

Can You Still Trust Trusts?

I recently read an article that declared that trusts offer “virtually no benefit to honest citizens”. That is quite a statement and one that I disagreed with so much I had to put pen to paper...

Trusts are recommended by Lawyers and Chartered Accountants for a variety of purposes. They have a number of unique characteristics that are not available in other structures. To understand this, let's take a closer look at some of these characteristics.

Firstly, a Trust is not an entity in its own right it's more of a “concept”. A trust is essentially an agreement (preferably in writing – a “deed of trust”) between those who are looking after assets (Trustees) on behalf of other parties (Beneficiaries).

The Trustees hold the assets in their own names for the Beneficiaries. However, the Trustees have no rights to the assets they are merely holding these on behalf.

Most Trusts are termed “discretionary” trusts. This is because the Beneficiaries only benefit at the discretion (choice) of the Trustees. In this way, no individual Beneficiary can lay claim to the assets of the Trust.

So you can see there is a distancing between the Beneficiary and the assets. This means that should a Beneficiary get into financial difficulties, their creditors cannot claim the assets of the Trust.

There is another party involved in the formation of the Trust - the Settlor(s). These are the people who set up the Trust in the first place. Usually, they also have power of appointment and removal of Trustees – this is not exercised very often, except when there is reason to remove a trustee or they resign or die and a replacement is needed.

Trust deeds and deeds of wishes are tailored to each unique situation, which comes down to the wishes of the Settlor. They need to think ahead and consider a number of potential scenarios to paint a picture of how the trust deed should work, who should benefit along the way and how to close the Trust and distribute the assets at the natural end of the life of the Trust (no longer than 80 years).

So, who can benefit from having a trust as part of their overall financial structuring? Firstly, there is no doubt that trusts are worthwhile considering for business owners. No business is without risk. Risk is a fundamental aspect of business. Good businesses with good owners/operators fail just like bad businesses or bad operators. Changing markets, collapsing clients and catastrophic events can all lead to good businesses failing. Trusts are just like insurance, one of many tools available for protecting asset value.

There are many aspects to the use of trusts in different business structures. Each structure is unique to the particular circumstance. This does mean that the structure becomes more complex and it is vital that the business owner understands the structure in place and the reasoning behind it. Your Lawyer or Chartered Accountant should be able to explain your structure and its key design concepts to you. This is very important for the long term stability of the structure.

It could be argued that the typical home owner who is not self employed or a business owner, has little to benefit from having their family home in a trust. But people have a habit of getting themselves into trouble along the way. We only need to look at the outcome of the recent property boom to identify many areas where good, honest and intelligent people signed up for property deals from unscrupulous businesses – Blue Chip is the prime example.

As a home owner, to determine if you need a trust, ask yourself if you plan to do any kind of investment or business deal that could have a negative outcome? Of course you have to contemplate this question before you sign up for any deal! My advice here is, if you are considering an investment or business deal, have your Chartered Accountant and Lawyer review the investment proposal and also the suitability of your current structures before you commit to anything.

Trusts can still offer some taxation benefits in certain circumstances. Again, each circumstance is unique and any dealings that have tax consequences need to be handled very carefully to ensure that you don't fall foul of the various anti-avoidance provisions in the tax legislation. All communications that even mention taxation consequences, or advice in relation to taxation, should be done on a strictly confidential basis. If done properly these communications then have legal privilege and are not subject to disclosure to Inland Revenue.

Trusts have been around for centuries and I don't foresee them falling by the wayside any time soon.