Trust eSpeaking

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LAWYERS | NOTARY PUBLIC

Spring has sprung and with that our spirits are lightened with longer warmer days. Please enjoy reading this Spring 2016 edition of *Trust eSpeaking;* we hope these three articles will be useful to you all.

To talk further about any of these articles, or about trusts in general, please don't hesitate to contact us – our contact details are above.

Beneficiaries' entitlement to trust information

A frustration for trustees

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Beneficiaries' entitlement to trust information

A frustration for trustees

The extent of a trustee's obligation to provide information to beneficiaries has been a continuing source of frustration for trustees, particularly those whose discretionary decisions may be challenged. Recently the Court of Appeal clarified the nature and extent of this obligation, and the beneficiary's corresponding rights.

Ivan Erceg, the bankrupt brother of the late Michael Erceg (the owner of Independent Liquor), recently took his quest for disclosure of trust information to the Court of Appeal.[1] He requested information relating to two trusts established by Michael Erceg, which were wound up in December 2010. No distribution had been made to Ivan. When Ivan was discharged from bankruptcy he requested that the trustees give him documents about the winding up of the trust and distribution of the assets. The trustees, in the unenviable position of having to decide whether to give a potential troublemaker ammunition, refused this disclosure. Ivan then applied to the court for orders demanding extensive information. The High Court refused his application, and the Court of Appeal upheld this result.

The Court of Appeal observed, amongst other things, that there is no presumption for or against disclosure of trust information. Each case will turn on its facts. However, it found the following factors should influence trustees' decision-making when deciding what, if any, information should be disclosed to a beneficiary:

- Issues of personal or commercial confidentiality
- The nature of the beneficiary's interest
- The competing interests of the beneficiary seeking disclosure, and those of the trustees and the other beneficiaries
- Whether disclosure can be in full or in part (that is, in redacted form)

1 *Erceg v Erceg* [2016] NZCA 7; [2016] 2 NZLR 622

- Whether safeguards are required on the use of information (for example, agreements about confidentiality)
- The effect of disclosure on family relationships and the relationship between the applicant and trustees, and
- The nature and the context of the application for disclosure.

Independent advice

Where the trust is large or significant decisions are to be made, it may be wise for trustees to get independent advice about disclosure. Often agreement can be reached between the beneficiary and the trustee about appointing an independent person to consider the information that is to be disclosed. Trustees may also apply to the High Court for directions. However, there can be significant cost in doing this, so it should usually be a last resort.

New legislation

Beneficiaries' rights to trust information have become so important that the Law Commission's proposed new Trusts Act addresses the issue. The proposed legislation will create a presumption of disclosure to 'qualifying beneficiaries', who include any beneficiary who the trustees believe the settlor intended to have a realistic possibility of receiving trust property. Trustees will be required to notify such beneficiaries that they are beneficiaries of the trust, and the proposed Act creates a presumption in favour of disclosure. The list of factors the trustees must consider when deciding whether, and to what extent, to disclose information is very similar to that laid out by the Court of Appeal in *Erceg v Erceg*.

The Supreme Court has granted leave for the *Erceg* case to be appealed.[2] However, depending on when a new Trusts Act is passed, the effect of the Supreme Court decision may be short-lived.

The issue of beneficiaries' rights in relation to trust property is controversial. If trustees are uncertain about what they should disclose to beneficiaries, it would be wise to seek professional advice.

2 *Erceg v Erceg* [2016] NZSC 69

Trusts under attack by former spouses and partners

Trustees need to be cautious

Trusts can sometimes be used to protect assets from future claims by a former spouse or de facto partner. However, lawyers and the courts are continuing to find ways around trusts in order to achieve what they see as justice. Recent decisions indicate why trustees need to be cautious.

A trust is sometimes said to be a 'coward's pre-nup'. Rather than asking your partner to sign a relationship property agreement, it's often easier to put your assets into a trust and hope that this will protect them in the event of a relationship breakdown.

But trusts remain vulnerable to other forms of claim. There have been a few cases where the court has said a former partner (these have all been women) has a claim to a share in the trust property because

she contributed to the property on an understanding that she would benefit.

A couple of years ago in *Murrell v Hamilton*[1], the Court of Appeal upheld a High Court decision giving $37,500 to a former de facto partner who had assisted with work on a new house owned by her partner's trust. She said he had led her to believe they were working together on the property for their mutual benefit. This case has set a precedent.

Two new Court of Appeal decisions

The first new case is *Vervoort v Forrest*.[2] Again the claimant says she did a great deal of work redecorating and refurbishing a property and establishing a garden. He says that any promise to her would have to have come from both trustees because the law requires trustees to act unanimously. She replies that he had been given authority by his other trustees to speak on behalf of the trust. At times he used his name and the trust's name as if they were the same thing. He even had an irrevocable power of attorney from his other trustees so he could sign on behalf of the trust whenever he wanted to. However, the woman claimant received nothing in this case because there was not enough detailed evidence of actual contribution to the property.

The second case[3] involved a married couple, both of whom had been married previously. The wife had put money into renovating the trust property using funds from the sale of her previous home. However the husband could point to payments he made to his wife equal to the amount she had contributed. Nevertheless the wife's payment was treated as a contribution to the property.

The court found that the other trustee had given the husband 'carte blanche' to do as he wished with the trust assets. So it was credible that the wife believed the assurances given by her husband. The court also mentioned that the husband could always have asked his wife to sign a relationship property agreement and this could have made it clear she was to have no expectation of an entitlement to the property that was held in the trust. In the absence of such an agreement, the wife had a natural expectation that she would benefit in this way. She was awarded $65,000.

Not sham trusts

In each case the claimant tried to claim the trust as a sham. The court rejected this claim every time. In the past anyone trying to make a claim against a trust has thrown in the word 'sham' like some sort of bogey man. It is now quite clear the court will not disregard a trust or call it a sham unless there is real evidence that there was a deliberate intention to deceive from the start.

It is still possible to use a trust in order to ring-fence assets against a future relationship property claim but there is no guarantee that this will work. Assets should be transferred to the trust before the relationship starts. It's important that one partner is not given sole authority to speak on behalf of all the trustees. It's also important to manage the expectations of any new spouse or partner by making it clear that what is in the trust stays in the trust, ie: contributions to the trust property will not lead to any entitlement to a share in the property. A written agreement drawn up by your lawyers is a good way to do this.

1 *Murrell v Hamilton* [2014] NZCA 377

2 *Vervoort v Forrest* [2016] NZCA 375

3 *Hawke's Bay Trustee Company Limited v Judd* [2016] NZCA 397

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Foreign trusts: Tightening up the rules

Foreign trusts have been in the news recently. The government has now introduced legislation to tighten up the rules. But what are foreign trusts and is this important to you?

For many years there has been no need to file a tax return for your trust if none of the settlors was a resident in New Zealand since the time when the trust was first set up, the trust's income was all earned overseas and was paid to overseas beneficiaries.

The New Zealand tax system is based on the assumption that we tax income earned or received in New Zealand. If the settlors always lived overseas and the income is earned overseas and paid to beneficiaries who live overseas, then there is no reason to tax the income in this country. The foreign tax regime was designed to avoid the Inland Revenue having to waste time checking returns for trusts where there is no tax to pay.

The problem is that some other countries charge income tax on a different basis. Those tax systems consider income earned by a New Zealand trust to be a New Zealand tax concern. So we are not taxing these trusts and often the country where the people are living is not taxing the income either. It was never intended that New Zealand should become a tax haven, but evidently some people have made use of this loophole.

Traditionally, only English-speaking countries had laws which allowed the establishment of trusts. So, for example, people in Europe and South America who wanted to set up a trust had to use the laws of another country in order to create their trust. Also in many countries you have to leave most of your estate to certain specified family members irrespective of what your will may say. Putting assets into a trust in another country was a way of getting around this. New Zealand seemed like a safe place where trusts would be enforced by our courts which are not as slow or expensive as some countries.

The Panama Papers

Foreign trusts were in the news recently because someone hacked into the records of a law firm in Panama. It seems there were some dodgy dealings going on. Apparently criminals and crooked politicians in other countries were hiding money in companies and other structures. Unfortunately this Panamanian law firm was also setting up trusts under New Zealand law for the benefit of some of their clients. So it seems that foreign trusts are no longer just a way to protect property.

Risks for New Zealand

These revelations clearly pose a risk to New Zealand's reputation as a good place to do business. We do not want to be seen as a place where people can hide illegally acquired funds or avoid their obligations. The government came under some pressure to deal with the problem and tax expert John Shewan was asked to provide a report.

Mr Shewan's recommendations have been accepted and the government has now introduced legislation which is expected to be passed by the end of the year.

New requirements ahead

The main new requirement is that foreign trusts must be registered. The registration forms must state the settlor, the people who have control, who has power to appoint and remove trustees or make other changes, and the trustees must be named. For each person their name, email address, residential address and tax number for their country of residence will need to be provided. Some beneficiary details will also need to be provided. Annual returns will be required to update this information and will have to include financial statements for the trust and details of distributions.

The new legislation will not require Inland Revenue to send this information automatically to all other countries but it will be available on enquiry from overseas authorities.

The new rules are unlikely to affect most New Zealanders. If you are living in New Zealand and receive distributions from a trust, you must pay the tax on income you receive unless the trustees have already paid it. New Zealand trustees must either declare the income as trustees' income (and pay 33% tax) or as beneficiary income (taxed at the beneficiary's rate). This has not changed and will not be affected by the new rules.