
THE BIG PICTURE: NEW RULES FOR TRUSTS

A toolkit for trustees

December 2020



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Risks and opportunities

After a decade-long reform process, long-awaited legislation governing trusts will come into force on 30 January 2021. The New Year will bring changes affecting both trustees and trust beneficiaries - from new duties and changes to record-keeping for trustees, to rights to information for beneficiaries.

Once in force, the Trusts Act 2019 will apply to all current and future family trusts and charitable trusts.

While it has been almost 65 years since Parliament last looked at the foundations of trust law, this reform isn't a seismic shift. Only some of the rules currently governing trusts are expressed in the Trustee Act 1956. The majority have been shaped by years of court judgments. When the Trusts Act 2019 takes full effect next year, it will adopt and modify some legal aspects of that case law and restate much of the previous statute in appropriately modernised language.

The new Act does, however, introduce some new concepts, and with those changes come risks trustees should be aware of. But the changes also bring an opportunity. Many trusts will have operated with little alteration since they were set up. These new rules provide a chance to rethink how each individual trust will best work for all those involved.



Trust deeds - what happens and who is affected?

It is important to recognise that the Trusts Act does not intend to displace the importance of the trust deed which sets out the terms of a particular trust. The trust deed remains the paramount source of the rules governing operation of each trust. The Act will sit alongside the trust deed to set out some supplementary rules.

Significantly, the incoming Act does not require conforming amendments to be made to all existing trust deeds. That said, it would be good practice for trustees to be aware of the more important changes made by the Act and, indeed, to adopt them if worthwhile.

The Act is primarily concerned with the rules on the office of trusteeship and the legal relationship between trustees and trust beneficiaries. With third parties – particularly creditors – general contract and applicable statutory law continues to govern.

THE COMPANY AND THE TRUST: TWO DIFFERENT LEGAL PERSONALITIES

Trusts and companies have a lot in common. Just as trusts have a trust deed, a company has a constitution specifying how the company and its directors may act but with the Companies Act 1993 supplying a large volume of supporting law.

In one important respect, however, there is a significant difference between the company and the Trust as two different forms of legal personality.

The company system provides for public registration with some oversight by the Registrar of Companies and, ultimately, the courts. For trusts the system continues to be of a “self-policing” nature. The Act does not provide for a registration system or a government sponsored “ombudsman” to monitor trustee activities and deal with complaints. Ensuring legal compliance with trust law remains entirely in the hands of trustees. That means that trustees do need to have some understanding of trust law principles.

Find the Trusts Act at www.legislation.govt.nz

Trustee duties

There are a number of more significant areas of change that trustees should be aware of. These include the trust law duties trustees should observe, the supply of information to trust beneficiaries, and the way trust records are kept, along with a raft of more minor issues. Among these, there may be areas or issues that individual trustees believe warrant more detailed consideration.

If there are particular areas of sensitivity a proactive approach to working through them now is more likely to promote the better long-term result.

For the first time statute law endeavours to express the range of legal duties trustees are expected to observe when administering their trust. In setting out these duties the Act seeks to capture in summary form the rules which have been developed in case law over many years. The objective is to widely publicise the principles that both legally qualified and lay trustees might usefully consult for guidance on how they approach implementation of the trust.

The formalisation of trustee duties is of key importance. If, in fulfilling their role,

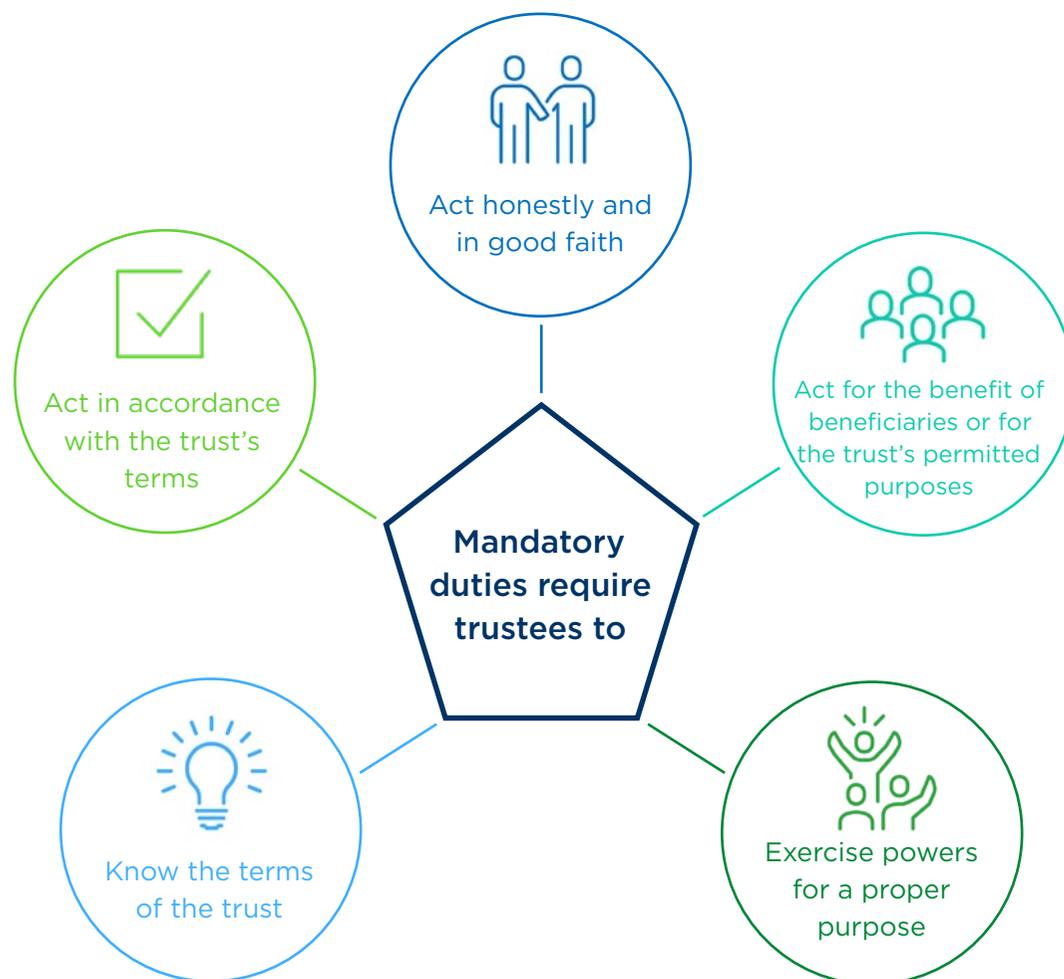
trustees cannot be said to have breached their legal duties, other parties such as trust beneficiaries have little ground for challenging trustee actions. Conversely a breach of duty may lay the foundation for a successful claim against trustees.

The Act divides trustee duties into two categories. One covers **mandatory duties** and the other **default duties**. The difference between the two is that only default duties offer trustees the element of choice – they can elect that some or all of the default duties will not apply to their trust.

If any of the default duties are not already excluded by the existing trust deed, and trustees want them to be excluded, then it will be necessary to amend the trust deed.



Trustee duties - mandatory



The overall theme of these duties is that trustees must keep the position and interests of all trust beneficiaries in mind when they come to decide trust matters. It would be ill-advised, for example, for trustees to decide a matter simply on the basis that it is “their” trust or that they contributed substantially to build up of its asset base. Trustees must have regard to the position of all trust beneficiaries.

For **family trusts**, recognition that it is the position of all beneficiaries which is relevant may lead to it becoming apparent that there needs to be some balancing between the interests of different beneficiaries. For example, in the usual family trust scenario of beneficiaries comprised

of parents and their children, parents who are in retirement might be judged to have a greater need for financial assistance from the trust compared with children engaged in paid employment. In making judgments on who to favour financially, the mandatory duties require the trustees to act honestly and in good faith.

For **charitable trusts**, the mandatory duty for trustees to act in accordance with the trust's permitted purpose is very important.

In distributing funds for a worthy cause the trustees of a charitable trust need to ensure that the cause aligns with the trust's stated charitable purposes. It wouldn't be compliant with the mandatory duty for trustees to simply consider a distribution for the general benefit of the community, for example, if that isn't the stated purpose of the trust.

Trustee duties - default



Some of these duties can be seen to overlap with mandatory duties. For example, default duties on acting reasonably, maintaining impartiality and not to profit personally from the trusteeship are similar to the mandatory duties of acting honestly and for the benefit of beneficiaries. The common theme is that trustees must act with propriety.

The default duties to invest prudently and to avoid conflicts of interests with beneficiaries are more freestanding. We would expect these principles to be covered in most existing trust deeds. It has been common drafting practice for many years for trust deeds to effectively “contract out” of the duty to invest prudently that was expressed in the former Trustee Act 1956. Trust deeds also usually include a conflicts of interest clause that may permit a trustee to decide a matter in his/her favour as a trust beneficiary.

The approach to investment and conflicts of interest are important aspects of trust administration. These areas have produced numerous legal claims against allegedly wayward trustees. Individual trustees may find merit in refreshing their understanding of how these two topics are dealt with in their own trust deed.

“ These areas have produced numerous legal claims against allegedly wayward trustees. ”

The approach to investment warrants one further observation. Although a trust deed may exclude or modify the duty to invest prudently the Act does set out a useful list of the factors which ought to be taken into account in any event. Trustees may find it helpful to consult section 59 of the Act for a statement of the range of factors that inform good investment decision-making.

What information should trust beneficiaries get?

Recent case law on disclosure of trust information by trustees to beneficiaries shows that the courts are very much in favour of disclosure. The Act is likewise sympathetic to disclosure, and sets out detailed rules that will apply from the end of January.

The Act's rules on disclosure apply to all current and future family trusts. It is not possible for a trust deed to exclude their application.

The objective of the disclosure rules is to ensure that beneficiaries have access to sufficient information to

enable the trust to be enforced against the trustees. If a trust beneficiary has a sense that administration of the trust may have gone awry, the disclosure rules provide a means of facilitating further investigation to check whether concerns are well founded.

BASIC TRUST INFORMATION

A proactive approach is specified by the Act. It is up to the trustees to decide whether to take the initiative and make a disclosure of basic trust information.

Both the provision of "basic trust information" and requests from beneficiaries for "other trust information" are covered by the Act. These categories differ in the kind of information that should be supplied, and in how trustees are to deal with them.

OTHER TRUST INFORMATION

A reactive approach is stated. It is left to trustees to decide how to respond to a request from a beneficiary for other trust information.

The Act creates a presumption on disclosure for each category, but leaves the final decision whether to do so with the trustees.

Significantly, neither basic trust information nor other trust information covers provision of a record of trustee reasons for decisions they have made. This exclusion enables trustees to maintain confidentiality around their deliberations.

What information should trust beneficiaries get?

Basic trust information

The Act creates a presumption that trustees will provide beneficiaries with basic trust information.

Basic trust information is:



Confirmation that a person is a beneficiary



The name and contact details of the trustees



Details of any changes of trustee



The right of the beneficiary to request a copy of the trust deed and other trust information

A list of factors is outlined in the Act to help trustees decide if the presumption in favour of disclosure should be followed. After considering this list (detailed on page 9), if trustees reasonably consider that the basic trust information need not be made available to every beneficiary, the information may be withheld from one or more beneficiaries.

The responsibilities around basic trust information are ongoing. If basic trust information has not been supplied to all beneficiaries, the trustees must consider at reasonable intervals whether the information should be made available.

What information should trust beneficiaries get?

Other trust information

There is also a presumption that trustees will supply information that a beneficiary has requested. Again, trustees should consult the list of factors (on page 9) in the course of deciding whether to meet the request.

If, after consideration of the factors, the trustees reasonably consider that the information should not be supplied, then it can be refused.

The category of 'other trust information' will most likely involve requests for financial statements. It would be hoped that provision of the statements is the end rather than the start of the exchange of information.

One area of sensitivity may be the potential disclosure of distributions made to beneficiaries. Where trustees have exercised their discretion to favour some beneficiaries over others the fortunate ones could expect what they have received to remain private.

“ The rules on the supply of trust information to beneficiaries are likely to be the most far-reaching change in practice made by the Act.

Redactions could be considered in this case. In the past, trustees have not generally made extensive disclosure of trust affairs to beneficiaries. The Act, with its presumptions in favour of disclosure, may push disclosure toward becoming a routine feature of trust administration.

At the very least, trustees should review the checklist of factors around disclosure (on page 9). One key factor may be the reference to the age and circumstances of a beneficiary. In some scenarios, this may raise the question of whether the beneficiary has reached sufficient maturity to absorb and understand the trust concept. Trusts are a vehicle for the long-term holding of family wealth, with that wealth to be drawn on sparingly in light of circumstances as they develop, taking the interests of all family members into account. The reserve nature of a trust needs to be firmly understood.

Despite the obvious sensitivity around disclosures of family wealth, with careful thought trustees should be able to successfully navigate the legal requirements related to their particular circumstances.



What information should trust beneficiaries get?

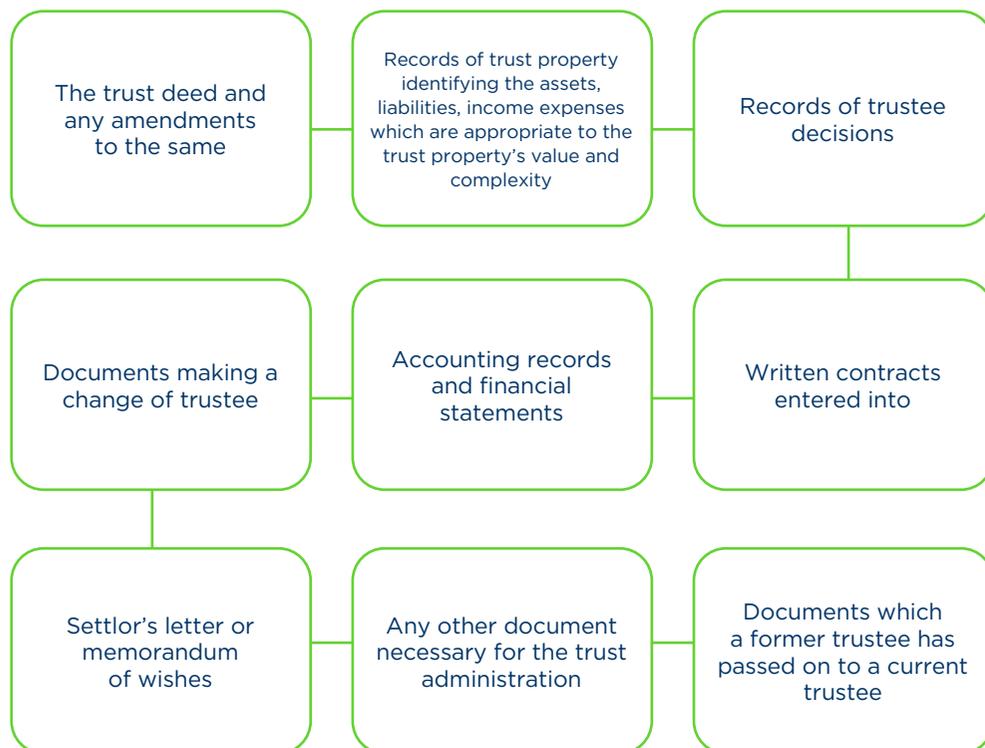
Trustee checklist – should information be supplied?

The Act provides an extensive list of factors to guide trustees in deciding whether either of the two presumptions on disclosure mean information should be supplied to beneficiaries.

- ✓ the nature of beneficiaries' interests in the trust and the likelihood of a distribution to the beneficiary in the future,
- ✓ whether personal or commercial confidentiality applies,
- ✓ the expectations of the settlor on the sharing of information when the trust was created,
- ✓ the age and circumstances of beneficiaries,
- ✓ the effect on the beneficiary receiving the information,
- ✓ the effect on trustees and beneficiaries if information is provided,
- ✓ the effect of giving the information on relationships within the family,
- ✓ the effect of giving the information on the relationships between trustees and beneficiaries,
- ✓ the practicality of giving information to all beneficiaries where there is a large number of them,
- ✓ the practicality of restricting use of the information,
- ✓ the practicality of redacting the information,
- ✓ the context of an information request, and
- ✓ any other relevant factors.

Keeping trust records

Trust documents that must be held



A range of requirements for keeping records relating to a trust are set out in the Act.

It lists documents that each trustee must keep, as far as it is reasonable. This requirement extends to all trustees.

If a trustee has an incomplete set of records, the documents not held must be able to be obtained from a trustee who does hold them. Records need to be retained for the duration of the trust.

The requirement to keep financial records may not be too onerous, particularly if existing record keeping obligations are already in place.

A trust which earns income within the income tax base is already required to retain business records for each tax year for seven years after the end of that tax year. Retention of GST records are required for seven years after the end of the relevant GST taxable period. Obviously the Act overlaps with the taxation requirements although, significantly,

the requirements set by the Act are not time-limited.

A trust which is exempt from income tax, on the basis of registration under the Charities Act 2005 as a charitable entity, is not subject to specific record retention requirements. Although the Charities Act provides for the filing of annual returns, that statute does not also set out rules on the keeping of records. This means that the rules set out in the Act govern the keeping of records by charitable trust trustees.

Some charitable trusts may need to consider both the requirements of the Act and taxation requirements. Charities which receive donations, and which apply funds offshore, need to keep records relating to these matters. These tax requirements are not time-limited.

Keeping trust records

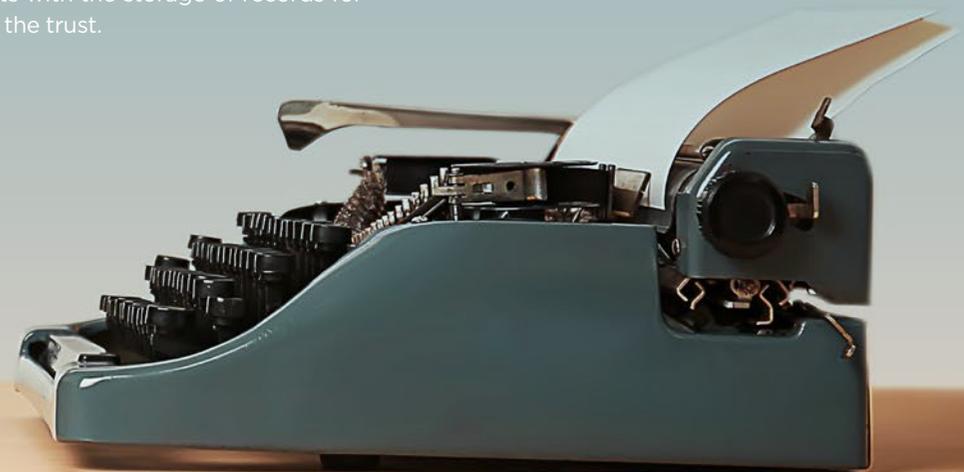
Form of the records

The Act does not provide any guidance on how records should be retained. In particular it doesn't specify whether the records must be in hard copy, electronic format or a combination of the two. The Contract and Commercial Law Act 2017 may be of assistance.

The Contract and Commercial Law Act 2017 addresses the scenario where a statute requires information in paper form to be retained. In that scenario, the information may be retained in electronic form if the

electronic form provides a reliable means of assuring that the integrity of the information is maintained. Information stored electronically is also required be readily accessible for future reference.

The storage of trust records by electronic means does seem to be legally permissible. This assists with the storage of records for the life of the trust.



Other key changes

There are a range of other issues of particular significance to trustees outlined in the Act.

Trustee indemnity

Case law entitles a trustee to be indemnified out of trust assets for all costs and expenses properly incurred in carrying out trustee duties. This indemnity can extend to the cost of engaging in trust litigation (though more refined rules apply in that class of case).

These principles are based on recognition that trustees are not usually remunerated, so it is appropriate that they be covered for costs when volunteering their services. The Act confirms that expenses incurred by a trustee are to be met out of trust assets when they are acting reasonably on behalf of the trust.

The Act also makes it clear that the usual indemnity does not apply where the trustee has been seriously remiss in the performance of trustee duties. Where there has been dishonesty, wilful misconduct or gross negligence on the part of the trustee, there can be no indemnity out of trust assets.

Appointment and removal of trustees

One problem which has come to the fore in recent times has been the ability to retire a trustee who may no longer have the appropriate mental capacity. The only solution currently available is to apply to the High Court for approval of a change of trustee. Doing so, however, would add to the costs of the trust, to the detriment of beneficiaries.

The Act proposes a less formal solution. The ability to remove and appoint a trustee is conferred on an attorney who holds an enduring power of attorney over the property of a trustee who is mentally incapable. This and other changes are introduced by the Act to help facilitate the removal and appointment of trustees (along with appropriate safeguards to prevent abuse).

Delegations

Under existing law it is difficult for a trustee to delegate the exercise of trustee functions. The office of trustee is regarded as one of a personal nature, which must be carried out by the trustee and no other. This has suggested that trustees should “micro-manage” trust affairs.

The Act relaxes current law. Trustees will be able to appoint another person to exercise many trustee powers and functions. However, if they do so, the trustee must retain oversight to ensure that in practice the arrangements work as intended.

Dispute resolution

Currently, disputes between trustees and beneficiaries usually have to be resolved in legal proceedings before the High Court. That may not only be due to the dispute raising trust law legal issues, but also because only the High Court has the power to bind the trustee and all beneficiaries to settlement of the dispute. Court approval may be necessary, for example, if some beneficiaries are minors.

In a novel step, the Act authorises alternative dispute resolution processes to resolve a trust dispute. The process may be a mediation or an arbitration. As a result, alternative dispute resolution becomes a pathway for disputes between trustees and beneficiaries.



Other key changes

Maximum duration period

A trust deed invariably expresses a maximum duration period for the trust. That was because the legal rule known as “the rule against perpetuities” prohibited a family trust from lasting more than 80 years. A charitable trust is not subject to this rule.

The Act abolishes the rule against perpetuities. In its place is the statement that the maximum duration period for a trust is 125 years.

It may be possible for an existing trust to transition from a maximum life of 80 years to a maximum of 125 years. If the trust deed contains a power of amendment, this change could be made by an appropriate deed of amendment.

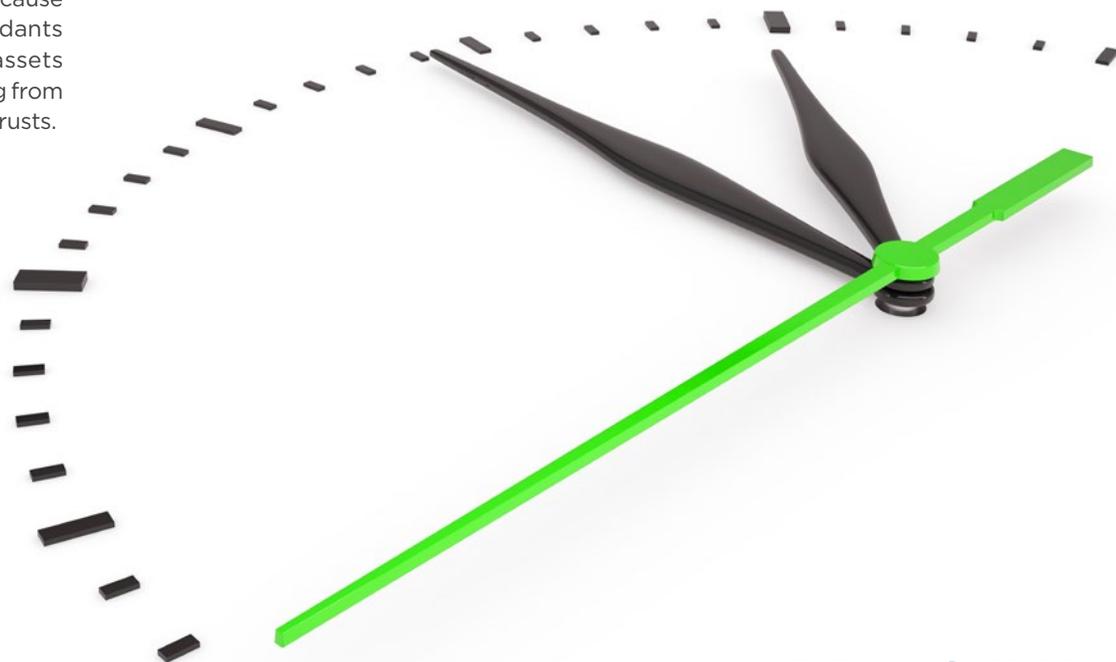
An amendment of this kind could be advantageous in some circumstances.

A scenario which often occurs is for a family trust to eventually be “divided up” for the benefit of the children of the parents who first started the trust. The division is accomplished by “resettling” an appropriate share of trust assets on trusts newly created for each child.

Importantly the perpetuity period or duration period for the new trusts must be no greater than the governing duration period for the original trust. This would mean that an enlargement of the perpetuity period for the original trust can also flow through to the new trusts. That may assist the children, because it could extend the line of descendants potentially able to benefit from assets (including replacement assets) flowing from the original trust through to the new trusts.

Other changes

There are also additional law changes made by the Act of more relevance to legal advisers than trustees. While these changes may influence the future drafting of trust deeds, they do not create deficiencies for existing trust deeds.



Our practice

Our team of trust specialists work closely with clients to ensure their objectives are achieved with solutions tailored to their specific needs.

We help individuals and families find practical and effective solutions to meet their personal asset planning requirements including the establishment of discretionary family trusts. We also regularly advise charities and trusts relating to commercial arrangements.

We provide advice on trust governance matters, including preparation of trustee resolutions and related documentation, and are experienced in disputes around trusts and contentious trust matters.

Our trust specialists are also tax experts, experienced in providing tax advice on trust related matters.

Whatever your needs, our team can ensure that your objectives are achieved with tailored solutions.



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