



**SUBMISSION
TO THE
LAW COMMISSION**

Review of the Law of Trusts

Stage 1: Second Issues Paper

Some Issues with the Use of Trusts in New Zealand

March 2011

Introduction

1. This Submission is from Trustee Corporations Association of New Zealand Inc (“TCA”) in response to the Second Issues Paper. We are available to meet with the Law Commission to discuss our Submission. We can be contacted at:

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2. TCA is a long established association to which all Trustee Corporations belong. The members of the TCA are Public Trust and each of the Trustee Corporations authorised under the Trustee Companies Act 1967 to act as Corporate Trustee for financial products – being Trustees Executors Limited, The New Zealand Guardian Trust Company Limited, New Zealand Permanent Trustees Limited (wholly owned by Public Trust) and Perpetual Trust Limited. Covenant Trustee Company Limited, although not authorised under the Trustee Companies Act 1967, is an associate member of TCA.
3. TCA maintains relationships with government ministries, regulatory bodies and financial sector groups. TCA sets minimum standards as practice guidelines for the performance of Corporate Trustees – standards for integrity, competence, financial capacity, internal controls, powers and duties, standards for conflict of interest management and for reports from scheme operators.
4. Trustee Corporations are most often associated with drawing up wills and trusts, putting in place enduring powers of attorney and handling estates, a service known as Personal Trusts. TCA contends that its members are uniquely qualified to fill this important role which requires independence, experience, professionalism and above all a focus on investor and beneficiary protection.
5. TCA members also provide prudential supervision of a wide range of investment products and financial arrangements in a number of ways and at various levels. In certain instances, fund managers must appoint a Corporate Trustee to meet regulatory requirements before they can offer a financial product to the market.
6. As at 30 June 2010, total Personal Trusts (excluding agencies and administrations) under supervision exceeded 26,000 with a value in excess of \$6.3b. Corporate Trust funds under supervision exceeded \$159b.
7. TCA appreciates this opportunity to comment on the Second Issues Paper.

TCA's General Comments

TCA acknowledges that the focus of this second issues paper is on family trusts, and that the number of family trusts in New Zealand and their use, particularly as a means of protecting property from creditor and relationship claims, is a cause for concern. However, the TCA believes that it is important not to let these issues cloud the review of our trust law, and the Trustee Act, as family trusts (of the common mum and dad discretionary variety discussed in the paper) are only part of the trust landscape.

Trusts are not only used in the personal and family property contexts but also as a vehicle for managing collective investments (unit trusts and superannuation trusts), in the business context (trading trust) and for charitable purposes. The TCA believes that any proposed changes to our trust law needs to be cognisant of the impact that these changes, perhaps aimed at addressing perceived problems with personal and family trusts, may have on the other types of trusts used in New Zealand.

Even within the context of personal and family trusts, no two trusts are the same. Some of these trusts are discretionary trusts created inter vivos by deed and some are life interest type trusts created by Will, and there are others in between. We must be careful not to tar all trusts of a family property nature with the same brush. A large number of these are established as a means of achieving legitimate objectives and are well administered by their Trustees.

As noted in our previous submission the TCA believes that the trust structure is a very important and useful tool and one that offers great flexibility in the management of property, for many different purposes. For example, a trust is often the best way of managing property for the benefit of family members who do not have the capacity to manage the property themselves due to age, medical or other personal issues.

Whilst the TCA shares the concern that some personal and family trust arrangements are being used for less than legitimate purposes it wishes to stress that the structuring of affairs to defeat creditors, avoid relationship property claims, obtain access to social assistance and take advantage of misaligned tax rates is not a problem with trusts per se. Companies, limited partnerships and other kinds of legal arrangements can be also used to achieve those same objectives.

It is TCA's view that a significant contributing factor to the misuse of trusts is poor advice at the outset and poor governance and administration going forward. The result is often trusts that are established for less than legitimate purposes and Trustees that are not fully aware of their obligations. The solution to the problem of misuse of trusts is not increased regulation. The solution is quality advice at the outset on the merits of establishing a trust and the appointment of independent, professional Trustees who are well placed to perform the duties of a Trustee and bring an independent mind and professional expertise to Trustee decisions.

TCA's responses to the Commission's specific questions follow.

Q1	In your experience, what are the reasons that people set up trusts?
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TCA comment

People set up trusts for a wide range of reasons. One of the major strengths of the trust is its flexibility. This allows advisers and clients to work together to tailor each arrangement to meet the individual client's particular circumstances and needs. It is therefore not possible to

accurately detail all the reasons that trusts are established in the family context. However, in the experience of our members the main reasons why people establish family trusts are:

- To protect property from claims by future spouses or partners (particularly for people looking at entering second relationships or who have built up substantial wealth before entering a relationship). The object here is often not to deprive the spouse or partner of their entitlement to relationship property but to ensure that separate property is protected for the benefit of others (often children from a previous relationship)
- To protect significant lifestyle assets such as the family home from potential claims by creditors. It is entirely legitimate and sensible for people about to engage in business to look to protect their family property, in the same way that it is legitimate to reduce the risk of personal liability through the use of a company. Trusts are often used for this purpose.
- To ensure that property is appropriately managed for children and other family members following death. Many people are concerned about their children inheriting large sums of money at a young age and/or at a time when they are not able to manage and invest it wisely. A trust is good solution to this as it enables Trustees to assess the circumstances at the time and make appropriate decisions to protect the children's interests.
- To manage issues that arise in the blended family context and the often conflicting obligations owed to new spouse/partner and children from a previous relationship. Trusts are often the best way of ensuring the interests of both parties are looked after.
- To manage property for family members that have a disability or who for whatever reason are not able to manage property themselves.
- To ensure that family wealth is managed in a tax efficient manner. The TCA does not believe that the use of trusts in the context of a wealth management/estate plan is as a matter of course a tax avoidance arrangement as it is legitimate for people to consider tax implications when structuring their affairs.

Historically concerns around estate duty (and the possible re introduction of it, or an inheritance tax) were also a factor. The manner in which social assistance is, and has been, assessed has to an extent also driven the use of trusts although the transfer of property directly to other family members is also a common means of planning in this context.

Q2	Do you think there are any purposes for which trusts should not be used? If so, what are these are why?
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TCA comment

TCA is strongly of the view that trusts should not be used for illegal or immoral objectives. TCA notes that under existing law, trusts established for such objectives are invalid (see Garrow and Kelly, *Law of Trusts and Trustees*, 6th edition, chapter 7 and Richardson, *Nevill's Law of Trusts, Wills and Administration*, 10th edition, Chapter 5).

Q3 Should trusts be available to be used to achieve any objective or should there be limits placed on the ways in which trusts may be used?

TCA comment

As noted above, trusts established for illegal or immoral objectives are invalid under current law. TCA considers that this is appropriate. Any further restricting of the purposes for which trusts can be established could inadvertently jeopardise one of the primary strengths of the trust arrangement: its flexibility. It might also bring into question the validity of many current trusts. TCA considers this outcome would be undesirable.

Q4 Is the extent of the control that a settlor may retain a cause for concern? If so, how might that matter be addressed?

TCA comment

As the Commission will be aware, the trust instrument may provide settlor with some residual control over the trust. This may be limited to the appointment and removal of Trustees but may also extend to giving consent before the Trustee can exercise certain powers such as the power to vary the trust, add or remove beneficiaries, etc. In some cases the settlor's consent may even be required before any distributions are made. In the TCA's view it is entirely up to the settlor to determine the terms of the trust on which he or she wishes to settle his or her property (subject, of course, to the trust having the essential elements of a trust as discussed in the Commission's previous paper).

The issue here, as we understand it, is not so much with the settlor retaining some control via the trust instrument or the terms of the trust but with the settlor controlling or influencing the decisions of the Trustees. The real issue is therefore the independence of Trustees in the execution of their decision-making powers. Trustees who fail to bring an independent mind to their decisions, or act only at the settlors' behest, are in breach of trust and risk being sued by the beneficiaries (eg children or grandchildren of the settlors). This should provide sufficient disincentive to place any undue reliance on the settlors' wishes.

It is inevitable that some Trustees, presumably acting in ignorance of their duties, may fail to bring an independent approach to their decisions. However, approaching this issue obliquely by attacking settlors' residual control is unlikely to solve the problems caused by Trustees' failure to act in accordance with their duties. Rather, it is the appointment of Trustees who understand their obligations and bring an independent mind to Trustee decisions that will mitigate this problem.

Q5 New Zealand appears to have a significantly higher proportion of trusts per head of population than comparable jurisdictions? Why is this? Is it:

Concern about existing or possible future government policies?

Prompted by a desire to protect assets from business risk?

To control the use or destination of assets to avoid obligations to third parties?

To avoid claims by spouses or partners of children to inherited assets?

To access state provided assistance?

Any other reasons?

TCA comment

All of the above and many more besides. The more relevant question is why do other countries not have so many trusts? The answer is that they have:

- capital gains tax.
- inheritance taxes.
- gift taxes.
- stamp duty.
- higher tax rates for trusts.

In contrast to overseas jurisdictions, New Zealand has the following features which also encourage the establishment of trusts:

- the ease of establishing a trust in New Zealand as compared to overseas.
- our relationship property regime has weak trust-busting powers as compared to overseas regimes (some of which look straight through trusts).
- trusts are often the most appropriate vehicle for the management of assets in complicated family relationship situations (eg, where a person has a number of successive partners with children from each relationship).
- inheritance rules in some overseas jurisdictions are prescriptive and do not contemplate or allow for the management of estate assets through a trust.

Q6 Are the existing legislative mechanisms for addressing the impact of trusts adequate? If not, can they be made more effective and how? Is the solution to strengthen the current provisions or is a stronger, more uniform solution called for? If you think there should be a single provision in trust legislation, what factors should be included in this provision?

TCA comment

TCA considers that, subject to the proviso below, the current legislative mechanisms are largely adequate.

The solution is not to attempt to impose a uniform trust-busting provision. As noted above, the various issues identified in the issues paper with the use of trusts are not trust-specific. Other kinds of legal arrangements can be used for the same purposes and to achieve the same outcomes. Targeting trusts through a uniform trust-busting provision will merely encourage the use of other techniques to achieve the same outcomes while at the same time complicating trust law and further undermining the integrity of trusts. It will not, in TCA's view, solve the problem.

The entity-neutral provisions of the Insolvency Acts are an example of the effective targeting of transactions (as opposed to entities). This sort of provision is equally effective against dispositions to trusts as to other kinds of legal entities or arrangements and, in TCA's view, should be the desired approach.

The weak claw-back provisions of the Property (Relationship) Act 1976 are one area that could however be strengthened. The Court's ability to make orders in respect of property transferred to a trust (even the transfer of relationship property that has had the effect of defeating a claim) are relatively limited, and in the TCA's view this has been a key factor in some of the sham cases referred to in the paper and the somewhat muddled law we now have as a result.

Perhaps the other area that needs to be looked at is our succession laws (such as the Family Protection Act 1955 and Law Reform (Testamentary Promises) Act 1949). Trust can be used as a means of sidestepping a testator's obligations under these Acts and the TCA suspects that this will be even more of an issue if gift duty is abolished. However, our law in this area is also long overdue for review and the TCA believes that the avoidance issue is one best addressed in that context rather than via our trust law.

Q7	Do you think that the principle that trusts should have a purpose or effect that is lawful and not contrary to public policy, or some other principle, should be included in New Zealand's trusts legislation?
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TCA comment

This is not necessary as the law already provides for this. Refer to *Garrow and Kelly* (above), chapter 7 and Richardson, *Nevill's Law of Trusts, Wills and Administration* (above) Chapter 5.

Q8	Are there any further adverse impacts of the proposed repeal of gift duty in relation to trusts? Are there change that should be made to trust law to address these adverse impacts?
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TCA comment

As noted, it will be possible to effect immediate transfer of all of one's assets to a trust without any duty to pay. This may make avoidance of one's obligations under Property (Relationships) Act 1976 easier. The strengthening of provisions targeting transfers that have the effect of defeating relationship property claims is the appropriate response. The same applies in respect of Family Protection Act 1955 and Testamentary Promises claims (should these regimes be retained).

The TCA does not however believe that the repeal of gift duty should result in any change to our trust law.

Q9	Is the law on sham and alter ego trusts satisfactory? If no, in what respects might it be altered? Is the "bundle of rights" concept satisfactory? Does it provide an acceptable way of addressing inequities in the area of relationship property? Should the law in these areas be left open to the courts to develop or is a legislative response called for?
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TCA comment

The 'bundle of rights' concept cuts across established legal principles – how do you place a value on the inchoate interests of discretionary beneficiaries? The law on shams and alter ego trusts is unclear. TCA believes that these judicial developments are the result of the Courts attempting to address the inadequacies of the claw-back provisions in the current relationship property regime. As noted above, the appropriate response is to strengthen those provisions rather than to create a statutory test for shams and alter-ego trusts.

Any further application and development of the shams and alter-ego doctrines should be left to the Courts. Sham and alter-ego are highly dependent on the particular circumstances of each case. It would therefore be difficult, if not impossible, to effectively distil a statutory test. Any such test would, in any event, require further interpretation from the Courts.

Q10 Should there be a statutory provision, such as that proposed in paragraph 5.47, enabling the courts to set aside a trust following consideration of a range of factors? Are there any other factors that should be included?

[Paragraph 5.47 proposes the following non-exclusive factors:

The intentions of the settlor in establishing the trust.

The intentions of the Trustee or Trustees.

Whether the Trustee was indifferent as to whether a valid trust was intended to be established.

How the affairs of the trust have been conducted.

Whether property of the settlor has been intermingled with trust property.

Whether the settlor has treated trust property as his or her own.

The degree of control exercised by the settlor over the affairs of the trust.

Whether the Trustees have acted independently of the settlor in carrying out their duties.

The real nature of the arrangement irrespective of how it is described.]

TCA comment

No. As noted above, TCA does not consider a universal trust-busting power to be an appropriate response to the issues raised in the paper.

Conclusion

TCA welcomes the opportunity to discuss any matters raised in our submissions above. Our members appreciate the opportunity to provide what we consider to be practical and workable ideas.

To conclude, TCA notes the recent negative publicity around the use of trusts. For example, the use of trusts by former finance company directors to avoid creditor claims while still apparently enjoying the benefit of significant assets. TCA shares the concern about the misuse of trusts. However, TCA wishes to stress the following points:

- The trust arrangement is fundamentally a legitimate and useful vehicle for the management of assets.
- While trusts can be misused, the trust concept itself is fundamentally sound. TCA notes that other kinds of legal structures (eg, companies, limited partnerships various types of contractual arrangements) can and are equally used to achieve improper objectives. It makes no sense to target trusts. Doing so will not solve the issues.
- Poor governance and a poor understanding of the role and obligations of Trustees are a significant contributing factor to the misuse of trusts. These are a particular feature of 'commoditised trusts', many of which would not stand up to judicial scrutiny. Regulation is not the cure. Rather the **keys** are:
 - **Quality advice regarding establishment of the trust so that the relevant parties are aware of their rights and obligations;**
 - **Independent and professional Trustees to ensure proper administration and governance and to bring an independent mind to Trustee decisions.**

Trustee Corporations Association of New Zealand Inc
31 March 2011