALLY

33% TOP PERSONAL TAX RATE

- Aroha receives $100,000 in dividends, and is taxed at 33%.

$33,000 TOTAL TAX

39% TOP PERSONAL TAX RATE

- Aroha receives $100,000 in dividends, and is taxed at 39%.

$39,000 TOTAL TAX

SHARES ARE HELD IN A TRUST

33% TOP PERSONAL TAX RATE

The trust receives $100,000 in dividends. The dividends are shared among the beneficiaries as follows:

- Brian gets $70,000 (marginal tax rate = 30%). Tax paid on dividends = $14,020.
- Charlotte gets $10,000 towards university fees (marginal tax rate = 10.5%). Tax paid on dividends = $1,050.
- Aroha gets $20,000 (marginal tax rate = 33%). Tax paid on dividends = $6,600.

$20,770 TOTAL TAX

$12,330 TAX DIFFERENCE

39% TOP PERSONAL TAX RATE

The trust receives $100,000 in dividends. The dividends are shared amongst beneficiaries as follows:

- Brian gets $70,000 (marginal tax rate = 30%). Tax paid on dividends = $14,020.
- Charlotte gets $10,000 towards university fees (marginal tax rate = 10.5%). Tax paid on dividends = $1,050.
- Trustee retains $20,000 (marginal tax rate = 33%), which is subsequently reinvested into the company. Tax paid by trustee on dividends = $6,600.
- Aroha gets nothing (marginal tax rate = 39%).

$20,770 TOTAL TAX

$18,230 TAX DIFFERENCE

KEY CONTACTS

With the benefits of a family trust come various responsibilities and legal obligations. Before establishing a trust, you should seek legal advice from a qualified professional who will help you to decide whether a trust is right for you. We provide advice on trust governance, including preparation of trustee resolutions and related documentation, as well as on tax issues and trust disputes.

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