



Trusts

Why establish a trust?

For a long time trusts were thought to be exclusively for the rich and powerful, and beyond the average New Zealander's reach. In more recent times as the complexity and risk of conducting business increases, the introduction of relationship property laws and society in general becoming more litigious many more people are taking up the opportunity to use this ever practical asset protection tool. One question that must be on the lips of every owner of assets is, "Do I need a trust?"

There are different types of trusts, and people have many different reasons for establishing one. The most common form of trust, which we will discuss in this article, is a family trust; however the principles and information supplied will also apply to other trust structures as well.

A family trust is created when one person (or people) called the settlor transfers assets to people called trustees who, in turn, hold these assets for the benefit of a group of people called the beneficiaries.

This relationship between the parties is governed by a trust deed which sets out, amongst other things, the groups of people to benefit, the powers of trustees, the settlor's intentions and when the trust is to be wound up and the assets transferred to the listed final beneficiaries.

An individual can hold any number of these roles. However it is important to remember that the trustees control the assets for the benefit of the beneficiaries. Also, records of all decisions must be properly maintained to avoid the trust being challenged as a sham, or an alter ego trust which potentially removes the intended level of asset protection.

Protections from a trust

For most people the principal purpose of a trust is to safeguard the family's assets and wealth against risk for a variety (or combination) of reasons which may include:

- Protecting assets from business risk



- Protecting your children's inheritance from claims by their partners or business creditors
- Providing for special family needs, such as a child with a disability
- Protecting assets in a second marriage/relationship situation and/or relationship breakdown
- Preventing claims on your estate when you die (family protection and testamentary promises)
- Minimising tax liability
- Protecting assets against the possible introduction of capital gains tax, death duties or succession taxes
- Protecting against income and asset testing for, say, rest home charges
- Providing funding for education costs for children and/or grandchildren
- Allowing family assets, such as family homes or holiday homes, to pass to the next generation without exposing inheritances to relationship property or other claims and also the need to go through the gifting exercise again; or to
- Giving to the community through a charitable trust.

Establishing a trust

When a trust is established the settlor gives, or transfers, property to the trustees to hold for the beneficiaries.

Any property or asset can be transferred to your family trust. However, it is generally recommended only to transfer assets which are likely to retain or increase their value, such as property. For most people this usually involves transferring their family

home, and perhaps rental property and some monetary investments.

Usually the assets are sold to the trust at current market value to avoid having to pay gift duty. As most trusts do not have the ready cash to pay the purchase price, this sale creates a debt due to the settlor which is forgiven over time by a gifting programme. Any debt that is still not forgiven is a personal asset and is available to personal creditors.

Gifting programme

The process of transferring your assets to the trust is known as 'gifting'. A 'gifting programme' is the regular process (usually annual) established to reduce a loan owed to you by the trust by regular 'gifts' which are made in such a way that there is generally no liability for gift duty.

In New Zealand an individual can gift up to \$27,000 in any 12 month period without paying gift duty. A couple can therefore make gifts totalling \$54,000 over the same period. In assessing this amount, ordinary gifts of less than \$2,000 in total (birthday or Christmas gifts, for example) are usually not taken into account. The gifts are made by signing a document every year which 'writes off' \$27,000 of the debt.

Gifting at the rate of \$27,000 year, or \$54,000 for couples, can be a slow process. In order to make the most of the advantages of having a trust, it is important not to delay the process of transferring assets to your family trust.

If you die before forgiving the entire debt

owed to you by your trust, the balance of the debt can be forgiven in your Will. Under current law, a forgiveness of debt under a Will, as with any other gift under a Will, is not liable for gift duty.

Transferring assets

Transferring or 'gifting' your personal assets to a trust means the trustees will own the assets and control their use.

To ensure the trust cannot be challenged by the Inland Revenue Department or the courts as a sham or alter ego trust, this transfer of assets from a settlor's personal ownership to the trust must be clearly documented, not only at the time of establishing the trust but also on an ongoing basis.

The trustees must keep a proper record of decisions so that they can be shown to be the decisions of all trustees, and not your personal decision as settlor.

If you are a settlor, trustee and beneficiary, it is even more important that the trustees' decisions, including yours, are properly recorded. Having an independent trustee also helps to identify the separation between your personal affairs and trust business.

Is a trust for me?

A family trust may or may not suit your specific family circumstances, nor does one trust size fit all. But for most people, a trust structure to protect their family's assets is the best solution.

Some financial commentators are suggesting that trusts are no longer the best vehicle to hold investment assets now that KiwiSaver and PIEs (portfolio investment entities) are up and running, and LAQCs (loss attributing qualifying companies) are still being used.

However, it should not be overlooked that investments through PIEs and LAQCs do not give any protection from other risks of the types noted above. The assets remain yours and are at risk from claims by creditors or family members.

A trust is still, for most people, the most effective way to protect your family's assets long term. Talk with us to help you decide on what is the best asset protection for your own family's needs.

Managing your Rental Property

Not as easy as it looks

Many New Zealanders have invested in rental properties to help fund their retirement; but there is more to it than simply collecting the rent. What happens if the landlord/tenant relationship breaks down? What are each party's obligations?

Mr Smith decides to enter the property market and purchase a modest two bedroom unit. The unit is heavily mortgaged.

Mr Smith's new tenants come to him highly recommended and they are handed the keys to the unit. However, on checking his bank statement at the end of the tenancy's first week, Mr Smith finds his tenants have missed their first rental payment. He visits the unit and finds five cars parked in the driveway, a tent pitched on the front lawn and a lively party taking place. A number of gang members are enjoying the tenant's hospitality.

Mr Smith is determined to resolve the problem immediately. Over the next week he writes to the tenants and advises them they are to vacate the property immediately. He visits the property everyday. He knocks loudly on the door, calls out to the tenant and circles the unit shouting for the tenant to "open up". He receives no response. It appears to Mr Smith that the tenants have fled.

After his sixth visit to the property, Mr Smith decides to look inside using his spare set of keys. There is nobody at home. As he is leaving the unit the tenants arrive home. Mr Smith scuttles away with an echo of abuse from the tenants ringing in his ears.

After checking with the Department of Building & Housing (formerly Tenancy Services) Mr Smith lodges an application with the Tenancy Tribunal seeking immediate eviction of the tenants.

Seven days after he has lodged his application, Mr Smith receives a notice from the Tribunal advising that the tenants have lodged a counter-claim. In that claim the tenants have sought compensation from Mr Smith for breach of quiet enjoyment, harassment, illegal entry and failing to provide proper notice to vacate.

At the subsequent hearing Mr Smith is devastated when the Tribunal finds in favour of the tenants and awards compensation, together with exemplary damages to the tenants of \$1,500.

It is all too much and Mr Smith decides to sell his property to join KiwiSaver.

Lessons learnt

What lessons can be learnt from the unfortunate experiences of the hapless Mr Smith?

- All tenancy agreements, including matters relating to the resolution of tenant/landlord disputes, are governed by the Residential Tenancies Act 1986 (the Act).
- Tenancy law is in some respects similar to employment law; a failure to follow correct procedure as specified by the legislation, can result in a landlord or tenant being in breach of the Act, even in circumstances where the merits of the case appear to lie with the party in procedural breach.
- A landlord's right to entry is strictly prescribed by the Act. Proper notice must be provided to the tenants.
- Landlords and tenants can only terminate a tenancy in accordance with the provisions of the Act.
- Failure to terminate a tenancy in a prescribed manner can result in a breach for which the offending party may be held liable for payment of compensation.
- The standard notice period required for a landlord to terminate a tenancy is 90 days. There are however occasions when a landlord can terminate a tenancy on 42 days' notice such as the landlord requiring the property for occupation by the landlord or any member of the landlord's family OR where the landlord has agreed to sell the property and under the terms of the agreement must provide the purchaser with vacant possession.



- Tenants must provide the landlord with 21 days' notice if they wish to leave the tenancy.
- If a tenant vacates a property without providing adequate notice, the tenant may be required to pay the landlord three weeks' rental in lieu of notice.

Conclusion

If you are thinking about entering the rental property market, we recommend that early on you familiarise yourself with the Residential Tenancies Act, and a landlord's obligations and responsibilities.

Similarly, tenants should also be aware of their obligations, and the remedies that are available to them in case the landlord does not fulfil any of the obligations imposed by the Act.

As with all contracts it is important that the arrangements in the tenancy are agreed and appropriately recorded by both parties before the tenancy begins.

Majority Shareholders

Rights and responsibilities

Company shareholders have a duty not only to the company itself, but also to other shareholders. In this article we look at the rights and responsibilities of majority shareholders and also point out the obligations they have to those with minority shareholdings.

Most companies in New Zealand are small, and have between two and five shareholders. Generally the shares are divided between the shareholders on an unequal basis, so that some shareholders have more than others. This unequal distribution can arise for any number of valid reasons and, because companies are largely democratic, it means that the majority shareholders have a greater say in what the company does.

Shareholders do not usually get involved in the company's affairs that often because the day-to-day running of the company is the responsibility of the directors and the managers they appoint. However, some fundamental decisions are the reserve of shareholders, such as changing the constitution, approving an amalgamation with another company, putting the company into liquidation, approving a major transaction and, most importantly, appointing and removing the directors.

...there is a limit on the extent to which the majority shareholders can run the business without reference to the minority.

Some of those decisions can be made with a simple majority of votes (anything over 50%), whereas others require a 'special resolution' passed by a 75% majority (or more if the company's constitution says so).

Majority shareholders are clearly more likely to dominate the decision-making because they have more votes. This is only fair, since they have more share capital tied up in the company.

It is natural that an owner/operator with, say, 80% of the shares will not want the

minority shareholders to interfere too much in the day-to-day running of the company. This is particularly so if the business has been built up on the strength of the owner/operator's hard graft, experience, charisma or business contacts. But there is a limit on the extent to which the majority shareholders can run the business without reference to the minority.

Minority shareholders' rights

Minority shareholders usually have voting rights, the right to receive dividends and distributions of capital, to buy new shares or put up shares for sale, receive the company's annual report and financial statements, and have those financial statements audited, to have a special meeting held and a specific issue discussed, and to vote on any major transactions and the other matters referred to above. They can also insist on the company and its directors complying with the Companies Act and the constitution.

They also have the fundamental right not to be ignored, taken advantage of or bullied. Section 174 of the Companies Act says that if those who control the company run it in a way that is 'oppressive, unfairly discriminatory, or unfairly prejudicial' to any shareholder, then that shareholder can ask the court to make amends.

The court has a wide range of powers to put things right including ordering someone to buy the minority's shares at a fair price, pay compensation to the minority, change the way the company is run, correct the company's records, unravel any transactions that have been entered into, and to put the company into receivership or liquidation.

Not all minority shareholders have the resources or the willpower to rush off to court every time their rights get trampled

on. But they can if they want to, so this acts as a very effective limitation on the ability of those running the company to treat it as their own personal fiefdom.

Minority shareholders cannot complain about every little setback or disappointment. For example, if the dividends turn out to be less than anticipated, or certain management decisions turn out to be ill-conceived, this will not normally constitute oppression. The courts will not second-guess management decisions; anyone can get it wrong occasionally, despite the best of intentions.

Oppressive behaviour

However, when those in control of the company prefer their own interests over those of all the shareholders they can come unstuck. Examples of minority shareholder oppression range from a director taking a very large salary and charging excessive rent to the company for the use of premises they own while delaying the repayment of a minority shareholder's loan account, issuing shares to a friendly party for the purpose of diluting another shareholder's voting power and jeopardising the proposed sale of those shares, setting up another business that competes with your own company, wrongfully excluding a fellow shareholder from participation in the company, making decisions that adversely affect a fellow shareholder without telling him or her about the meeting, to failing to put a major transaction to a shareholder vote.

All shareholders need to know their obligations, rights and responsibilities. Legitimately enforcing majority rights is fine, but dirty tricks and strong-arm tactics are not.

When Near Enough May Not Be Good Enough

Irrigation consents

The supply of water has become a critical issue in the agriculture sector. The result is that, sadly, in many areas battle lines have been drawn within farming communities when checking irrigation bore sites. This article highlights the importance of reviewing the exact location of irrigation consents not only as part of due diligence on a farm acquisition, but also as good fundamental farming practice.



Heightened policing

As water has become more politically and financially significant, and perhaps smarting from accusations of having been over-generous with allocations in the past, regional councils are stepping up their policing of irrigation consents. As part of this vigilance, councils are checking, amongst other things, that irrigation bores have been installed precisely where the relevant consent authorises them to be.

The spectre of an abatement notice

Many regional councils have identified that a surprisingly large number of consent holders have deviated 'a little' from the terms of their consents in a way that those consent holders never imagined would be a problem.

When we are talking about the exact location of an irrigation bore, as little as a 25 metre deviation from a consented location could be enough to result in an abatement notice requiring the holder to immediately cease pumping until the deviation has been remedied. If that is the case then the consent holder has a big headache. Either they must invest in moving the bore back to where the

consent stipulates that it should be, or they must seek a new consent in which case the headache may turn into an expensive nightmare if there are unhelpful neighbours. It is possible, and probable, that other consent holders will fall within a 2 km radius of the unconsented bore. A new application for consent may therefore be much harder to obtain if these neighbours do not consent. Consent holders are then into the expensive realm of aquifer testing, with no guarantee of success.

Location easily verified

Thanks to modern GPS (Global Positioning System) technology and on-line mapping services such as Google Earth, TopoOnline and regional councils' GIS services, satisfying yourself that a bore is in the right place is quick and easy. If you are adept at using a hand-held GPS, you could do a preliminary check yourself. Considering the critical value of water, it would be prudent in any case to have your own results checked by an irrigation consultant or hydrologist. It is simple stuff, but could save you a huge headache further down the track.

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Postscript

Why wouldn't you put your children or grandchildren into KiwiSaver?

Do you remember having a Post Office Savings Bank account when you were younger? If you do, you may remember the thrill of depositing your pocket money or your hard-earned dollars into an account and seeing the magical balance go up. Your parents may have even given you a helping hand to get your future nest egg started.

We all know that today's kids are probably more interested in Xbox, texting and Bebo than saving for their future, but have you considered KiwiSaver as a future savings option for your children or grandchildren? If not, why not?

Well, it really is a 'no brainer'. If you open a KiwiSaver account for your children or grandchildren, the government will kick-start their KiwiSaver account with \$1,000. As you or the children are able to, you can place deposits into the fund to build it up.

We think it's a great idea to set aside a regular amount each year, but if this is a bit too much, a few product providers have set \$0 as the minimum contribution per annum. What this means is that you can invest the \$1,000 start-up from the government for a child at absolutely no cost to you. *If you don't do this, then you are effectively saying you don't want a free cheque for \$1,000 for your children or grandchildren.*

Let's say you set up a KiwiSaver scheme for a newborn earning 6% pa after tax and fees. Assuming you place no deposits over a period of 18 years, your child will have, at 18, a KiwiSaver balance of around \$2,900 (which will have cost you nothing). Now, in that same scenario, depositing just \$400/year into their account (about the cost of two lattes per week), the child would end up with nearly \$16,000 after 18 years. That's some start in life.

If you would like more information, please call us and we will put you in touch with a financial adviser who can help you by explaining the options available.

Remediating defective consumer goods

A recent case in Auckland's High Court¹ tested the Consumer Guarantees Act 1993 (CGA). Mr Turvey purchased a motor vehicle from a registered motor vehicle trader (the supplier for the purposes of the CGA). After six months certain defects appeared in the vehicle, which Mr Turvey had repaired by a third party. Mr Turvey then filed a claim against the supplier for the repair costs and for general damages.

The High Court overturned the District Court decision and held that where the defect can be remedied and is not of a substantial character, the purchaser must follow the requirement in the CGA to allow the supplier the opportunity to remedy the failure or defect within a reasonable time. The judge referred to the underlying policy of the CGA, that businesses should bear the risk where the goods and services they supply fail to comply with consumers' reasonable expectations. The High Court held that Mr Turvey was not entitled to claim under the CGA for the repair costs from the supplier, as he had failed to give the supplier the opportunity to remedy the defects first. The High Court did award Mr Turvey damages however, for consequential loss under the CGA.

This decision sends an important message to consumers that they should always ask the supplier to remedy any defect in consumer goods first. Consumers should avoid taking matters into their own hands, because they may lose out altogether where they arrange for a third party to repair defective consumer goods.

¹Acquired Holdings Ltd v Turvey HC, 14/11/2007, Winkelmann J, Auckland, CIV 2006-404-7284



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