

BENEFICIARIES & THEIR EXPECTATIONS

Vicki Ammundsen, Ayres Legal

Notes...

Lindsay: I'm pleased to introduce Vicki Ammundsen a Partner in Auckland law firm Ayres Legal. Vicki specialises in trust and relationship property law which she combines with an experienced background in tax law. She authors a number of books on trusts, trustees and tax including *The Taxation of Trusts* and *The Trustees Handbook*. I subscribe to and can recommend her blog called *Matters of Trust* where she regularly shares thoughts and information on matters affecting trusts.

Vicki, I've heard you say "beneficiaries are what trusts are all about". Can you explain that?

Vicki Ammundsen: I can and I'll try not to get too technical. We often hear people talking about "trusts" all the time - we hear talk about "his trust", "her trust", "my trust", "the trust", etc. In reality there is actually no such thing as a trust.

When we talk about "a trust", what we're really talking about are a complex set of relationships between a trustee who owns and manages the trust property for the benefit of the beneficiaries. As a matter of law, if we do not have any beneficiaries, we do not have a trust.

Lindsay: What sorts of beneficiaries can you have in a trust and how are they considered?

Vicki: For the purposes of this interview, I'm just going to talk about beneficiaries in the context of a New Zealand family trust. Most family trusts are what we call discretionary trusts and in these trusts you have typically got two types of beneficiaries.

Firstly, you've got what are known as the discretionary beneficiaries. What these beneficiaries get (or whether they get anything), is entirely at the trustees' discretion and really they only have a right to be considered for a benefit.

Secondly, we have a class of beneficiaries who we call the final beneficiaries. The final beneficiaries (who may also be discretionary beneficiaries) are the beneficiaries who will receive the trust assets when the trust comes to an end, provided there are assets left in the trust at time.

The trust deed will specify what the trustees can do during the life of the trust and at the end of the trust. For most trusts, during the life of the trust, the trustees can do anything they want – they can pay income, they can pay capital, they can pay everything to one beneficiary, they can spread it out evenly, they can pay it in any way

they want to, because they have very wide discretions.

When a trust comes to an end, the trustees may have discretion to pay to whichever beneficiary or beneficiaries they have chosen, or, they may be obliged under the trust deed to divide what remains equally amongst the surviving final beneficiaries or the trust deed may refer to some other sort of mechanism to determine the final beneficiaries. Each trust deed will be different.

Lindsay: So when it comes to beneficiaries, the trust deed will identify the beneficiaries who can benefit at the trustees discretion while the trust is running and it will also name the final beneficiaries, or show a mechanism to identify who the final beneficiaries will be.

Vicki: That's right. The decision on who will benefit and how things will work, is actually made by the person who settles the trust (who we refer to legally as the settlor) when the trust is being set up. The settlor has a really big responsibility to think very carefully about whom they want to benefit as a beneficiary of the trust.

I mentioned before that the discretionary beneficiaries have only a right to be considered for benefit by the trustees. However, trustees have an obligation to consider all of the beneficiaries and they just can't just choose the beneficiaries that they think of in their own head as "the real beneficiaries".

That requires any trustee of a trust to know exactly who all of the beneficiaries are in the trust. They need to be familiar with the trust deed and know how the beneficiaries are defined. For example, the beneficiaries may have been defined by specific name or they may be defined by reference to a group or class of beneficiaries like, say, "the settlor's children" or the "settlor's grandchildren".

Where a group or class of beneficiaries is referred to like "the settlor's children", the trustees need to be able to identify who the settlor's children actually comprise. It will always depend on how the trust deed is exactly worded as to who can benefit as a beneficiary. Sometimes the trust deed might say that it is only the children of the settlor's marriage to someone, or it may state that children from a number of marriages or different relationships are included.

As a trustee, you have an absolute obligation to be able to identify all of the potential beneficiaries and then consider their interests.

When a trust is being settled, it becomes important that the settlor doesn't just name huge classes of people as beneficiaries in the trust deed. It's more important the settlor limits the beneficiaries to exactly who the settlor actually wants to benefit from the trust.

Lindsay: Vicki, you mentioned trustees have an obligation to consider the interests of all the potential beneficiaries. Presumably it would be important then for trustees to not only understand who can benefit as beneficiaries, but also to understand what all their needs and circumstances are?

Vicki: In focusing on their needs and circumstances you raise a really good point. Trustees are there to manage the assets of the trust for the benefit of the beneficiaries whereas a lot of trustees seem to treat beneficiaries a bit like a necessary evil. We need to move from that kind of thinking.

I'm of the view that trustees need to do the job properly. In regard to beneficiaries, that involves taking the time to get to know who the beneficiaries are, working out what their needs are, setting expectations with them, responding to their inquiries and deciding whether or not they should be notified that they are actually a beneficiary of the trust. A trustee requires a mind-set that being a trustee is a job, a job that needs to be done properly for the benefit of the beneficiaries.

In New Zealand we have many trusts, many non-professional trustees and few professional trustees. A lot of trusts have a small number of assets and the settlors tend to choose a friend or a relative to be the independent trustee (rather than appointing a professional trustee).

I accept some of this thinking is driven by cost and I may be being unfair here when I say it, but if a trustee's not being paid for the job and is just doing it as a favour for someone, you do tend to get a bare minimum approach.

Lindsay: It worries me that some trustees I talk to are not involved in the active day to day running of the trust and don't understand the positions of all the beneficiaries. Surely they're taking a risk?

Vicki: When you take on the role of a trustee, you're taking on a serious obligation that has risks and liabilities that go with it. The beneficiaries have got rights as well and they have the right to expect that the trustee will manage the trust assets well. If the trustee isn't actively involved, how are they going to know what the assets are or whether they're being managed properly?

If beneficiaries don't think a trustee is doing a particularly good job, the beneficiaries can go to Court and ask for the trustee to be removed. The Court has what's called an inherent jurisdiction which means that beneficiaries can go to Court to get some assistance. The Court's inherent jurisdiction allows it to make sure beneficiaries are being

properly provided for, taken care of and that their interests are being protected by the trustees who have taken on the job of doing so.

Lindsay: That sets the scene very well on why trustees need to be thinking about the interests of their beneficiaries. Vicki, what are the warning signs that trustees need to watch for?

Vicki: I think the biggest warning sign for independent trustees is where there is too strong an allegiance with the settlor/co-trustees. Commonly, a trust in New Zealand would be settled by a “mum and dad” who would also be trustees (let’s call them the settlor/co-trustees) and a third person would be appointed as an independent trustee. There have been a couple of recent cases before the Courts involving trustees who have aligned themselves to the original settlor or to a particular beneficiary (who have also been trustees) and it’s meant that the other beneficiaries’ interests haven’t really been considered.

In one case, the trustees favoured the settlor/co-trustee who hadn’t done very well in a relationship split. The trustees decided that a fixed beneficiary was being provided for through another trust and that it was more important that they provide for their friend, the settlor/co-trustee. In doing so, they ended up all being sued and found liable by the Court for the losses of the trust. So that’s one problem, when you’re not looking at all the beneficiaries and you’re just picking out one for special attention.

Another case along similar lines was a family trust where there was a property and the beneficiaries included a trustee (who was also a beneficiary) and his niece and nephew. A decision was made to distribute all of the trust assets to the “trustee beneficiary” and nothing to the niece and nephew. When it went before the Court, the Court said “well the problem we’ve got here (this was in the context of the independent trustee) is that you’ve been able to tell us that you gave nothing to the niece and nephew because you think they’ll be provided for elsewhere, but actually, you couldn’t tell me what the circumstances were for the beneficiary that you gave everything to”.

This case really highlights the importance as a trustee of not necessarily making friends with the beneficiaries, but looking at all of them objectively, getting to know about them and where appropriate, having some dialogue with them, discussing what their needs and wishes are.

While a beneficiary can always ask for assistance from a trust, whether they are given assistance is entirely at the trustee’s discretion. But going back to my earlier comment, often there is too much treating the beneficiary as the enemy. Moving forward, we need to see trustees working with beneficiaries, not being blindsided perhaps by the original

settlor who is also a trustee and a beneficiary, but treating all of those beneficiaries with the same level of dispassion and consideration – actually developing relationships between trustees and beneficiaries.

Again this comes back to treating the role of a trustee more as a professional role and where appropriate (which will often be the case), having an appropriate remuneration structure in place so the trustee is happy to do the job.

And for the beneficiaries, by having some more information, it will not necessarily mean they will get what they want (everyone thinks that their circumstances are better, special, different and that they need more!), but if you've got open dialogue and transparency, I think we will start to see healthier trustee – beneficiary relationships.

Lindsay: What you have just said is very important. If trustees engage with beneficiaries, it will give beneficiaries a chance to better understand more about how the trust works, how the trustees come to decisions and to share their views with the trustees. That must lead to healthier relationships.

Vicki: Yes, but it's also remembering when you're thinking about beneficiaries, that ultimately those beneficiaries (who might be the children of the current settlor/co-trustees) are likely going to be your pool of new trustees in the future. So as trustees, if we educate our beneficiaries better and work with them better, they will actually know what's going on and be better able to step up as trustees at the appropriate time.

There's an opportunity to educate them in the trustees' policies and how a trust is managed and to help them start to get their head around the idea that sometimes not getting all the money isn't the be all and end all. Instead they will learn that growing the trust assets for the benefit of the changing generations is a hugely important part of what being a trustee of a trust is all about.

Lindsay: Vicki, you've mentioned a couple of good practices for trustees in managing beneficiaries and their expectations. What other practices would you suggest?

Vicki: First is good communication. It's a really simple message. It's about being aware as trustees of your obligations because, quite frankly, fear motivates, and if trustees have a better idea of where their risk lies, it will be easier to stand up to co-trustees who might have very different ideas.

It's about having open dialogue and communication so beneficiaries don't feel like they're being left in the dark and things are being hidden from them. It's about putting the information out there, developing

relationships so you can all work together in the furtherance of the trust objects.

The next practice I'd recommend for trustees is to consider how they involve beneficiaries in trustee decisions, especially significant or challenging trust decisions. While a lot of trustees make their decisions in private, beneficiaries who feel consulted or involved in the decision process are more likely to feel engaged or supportive of a decision where they have been able to make their views known. Consultation enables trustees to obtain further input and ideas from beneficiaries, intercept potential issues or obstacles and provide further context, background and information.

Every time decisions are made, the trustees should prepare resolutions to record their decisions. While trustees don't have to give their reasons for their decisions to beneficiaries, I would still recommend as good practice that the trustees document on the trust file as part of their "paper trail", good notes and information gathered (separate from the resolution recording the decision), of the inquiry and consultation they have undertaken including any advice they have received and considered as part of their decision process.

It will help to have information as part of the trust records for significant or contentious decisions to demonstrate the trustees' process and thinking at the time a decision was made. It will also be information the trustees can refer back to if they are ever called upon to justify a decision as often the reasons for decisions get lost, forgotten or confused over the passage of time.

Finally, good practice to me is about good planning, good communication and good records.

Lindsay: To summarise, trustees have to be balanced, inquiring, understand beneficiary needs and circumstances and get on the front foot in engaging and building relationships with beneficiaries. Vicki, people can contact you through your website www.ayreslegal.co.nz and I recommend your blog www.mattersoftrust.wordpress.com for trustees to keep up to date on topical trust issues.

Vicki: Thank you very much Lindsay.