

Client Newsletter

October & November 2009

Trusts

Do you act as trustee for a trust?

Many people have set up trusts to which they transfer assets but give no thought to important ongoing administration and record-keeping requirements. The responsibility to ensure that the trust is managed correctly rests with the trustees. Ignorance is no excuse or protection. A trustee may be an individual or a company (often referred to as a corporate trustee). Trustees do not own the assets of the trust but have a legal obligation to manage those assets in the best interests of the trust beneficiaries.

Duties of the trustees

If the trustees do not carry out their duties they could be liable to the beneficiaries.

The key duties are:

- Trustees should ensure that assets are managed in an efficient and economic manner. Active management includes annual trustee meetings and having a trust management plan.
- Trustees must keep a full and proper record of the administration of the trust assets and render the same to the beneficiaries (if required). These records include accounting records and financial statements.
- Trustees generally cannot delegate their powers and discretions as they have a duty to act personally in managing the trust's affairs. Their decisions should take into account all the interests of the different beneficiaries.
- Trustees should act in the best interests of all beneficiaries.
- Trustees should not use knowledge obtained as a trustee for his own personal gain or advancement.

Liabilities of the trustee

A trust is not allowed to enter into contracts because it is not a separate legal entity. It is the trustees of the trust who have the legal capacity to enter into contractual arrangements for the trust and by doing so are personally liable to third parties.

However, the trustees normally state (expressly) when contracting for a trust that they are acting in their capacity as trustees and not personally. Moreover, the

trust deed almost always has the trustees' powers and rights embedded in the clauses of its deed.

The trustees can still be held personally liable and accountable for their actions or inactions as the case may be. For example, they can be personally liable to pay income tax owed by the trust under the Income Tax Act. Generally this would be limited to the assets of the trust as the trustees have a statutory right to be reimbursed by the trust. Also, there may be a clause in the trust deed limiting the trustee's liability.

The trust deed is not binding on third parties so the trustees should endeavour to include a clause known as a 'Trustees' Limitation Clause' in a contract. It should stipulate that their liability is limited to the assets of the trust. Even if they fail to do this and they have signed the contract indicating they are the trustees they can still be held personally liable.

It should be noted that there has been an instance where the trust assets were less than the liability and the trustees were personally liable to make up the shortfall.

The use of a corporate trustee in an effort to reduce liability (being limited to the company assets, which there are generally none) has disadvantages in that the directors can become personally liable if they have overlooked their obligations under the Companies Act.

The directors have a duty to act in the best interests of the company (not the trust) – in case of a corporate trustee though, the directors have to ensure that the company fulfils its duty as a trustee. If you are a trustee of a trust or a director of a corporate trustee, you should seek advice before entering contracts.

INCOME EQUALISATION SCHEME

The Income Equalisation Scheme allows farmers, fishermen, and foresters to even out fluctuations in income by spreading their gross income from year to year. This enables levelling of taxation liabilities and creating direct savings by avoiding high marginal rates of tax in high income years.

The scheme allows taxpayers to deposit income from certain farming, fishing, or forestry activities with the Inland Revenue Department using an IR155 deposit form. The money is paid into a special account and earns interest at 3% per annum on amounts left on deposit for more than 12 months. The deposit is held for a maximum period of 5 years and can be withdrawn in parts. The minimum deposit is \$200 and the maximum cannot exceed the net income from the taxpayers business in the year the deposit is accepted.

The deposits are tax deductible in the year for which they are made and any withdrawals are assessable in the year from which they are withdrawn. Deposits are normally held for a minimum period of 12 months. Refunds can be given within 12 months of the deposit provided the reason for the withdrawal is given in writing. Refunds for periods under 6 months will only be given for adverse events or hardship.

Where a taxpayer is considering an early withdrawal, say after 9 months, as no interest is paid until a 12-month period has been reached, then the taxpayer may want to consider other alternatives to obtain cash. This is because if the taxpayer waits a further 3 months, the interest received would be effectively 12% pa for those 3 extra months. The deposit must be made within a specified period which is the earlier of:

- One month from the date of filing the tax return for that year, or
- One month from the date that the relevant tax return is due to be filed.

For example, a client makes a deposit on 30 September 2009 of \$20,000. This will reduce the client's taxable income for the 2010 year by \$20,000. The Commissioner has discretion known as 'case or class of cases' to extend the specified period, particularly where taxpayers have been severely disadvantaged by early filing of their tax returns or due to adverse events where a special IR 139 form is filed.

The scheme can be used in particular to defeat the imposition of use of money interest charges when individuals are likely to exceed the \$35,000 residual income tax threshold. Usually the cost of funding higher provisional tax payments is considerably more than the interest cost of funding an income equalisation deposit to fix the use of money interest problem in the next year. For farming clients the scheme can be quite effective for levelling income between good and poor years.

Independent Earner Rebates

Until 1 April 2009, there were no rebates or relief for people earning income below the threshold for any government benefits. This group of the workforce struggled to make ends meet because their income was above the threshold for receiving State welfare benefits of any kind.

This has changed from 1 April 2009. Those who earn annual income between \$24,000 and \$48,000 will qualify for a rebate of up to \$520 per annum. This is set to increase to \$780 per year from 1 April 2010. However, if the taxpayer or their partner is entitled to receive any State assistance, whether it is from inside New Zealand or outside New Zealand, then they will not receive any Independent Earner rebate.

State assistance includes Working for Families entitlement but not New Zealand Superannuation. If the taxpayer is qualified for part of a year, then the rebate can be calculated proportionately based on the number of whole months.

Important: This is not advice. Clients should not act solely on the basis of the material contained in the *Client Newsletter*. Items herein are general comments only and do not constitute or convey advice per se. Changes in legislation may occur quickly. We therefore recommend that our formal advice be sought before acting in any of the areas. The *Client Newsletter* is issued as a helpful guide to clients and for their private information. Therefore it should be regarded as confidential and should not be made available to any person without our prior approval. 184/09.