

THE TRUST DEED

Tammy McLeod, Davenports Harbour

Notes...

Lindsay: I'm pleased to introduce Tammy McLeod who is a Partner at Davenports Harbour, a law firm on Auckland's north shore. Tammy leads a team specialising in trust and asset structuring and personal asset planning. She is co-convenor of the Trusts Special Interest Group of the New Zealand Institute of Chartered Accountants in Auckland and wrote a chapter on this topic in the New Zealand Master Trusts Guide so she's well qualified to take us through understanding the trust deed.

Tammy, the trust deed is the governing document for a trust. Each trust deed is different and they can be a bit daunting for someone who isn't familiar with these types of documents. Can you please take us through the key parts of trust deed and tell us why it's important.

Tammy McLeod: The way to look at a trust deed is to think of it as the rules for the trust. That makes it a really important document as it's the base or foundation document for a trust. As a trustee, it's crucial to read and understand it to know what you are responsible for and what you are required to do as a trustee. If a trustee finds reading a trust deed a little bit daunting, it's important they get advice to understand what it says and how it should be applied.

In New Zealand the Trustee Act 1956 governs the general law that applies to the way trusts are run and the rules in the Trustee Act apply to all trusts, unless they are overwritten by the rules within the trust deed. If there's anything in the general law that you don't want to apply to a trust, it needs to be correctly written into the trust deed.

Lindsay: I get the impression sometimes that people often see a trust deed as a standard sort of document that a lawyer can easily churn out. From what you're saying, getting the drafting right to correctly fit each individual situation would be very important...

Tammy: Yes, that's absolutely right - trusts are unique, families are unique. Each trust deed is different and deals with a different set of circumstances. While there may be similarities between trusts, it's so important to tailor each trust deed to each individual circumstance.

You're right, some people may have the impression their name gets put in at the top of a standard trust deed but I can't stress enough the importance of each trust deed meeting the individual circumstances for the people who are setting up the trust.

I review a lot of trusts in my work and a lot of times I can see where someone has just taken a standard trust precedent and "filled in the blanks". These people shouldn't then be surprised if the trust doesn't

achieve what they expected it to do, especially if it's not tailored to their family needs.

Lindsay: I've also noticed the wording of trust deeds has changed quite a lot over the years. Trust deeds these days are worded quite differently to those prepared in the 1990's for example.

Tammy: Definitely. When I started practice fifteen or sixteen years ago, the structure of discretionary trusts was just changing because estate duty had ceased. We'd had a period of time where mirror trusts had been used, then in the late 1990's we often saw trusts drafted with a very wide class of discretionary beneficiaries in a trust deed. Often there were people named that you knew would be unlikely to benefit from the trust.

From the early 2000's, as beneficiaries rights have increased and with changes to relationship property laws, trust deeds have tended to be drafted with a much narrower number of discretionary beneficiaries. You will also now find powers in trust deeds to change trustees and beneficiaries and powers to resettle trusts have become a lot broader over the years as well.

So, whereas trusts used to be quite fixed and rigid and you couldn't change the rules around the trust, over time broader powers to vary a trust deed have been drafted into new trust deeds to provide more flexibility to make changes and to keep up with changes in the law and how it's evolving.

Lindsay: What should a trustee look for in a trust deed?

Tammy: Firstly, I need to point out as a trustee you do have a duty to understand the trust deed.

Then one of the things I look at before I decide to take on a role as trustee is to see who are the beneficiaries and in what capacity are they beneficiaries? For example, are they beneficiaries who can only receive income or are they beneficiaries who can receive both income and capital? Are they discretionary beneficiaries or is it a trust which is a fixed trust to benefit particular people at a particular time?

Discretionary beneficiaries are beneficiaries where the trustees have the discretion as to whether they benefit those beneficiaries, and if so, how much to benefit them. So if I'm a discretionary beneficiary of a trust, I only have the right to be considered and while the trustees have to consider whether to benefit me, I don't actually have any fixed entitlement to the trust fund.

The next area I would then look at would be to make sure that the trust deed requires unanimous decision making by trustees. In my

view this is important because if you have majority decision making within a trust, then it is too easy for two trustees to outvote a third trustee or completely ignore the third trustee. To me, it can defeat the purpose of having independent trustees.

I'd be worried as a trustee being in a majority decision-making trust as regardless of whether I agreed with a majority decision being made; I'd be bound by the decision of my co-trustees. I recommend trusts which require unanimous decision-making from the trustees.

Lindsay: How do you tell if you have unanimous or majority decision-making? Some trust deeds appear to be silent on that point?

Tammy: If the trust deed is silent, that's where the Trustee Act steps in and requires the trustees to be unanimous in their decision making.

Lindsay: Thanks Tammy. Any other points you'd be looking for?

Tammy: I'd look for the trustee investment powers for investing trust assets and in particular to see if the deed includes what we call a "Section 13D Contrary Intention". Sections 13B and 13C of the Trustee Act place a very high onus on trustees to invest trust assets prudently (with an even higher onus on professional trustees). In the majority of family trusts I see, the main assets are often going to be the family home and shares in the family business which would be most unlikely to meet the very high standards under Sections 13B and 13C.

However, Section 13D of the Trustee Act does allow a trust deed to state that Sections 13B and 13C are not to apply. As a trustee, I always review the trust deed to see what is required for the investment of trust assets and in particular, to ensure that the Section 13D contrary intention is stated in the trust deed so that Sections 13B and 13C do not apply.

Lindsay: Tammy, I'll include an appendix to this guide with an extract of Sections 13B, 13C and 13D of the Trustee Act for people to see the specific sections that you have referred to (see **Appendix 2**).

Tammy: That would be helpful. The other things I'd want to look at would be to see if there is:

- A power to vary the trust deed which would enable the trustees to make changes to keep up with the current law
- A power to appoint and remove trustees and in what circumstances trustees can be removed and new trustees appointed

- A power to appoint and remove beneficiaries and whether that power is held by either the settlors or the trustees
- An indemnity to ensure that if something goes wrong, as an independent trustee you can be indemnified from the assets of the trust (while the Trustee Act includes a general indemnity for trustees, I like to see a more specific one in the trust deed itself)

Those things would be the main things that I would look for.

Lindsay: What sort of problems do you see regarding the trust deed?

Tammy: The first problem I see is that trustees don't understand the trust deed. So going back to what we discussed before, trustees need to read and understand the trust deed.

Secondly, trustees don't always know who is entitled as a beneficiary under a trust deed. For example, I've often reviewed trusts with settlors who have told me one of the reasons for establishing the trust, was to protect their children's inheritance in the event of a relationship breakdown between their children and their children's spouses.

Then, when I've read the trust deed, I find the children's spouses have been named as potentially beneficiaries of the trust. Another example would be where the settlors' letters of wishes refer to people the settlor may wish to possibly benefit but those people are not actually named as beneficiaries in the trust deed.

Lastly, there also seems to be a few issues around what beneficiaries can be paid. For example it is essential trustees know which beneficiaries are able to benefit from income or capital payments from the trust. If as a trustee you pay out capital to a beneficiary who's only entitled to an income, then you've effectively breached your duties as trustee and you can be taken to task by the beneficiaries to make good any loss.

Lindsay: I've also seen situations where non-beneficiaries have been paid. It's caused quite a bit of angst with the trustees and it isn't always easy to get back money that has been incorrectly paid out.

Tammy: That's exactly right. I think what people need to remember is that being a trustee involves a personal liability, so essentially you take on the liabilities of the trust. If you've paid money out to someone who wasn't a beneficiary and you can't get the money back, you're responsible for paying the right person yourself. Trustees must understand being a trustee involves a personal liability.

Lindsay: What then would you recommend as good practice for trustees relating to the trust deed?

Tammy: The first thing is to read it and understand it. If you don't understand it, take advice on it.

It is so important for trustees to meet on a regular basis and for most trusts I'd recommend meeting annually. Twelve months rolls around quickly and I'd suggest meeting when the financial accounts are prepared. There will be trusts which have more frequent meetings, perhaps six monthly, quarterly, even monthly because they are larger or they may have a lot of activity going on.

A meeting provides the chance for trustees to sit down and discuss what the beneficiaries are doing, what their needs and requirements are, to understand if someone's circumstances have changed, if someone's been born, if someone's died, someone's married, etc. It's then important for the trustees to relate that information back to the trust deed and tie it back in with who the settlors want to benefit and how they wish those people to benefit.

It's also about keeping up to date with any other changes, including the law. As an example, a few years ago there was a change to the Income Tax Act which changed the timing from the balance date that trustees had to decide on the allocation of income to beneficiaries. The time period was extended from six months to twelve months and for most trusts with a balance date of 31 March it will mean the trustees have now got twelve months to allocate trust income to the beneficiaries.

However, if the trust deed still has the old wording and says six months, as a trustee you're still bound to the six month rule unless the trust deed is changed. There are not that many trusts where the financial statements are done and the income is allocated out to beneficiaries by 30 September. That's just one example of why it is important to make sure the trust deed is kept up to date with changes that can occur.

Finally, I'd recommend trustees get advice if they're in doubt. If you don't understand the trust deed or if you're not sure whether you're exercising your discretions properly, get advice. Preferably it should be from someone who specialises in the trust area. There's always something to learn and I get advice myself, sometimes just to have a peer review a course of action or to make sure we will be exercising our discretions properly. When in doubt, take advice.

Lindsay: Tammy, you've really stressed the importance of trustees understanding the terms of their trust deed. Thank you for your insights and if someone wants to make contact with you they can do that through your website at www.davenportsharbour.co.nz.

Tammy: Great, thank you.