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Trust eSpeaking

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Welcome to the Spring issue of *Trust eSpeaking*. We hope you find the articles both helpful and interesting. If you would like to talk further about any of the stories in this newsletter, or about trusts in general, then please don't hesitate to contact us.

In this issue we have articles on:

Crown Retail Deposit Guarantee Scheme: Not all are eligible

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Clarification on the court correcting a Will

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Running a Family Trust

Make sure it stands up to scrutiny

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Taking on a trusteeship of a family trust has significant responsibilities and can have severe implications, something that many people do not realise when they agree to be appointed to this role. This article looks at a true scenario, the result of which became very serious… CONTINUE READING

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The next issue of Trust eSpeaking *will be published in March 2011.*

Appointment of a Law Firm Partner as Executor

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The Wills Act 2007, which came into force on 1 November 2007, has made some significant changes to how Wills are corrected in New Zealand. In particular it has brought some practical remedies to potentially costly and time-consuming errors. In this article we highlight a recent case which illustrates how the High Court may correct a Will to make sure the Will-maker's wishes are carried out.

Section 31 of the Wills Act allows the High Court to correct a Will if satisfied the document has a clerical error or will not enable the Will-maker's instructions to be carried out. This section was used in a recent case to amend a Will which attempted to appoint one of the partners of a law firm as executor, without naming which partner that was to be[1].

The scenario

Mrs Trehey died on 11 December 2009. She left a Will dated 26 November 2009 which provided for any one of the partners of a law firm, as well as another person, called 'M', to act as executors. The reasoning behind this was that in the event one or more of the partners were not available (due to death, loss of mental capacity or retirement) one of the remaining law firm partners could perform the duties of executor, together with M.

After Mrs Trehey's death, M and one of the partners of the firm applied for probate. The court registrar who dealt with the application took the view that the appointment of the executors was void for uncertainty. He believed the clause was unclear as to which one of the partners in the firm was to be appointed; further there was no mechanism or procedure provided in Mrs Trehey's Will for deciding this.

Application for correction

M and all of the partners of the law firm applied under s31 of the Act for an order that the specific clause of the Will be deleted and replaced with one specifying that all the partners of the firm were appointed as executors, but with a wish expressed that only one of the partners of the firm need act as executor, together with M.

The judge agreed with the registrar that the original clause did not give effect to Mrs Trehey's intentions as it did not have a mechanism for deciding which of the partners should obtain the grant of probate. The judge ordered that the defective clause be replaced with the proposed one. In the judge's view the replacement clause was effective as there was no uncertainty as to the identity of the executors of the Will; they were to be M and all the partners in the firm at the date of Mrs Trehey's death. The judge further stated that only one of them may apply for probate without the consent of, or renunciation by, the others.

Our comments

Clauses appointing some or all of the partners of a law firm without naming the individuals can cause great difficulty and are best avoided. Often the Will-maker wants to avoid the problem of a named executor being unavailable due to death or illness. (It is not possible to appoint a lawyer's trust company as executor under s63 of the Administration Act 1969.)

When making your Will the best practice is to name two or three people as executors on the basis that if one of them predeceases you or is unable or unwilling to act, then the other named executors can get the grant of probate.

It is very important to carefully choose the executors of your Will. They must be able to work together and be relied on to ensure your wishes are carried out. It is difficult, costly and time-consuming to apply to the High Court to remove a troublesome executor. Although the changes to the Wills Act have made correction of errors quicker and simpler, nevertheless we recommend that you review your Will every five years to make sure it reflects your current wishes and circumstances, and also to check the availability or willingness of the executors you have named in your Will.

1 In the Estate of Bernadette Anne Trehey High Court, Napier CIV2009-441-899, 16 February 2010

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Running a Family Trust

Make sure it stands up to scrutiny

The Sunday Star Times *recently published an article about Do-It-Yourself family trusts and how failure to manage them correctly can put the integrity of a trust at risk. This article provides some management tips for trustees so that you can best ensure your family trust will hold up to scrutiny.*

Once you transfer property to a trust, it no longer belongs to you. It belongs to the trustees who hold it on behalf of the beneficiaries. If you continue to treat the property as if it were your own, then you run a very real risk of a court deciding that there is no trust if its existence is ever challenged.

Trust administration

A trust is not a separate legal entity, unlike a company. The existence of a trust is evidenced by proper administration and record keeping. The following are suggested as basic requirements.

Regular meetings:

Trustees should meet regularly to review the asset position of the trust, to consider the needs of the beneficiaries, and to review the financial statements and trust investments. Even if your trust's only asset is the family home, we still recommend that the trustees meet and/or pass a resolution every year to confirm that the structure of the trust has been reviewed.

Record keeping:

Trustees should maintain a file containing all documents relating to the trust including a true copy of the trust deed, details of beneficiaries, details of the assets and liabilities of the trust and any contracts entered into by the trustees.

There should also be a minute book in which all resolutions of trustees are recorded. You only need to record the fact that you have considered the financial position of the trust, its purpose, the interests of the beneficiaries and what your decisions have been. You do not need to put down all the reasons for reaching those decisions. The minutes should be dated and kept in proper order in the trust minute book for easy reference.

If your trust does not have an independent trustee, then there is an even greater obligation on you to keep good records as evidence that you hold property as trustees and not in your own names.

Decision making:

Ensure any independent trustee is treated as an equal trustee with you and consult all trustees prior to any decision being made about trust property. If the independent trustee acts simply as a 'rubber stamp' trustee, this may be evidence that the trust is simply your 'alter-ego'.

Further, if an independent trustee does not properly take part in decision making, they may find themselves liable to compensate the beneficiaries for negligence for any resulting loss in the value of trust property. If you are a trustee for a family member or friend, then you should be vigilant in making sure that you are an active trustee. (See more on this on page 4 of this issue.)

Bank account:

If the trust earns any income, ensure it has a separate bank account and only conduct trust transactions through that account. Trust investments should not be mixed with your own investments.

Diary system:

Keep an efficient diary system to remind you about matters which require regular action; maintaining a gifting programme, reminders for preparation and filing of annual returns, income and other tax returns, and so on.

Conclusion

If you are to fulfill your role as a prudent trustee correctly, then you have a duty to manage the administration of your trust in the very best way possible to achieve the objectives for which it was established.

Trustee Nearly Bankrupted by the Construction Contracts Act

Take care when appointed a trustee

Taking on a trusteeship of a family trust has significant responsibilities and can have severe implications, something that many people do not realise when they agree to be appointed to this role. This article looks at a true scenario, the result of which became very serious.

Adam* agreed to act as an independent trustee for his friend Bob's* family trust. Adam's involvement in running the trust or being involved in decision-making was minimal and he was not paid for the position. At the time he agreed to take on the role he did not think of the potential risks. However, all was soon to change, and not for the better.

The trust owned a farm with a separate company, operated by the trust's beneficiaries, conducting the farming operations. The company had a contractor do extensive earth works and ancillary works costing well over $1,000,000 on the property. Unfortunately the 2008 recession arrived and the company was unable to pay fully for the construction work.

The contractor applied for relief against the trust under the Construction Contracts Act 2002. The contractor also sought that the trustees be made personally liable for payment as an 'associated person' of the respondent farming company in case the trust was unable to pay them. The matter was sent to adjudication and the adjudicator found in favour of the contractor.

Adam found himself responsible for payment of the construction work and the contractor could pursue Adam to repay all of the debt owed to it. Due to its struggling financial situation, the trust was not in a position to indemnify Adam.

Adam was dismayed at being liable to pay for the construction debts, despite never having derived any benefit from the trust or its assets. He had just wanted to do a friend a favour in agreeing to be the independent trustee for his family trust.

Adam was able to extract himself financially from the situation, but it was only by incurring significant legal costs. He was lucky: if Bob and the trust had left the scene before matters were resolved then Adam could have been left to repay the entire debt on his own.

This situation illustrates the need for trustees to be aware of s7 of the Construction Contracts Act 2002 and the potential liabilities that can be incurred as an 'associated person'. Under the trust/operating company structure, Adam was not involved in the decision to have the construction works completed, yet he was found to be associated with the company, and ultimately liable for the unpaid bill.

If you are asked to become a trustee of another person's family trust, ask yourself the following questions;

» Is it worth the risk?

» Will the settlors, or ultimate beneficiaries, keep me fully informed about what the trust and associated parties are up to?

» What do I know about trust law and my trustee responsibilities? and

» Should a professional independent trustee be appointed?

** Names have been changed to protect individuals.*

Crown Retail Deposit Guarantee Scheme: Not all are eligible

On 31 August 2010 South Canterbury Finance (SCF) was placed into receivership.

The Crown is facilitating repayment of SCF's prior-ranking debts along with all debt-security holders. The Crown has also decided, as of 31 August, that it will repay all depositors of guaranteed companies that default, including those that have already defaulted, regardless of any previous eligibility criteria that were in place for its Retail Deposit Guarantee Scheme.

The Treasury has said, "Criteria relating to citizenship and tax residency will no longer apply and depositors will not be assessed using those criteria. The repayment criteria for being repaid is that you are on the register of debt securities at the date of default."

However, not ALL security holders are eligible under the Crown guarantee; below we note who is eligible and what the Crown guarantee will not cover.

Eligibility

Debt securities eligible for repayment include: call deposits, term deposits, non-guaranteed deposits, debentures and bonds. The government's decision to repay all depositors of Crown-guaranteed financial institutions that have defaulted means repayments will be made to some depositors who may not have previously been eligible for repayment.

This decision applies for defaults by approved institutions from the start of the current Retail Deposit Guarantee Scheme until 12 October 2010. The Crown-guaranteed institutions that have defaulted are listed below.[1]

Eligibility criteria that include citizenship and tax residency will continue to apply in the event of a default after 12 October 2010 by entities approved for the extension to the Guarantee Scheme. The extension to the Retail Deposit Guarantee Scheme runs from 12 October 2010 to 31 December 2011.

What it does not cover

It is important to note that equity securities such as ordinary shares and preference shares remain **ineligible** for repayment under the Crown guarantee.

Also, trusts with trustees who are paid for their work as trustees are not eligible for the Crown guarantee as they fall under the wide definition of financial institutions, see: www.treasury.govt.nz/economy/guarantee/retail/qanda

Trusts with an accountant or lawyer as a trustee may still qualify. However if your trust has a corporate trustee which charges fees (rather than a law firm) your trust may not qualify.

Treasury said on 1 September that no decision had been made if the eligibility changes for South Canterbury Finance will also result in a change to these rules.

Prudent trustees will not invest in finance companies if they are relying on the Crown Guarantee for peace of mind.

Keep an eye on the Treasury website, www.treasury.govt.nz for further developments.

If you would like to talk more about the Crown guarantee and any investments you or your trust may have made, please don't hesitate to contact us.

1 South Canterbury Finance, Allied Nationwide Finance, Mutual Finance, Viaduct Capital, Vision Securities, Strata Finance and Mascot Finance.