

Insights and Commentary from Dentons

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Recent Developments in the Law and Administration of Trusts in New Zealand

Henry Brandts-Giesen and Sarah Kelly
Kensington Swan

1 Why and how trusts are traditionally set up and run

- 1.1 Asset planning in New Zealand is principally about preserving and enhancing the value of assets for the benefit of current and future generations of a family. Often this involves transferring the assets between generations. There are two key elements to this – investment and structure.
- 1.2 Banks and other financial institutions provide investment expertise in various forms. Nowadays, in New Zealand investors have ready access to world class investment advice, brokerage and management services.
- 1.3 On the other hand, lawyers and accountants typically wrap up family assets in structures intended to protect them from risk. Risk to private wealth can manifest itself in many forms but in a New Zealand context often arises from:
 - a Business activities (e.g. creditors and statutory liabilities).
 - b Family disharmony (e.g. relationship breakdowns and sibling rivalries).
 - c Fragmentation (e.g. farmland and family businesses).
 - d Death or incapacity of family members.
 - e Inflation, taxes, regulations and other economic forces.
 - f Family members who are spendthrifts, have harmful addictions or are financially uninformed.
 - g Lack of cash flow and/or liquidity.
- 1.4 Private wealth is typically structured, governed and administered in New Zealand in a manner which is quite unique to this country. In other countries, trusts are typically utilised by the wealthy and for the vulnerable. In New Zealand, family trusts are ubiquitous and it is common for people of quite modest means to hold assets in trust. Sometimes a family may have several trusts, each of which holds a single asset or only a few assets. Trusts have become a default setting for advisors and, furthermore, it seems to be the norm in New Zealand for trusts to be governed by the very same people who set them up and benefit from them. Often trusts are laden with bank debts (perhaps secured and guaranteed by the family) and have only minimal net asset valuations. It is common for family members to reserve powers which give them effective control over the assets.
- 1.5 This is all rather unusual when compared with asset planning in some other countries.

2 Some issues with the traditional approach

- 2.1 Often people in New Zealand have assets held in trust in circumstances where they receive only limited benefit from the arrangements. In many cases, the trusts may just add unnecessary complexity and expense to people's lives. This soon becomes apparent when the family is refinancing, buying and selling property, preparing tax returns or adjusting succession planning settings. Furthermore, some of these trusts may not withstand scrutiny from the court because of the way they are set up and/or operated.
- 2.2 Another unique aspect of New Zealand asset planning is the distinct lack of genuine and independent governance of trusts and family investment holding entities (such as underlying companies). Globally, there is an entire industry dedicated to the independent governance of family wealth. However, in New Zealand we tend to conflate the provision of two very distinct functions, namely legal advice and fiduciary services. In each case the providers of those services require different skills and have duties which are owed to different classes of people. If New Zealand were to ever alter course and align with other countries, then there should be significant commercial opportunities for independent professional trustees to fulfil the governance and administrative functions.
- 2.3 Trusts are one of the most complex legal relationships. Many lawyers do not properly understand trusts and fiduciary powers and duties, let alone lay settlors, trustees and beneficiaries. In New Zealand, most clients are adverse to appointing an independent professional trustee who is not also the family lawyer or accountant. A problem with that approach is that the family lawyer or accountant could be conflicted by a long-standing relationship with the people who set up the trust (whose interests may become misaligned with the next generation) and unaware of, or unable to fulfil, fiduciary duties to the wider family.
- 2.4 In many other countries, it is generally considered undesirable for family members to be the trustees and/or have effective control over the trust. Instead, truly independent, professional and licensed trustees in those countries are typically granted wide discretionary powers which they exercise judiciously, whilst mindful of fiduciary and other duties which are strictly enforced by the courts and regulators.
- 2.5 Historically, these idiosyncrasies were probably of only academic relevance in New Zealand, given net asset values may have been minimal and the interests of the beneficiaries and the trustees are generally aligned whilst the second generation are young and uninformed. However, in recent years some asset classes have increased exponentially in value and many beneficiaries have grown into adulthood and are likely to be better educated, informed and advised in relation to trust matters. This represents both risks and opportunities for advisors.

3 Specific areas of vulnerability for trusts

- 3.1 Increasingly, there are consequences to the traditional Kiwi way of doing things. Recent case law has raised questions the traditional approach. There are also increasing avenues through statute and common law remedies by which a trust can be attacked and the exercise of powers impugned.

Powers as property

- 3.2 Following the decisions in *Clayton v Clayton*¹, where a family member has a high level of control over the trust, the perceived asset protection benefits of the trust may be compromised. In that case the Court of Appeal decided that certain powers reserved to the settlor were property belonging to the settlor on the authority of *TMSF v Merrill Lynch Bank & Trust Co (Cayman) Ltd* [2011] UKPC 17, 1 WLR 1721.
- 3.3 Whilst this decision caused some consternation in New Zealand the principle is fundamentally sound. A personal power under a trust (e.g. a power to revoke the trust or a general power of appointment) that can be used to benefit the person exercising it has a value which may be correlated to the nature and value of the assets of the trust. It is also a right in the general sense. Furthermore, the concept that powers are property long predates *Clayton* and indeed *TMSF*. Options to purchase are powers and it is accepted that they are property.²
- 3.4 A consequence of this is that in respect of non-fiduciary powers reserved to a settlor, the court could, in proceedings brought by creditors or a former spouse or de facto partner, exercise its *in personam* jurisdiction over the settlor and oblige him or her to exercise those powers and thus expose the assets to satisfy the claims.

Disclosure of information to beneficiaries

- 3.5 An issue that trustees frequently face is how to approach a beneficiary's request for trust information. The Supreme Court in *Erceg v Erceg* [2017] NZSC 28 is the most recent, and leading authority with respect to disclosure of trust information to beneficiaries. In its decision, the Supreme Court provided that the starting point where a request for disclosure by a beneficiary is made, is the obligation of a trustee to administer the trust in accordance with the trust deed and the duty to account to the beneficiaries of the trust. This creates a presumption of disclosure to beneficiaries. However, the Supreme Court went on to set out the following factors which should be considered by the trustees where a beneficiary has requested disclosure of trust information:
- a The nature of the documents that are sought;
 - b The context for the request and the objective of the beneficiary in making it;
 - c The nature of the interests held by the beneficiaries seeking access;
 - d Whether there are issues of personal or commercial confidentiality;
 - e Whether there is any practical difficulty in providing the information;
 - f Whether the documents sought disclose the trustees' reasons for decisions made by the trustees;
 - g The likely impact on the trustee and the other beneficiaries if disclosure is made;
 - h The likely impact on the settlor and third parties if disclosure is made;
 - i Whether disclosure can be made while still protecting confidentiality (i.e. through redaction); and

¹ *Clayton v Clayton* [2016] NZSC 29 and *Clayton v Clayton* [2016] NZSC 30.

² *Wright v Morgan* [1926] AC 788 (PC)

- j Whether safeguards can be imposed on the use of trust documents (i.e. undertakings and inspection by professional advisers only).
- 3.6 The Trusts Bill proposes to deal with the issue of disclosure of trust information to beneficiaries directly. This is discussed in more detail below, but in short, the Trusts Bill proposes:
- a A presumption that trustees will give to beneficiaries and their representatives basic trust information;
 - b A presumption that trust information will be given to a beneficiary or their representative upon request; and
 - c An exception to the above presumptions if certain factors exist.

Clawback provisions available to creditors

- 3.7 Creditors might have a claim against assets in a debtor's trust pursuant to the Property Law Act 2007 ('**PLA**') and the Insolvency Act 2006 ('**IA**').
- 3.8 Sections 344 to 350 of the PLA enable the court to set aside certain dispositions of property. Where a certain disposition has been made to a trust, the court is able to 'claw back' assets that are held in that trust.
- 3.9 Sections 204 to 213 of the IA concern voidable gifts. Under section 204, if a gift is made within two years of a person being declared bankrupt, the gift is cancelled at the initiative of the Official Assignee. Under section 205, if the bankrupt person makes a gift within two to five years of being adjudicated bankrupt, and at the time of making the gift the bankrupt was unable to pay his or her due debts, the gift is also cancelled. A bankrupt is presumed to have been unable to pay his or her debts unless the party claiming under the gift proves that the bankrupt was – immediately after the making of the gift, or at any time after that up to his or her adjudication – able to pay his or her debts without the aid of the property of which the gift is composed. There is a defence under section 208 where a person receives a gift without reasonable grounds for suspicion of the donor's insolvency and alters his or her position in reliance upon that gift.

Clawback and compensation provisions available to spouses and de facto partners

- 3.10 Claims by a party to a previous relationship can also be made against a trust under the Property (Relationships) Act 1976 ('**PRA**') and the Family Proceedings Act 1980 ('**FPA**').
- 3.11 Section 44 of the PRA is a clawback provision which allows the court to set aside a disposition of property made to a person where the disposition is made with the intention of defeating the rights of that person's spouse or partner under the PRA.
- 3.12 Section 44C of the PRA allows the court to make orders compensating a spouse or partner whose rights have been defeated by a disposition of relationship property to a trust. The court will look at whether the disposition has the effect of defeating the rights of a spouse or partner, regardless of the intention of the party in disposing of the property to a trust. Section 44C is subordinate to section 44, so the court must be satisfied that section 44 does not apply before addressing a claim under section 44C.

- 3.13 Section 182 of the FPA gives the court a wide discretion to revisit the terms of any agreement or settlement made before or during a marriage or civil union. It is important to note that the FPA only applies to married, and not de facto, couples. However, it seems likely that this anomaly will be addressed in future legislative changes. Section 182 of the FPA was considered in *Clayton v Clayton*.

Anti-avoidance provisions in other legislation

- 3.14 Certain anti-avoidance enactments allow arms of the Government to disregard a trust. These include – the Social Security Act 1964 ('SSA'), the Child Support Act 1991 ('CSA'), the Income Tax Act 2007 ('ITA') and the Criminal Proceeds (Recovery) Act 2009.
- 3.15 By section 147A of the SSA, if the Chief Executive of the Ministry of Social Development is satisfied that an applicant or the applicant's partner has 'directly or indirectly deprived himself or herself of any income or property' (other than an exempt asset) the Chief Executive may conduct a means assessment of the applicant as if the deprivation had not occurred. This means that assets that have been transferred to a trust, or income that is earned by a trust, may still be included in an applicant's means assessment. This could result in an applicant being ineligible to receive a residential care subsidy.
- 3.16 Amendments to the CSA combat the use of trusts to avoid child support payments. A person's income for the purposes of assessing child support now includes:
- a Income retained in a close company where the person is a major shareholder;
 - b Trustee income where the person is a settlor of a trust, other than by virtue of providing personal services for less than market value in the administration or the maintenance of trust property. A 'settlor' for these purposes is defined in the ITA and includes any person who transfers value to or for the benefit of a trust.
 - c Other payments received by a person and used to replace lost income or to meet their usual living expenses where the total payments exceed \$5000 per year. This includes capital distributions from a trust, regardless of whether the person is a settlor of that trust.
- 3.17 Trust structures which constitute tax avoidance measures are prohibited by the ITA. Such arrangements can include adoption of certain trust structures which allow individuals to evade paying tax. Where a single step in a larger scheme is for the principal purpose and has the effect of tax avoidance, the scheme, as a whole, can be considered tax avoidance. Where this occurs, the Commissioner will revise the taxable income of those affected by the scheme in order to eliminate any advantage obtained.
- 3.18 Real or personal property that is the proceeds of, or used in the commission of serious offences may be forfeited to the Crown under the Criminal Proceeds (Recovery) Act 2009.

Common law

- 3.19 The increased possibility of a trust being compromised under common law principles is another potential risk to trusts in New Zealand.
- 3.20 A sham trust is an oxymoron. However, where there is intention to deceive as to the true nature of a transaction a court may order that arrangements which purport to be a trust are a sham and therefore disregarded. Generally, a common intention to deceive is required at the time of creation of the trust, or when property is transferred into the trust (known as an

'emerging sham'). Where there is an emerging sham, only the property transferred into the trust at the relevant time is at risk. The common intention between the settlor and either the beneficiaries or the trustees must be evidenced, and is determined by the court by looking at the subjective intention behind the documentation. The evidential criteria to be satisfied is onerous. As such, poor administration, breaches of trust and lack of legal knowledge are not in themselves sufficient for a court to make the finding. This high threshold exists to preserve the certainty of commercial arrangements and beneficiary rights.

- 3.21 A trust may be deemed to be the alter ego of the settlor where the settlor has exerted too much control over the administration of the trust, and by extension, the trustees. This issue has primarily arisen in the context of de facto or marital relationships, where there is a question as to whether a partner is entitled to receive a share of the trust property on relationship breakdown. Features of an alter ego arrangement include a lack of independence by the trustees (acting at the instruction of the settlor), reservation of powers for the settlor (e.g. sole ability to appoint and remove trustees), and a lack of records regarding the administration of the trust. Despite the finding of alter ego, the trust may not automatically be disregarded by the courts as it is not an independent cause of action, but rather, it acts as supporting evidence to prove a sham trust.
- 3.22 The concept of an illusory trust is relatively new and may arise when a settlor maintains wide powers of control over the trust property. Like an alter ego arrangement, a trust cannot be declared invalid merely because it is deemed to be illusory. Instead, relevant evidence may support an argument that the trust is invalid because it is a sham.
- 3.23 A constructive trust is a trust that arises by operation of law, rather than by express declaration of the settlor or trustees. A constructive trust may be imposed by the courts on the basis that it would be unconscionable for the person on whom the trust is imposed to deny a beneficial interest to the claimant.
- 3.24 Constructive trusts were often claimed by former de facto partners and sometimes imposed by the courts on personal property before the Property (Relationships) Act 1976 (previously the Matrimonial Property Act 1976) was extended to apply to de facto relationships. Where a constructive trust was imposed, a party to a de facto relationship was typically able to claim an interest in trust property.
- 3.25 It is also possible for constructive trusts to be imposed over property owned by an express trust. This occurred in *Vervoort v Forest*.³ In that case, the settlor of an express trust, Mr Duffy, was also one of two trustees but was able to exercise a high level of control over the trust, due to a lack of involvement from the other trustee in the trust management and decision-making. The Court of Appeal overturned the decision of the High Court and found that where one partner has de facto control of a trust and contributions have been made and expectations between the parties to the relationship have arisen, the non-controlling partner may make a claim. In such situations, the Court of Appeal confirmed that a constructive trust can and should be imposed over the assets of an express trust if equity requires it.
- 3.26 Where a constructive trust is found, the remedy will depend on the contributions made to the trust property by the non-controlling relationship partner. The remedy is unlikely to be an equal share in the trust property but it may be significant.

³ *Vervoort v Forest* [2016] NZCA 375.

- 3.27 Resulting trusts arise by operation of law, where property transferred to a trust is held for the benefit of the transferor. By way of example, it could be found that a resulting trust exists where a family home is held by a trust and that trust is in fact controlled by one spouse. In such a situation, the family home could be found to be beneficially held by the controlling spouse and therefore subject to the rules of the Property (Relationships) Act 1976. Resulting trusts have not yet been considered in the context of family trusts, but it is conceivable that the concept may be extended to them in certain circumstances.

4 Increasing compliance burden for Trustees

- 4.1 Another emerging theme in the law and administration of trusts in New Zealand is the increasing compliance burden being imposed on trustees and their advisors. Over recent years the governments of developed countries have increased their efforts to combat tax evasion and organised crime by introducing onerous and complex compliance regimes and extending their scope beyond financial institutions.
- 4.2 These compliance regimes are resulting in significant changes to the ordinary course of business for lawyers, accountants and trustees in New Zealand and, in a trust context, require them to gather much more information about settlors, beneficiaries and trustees. The regimes also impose obligations to disclose information to law enforcement and government agencies, in certain circumstances. This is a paradigm shift from the traditional role of a trusted advisor. It will also likely cause an increased cost of doing business.
- 4.3 These regimes are also a paradigm shift in the way that laws are enforced. Enforcement agencies and revenue authorities have shifted emphasis from the traditional approach of investigating offenders directly. Instead they are imposing information gathering obligations on the third parties and intermediaries with whom offenders interact and have professional relationships. In terms of effectiveness, this is likely to be equally as brilliant as it is audacious.
- 4.4 There are all manner of public policy issues that arise from this new approach to law and revenue enforcement. However, the reality is these compliance regimes have been implemented and are here to stay. The Rubicon has been crossed and now lawyers, accountants and trustees must meet the challenge of compliance.

FATCA

- 4.5 FATCA is US legislation with global effect designed by the US Internal Revenue Service ('IRS') to detect and prevent tax evasion by people with funds held in offshore accounts who should be paying tax in the US.
- 4.6 FATCA made its way into New Zealand law when an intergovernmental agreement was made between the US government and the New Zealand government in 2014. The legislation places the onus of reporting to the IRS on foreign financial institutions which hold financial assets, as opposed to the individual account holder themselves.
- 4.7 The definition of 'financial institution' under FATCA is extremely wide. The regime may impose on some trusts the obligation to register on the IRS website as a 'financial institution'. Remarkably, this is so even though the trust is not in business and may have no US citizens or tax residents or US investments connected with it.
- 4.8 Every trust in the known universe will be either a FFI (foreign financial institution) or a NFFE (non-financial foreign entity) for FATCA purposes. The terms are all encompassing and

mutually exclusive. The precise classification of a trust will depend on what assets are held and who 'manages' it.

- 4.9 If a trust is a FFI for FATCA purposes, it must register as such on the IRS website and obtain a Global Intermediary Identification Number (GIIN) – even where there is no US person controlling or otherwise connected to the trust (e.g. beneficiaries and settlors). If there are US persons controlling the trust then the trustee will need to report certain information to the IRS in relation to them.

CRS

- 4.10 CRS is essentially a global version of FATCA. CRS builds on FATCA with its aim being to combat offshore tax evasion on a global scale. Like FATCA, CRS applies only to entities and not individuals and a trust is an entity for these purposes. Every trust will be either a FI (financial institution) or NFE (non-financial institution) for CRS purposes.
- 4.11 If a trust is a FI for CRS purposes, it must register as such with the IRD and if there are controlling persons who are resident in a foreign country then the trustee will need to report certain information to the IRD, which will then exchange that information with the relevant foreign country.
- 4.12 It is very possible for a garden variety New Zealand discretionary family trust to be caught by the FATCA and/or CRS regimes and become subject to reporting requirements. Failure to comply can result in financial penalties to the trustees under the Tax Administration Act 1994.

AML/CFT

- 4.13 The Anti-Money Laundering and Countering Financing of Terrorism Act 2009 ('**AML/CFT Act**') is the cornerstone of the New Zealand anti-money laundering and countering terrorist financing regime. As with related legislation around the world, the AML/CFT Act requires a 'reporting entity' to conduct customer due diligence on a customer before undertaking any business activities with them.
- 4.14 In New Zealand, the definition of reporting entities includes:
- a Financial institutions;
 - b Financial advisers;
 - c Trust companies;
 - d Casinos;
 - e Lawyers and conveyancers (from 1 July 2018);
 - f Accountants (from 1 October 2018);
 - g Real estate agents (from 1 January 2019); and
 - h Businesses trading in high value goods (from 1 August 2019).
- 4.15 Where a reporting entity establishes a relationship with a trust, that reporting entity must conduct an enhanced form of customer due diligence on the trust and certain persons associated with the trust. This is because trusts are internationally recognised as presenting a high risk of money laundering and terrorist financing.

- 4.16 In practice, this means that where a trust wishes to establish a relationship with a reporting entity (e.g. a bank), the trustees are required to provide detailed and comprehensive documentation so that the reporting entity can satisfy its obligations under the AML/CFT Act. This includes verified documentation about the trust, settlor, trustees, protector, beneficiaries, and the source of wealth.

EU's 4th Anti-Money Laundering Directive

- 4.17 On 26 June 2017 the European Union's 4th Anti-Money Laundering Directive was implemented into UK law by the Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (the '**Regulations**').
- 4.18 The Regulations update the UK's existing Anti-Money Laundering regime. In doing so, they introduce new beneficial ownership reporting requirements for trusts which are subject to UK taxation. The reporting aspects of the Regulations have extraterritorial effect as they purport to apply regardless of where the settlor, trustee and beneficiaries are resident for tax purposes.
- 4.19 Affected trustees are required to report a wide range of information to Her Majesty's Revenue & Customs. Due to the complexity of the UK tax system, reporting obligations may arise in unexpected ways, such as owning shares in UK listed companies. There are civil and criminal penalties for non-compliance, and so it is important for New Zealand-based trustees, lawyers and accountants to have a basic understanding of the circumstances in which UK taxation (and therefore a reporting obligation) arises.

5 Trusts Bill

- 5.1 In a report by the New Zealand Law Commission, delivered in August 2013, it was recommended that a modern Trusts Act be enacted to replace the Trustee Act 1956 (the '**Trustee Act**'). As a consequence, the Trusts Bill (the '**Bill**') is currently before the Select Committee. Submissions on the Bill closed on 5 March 2018.

Purpose and application of the Bill

- 5.2 The Bill, when enacted, will replace the Trustee Act and the Perpetuities Act 1964. Given the inherent lack of understanding of trusts in New Zealand the purpose of the Bill is to make trust law more accessible, clarify and simplify core trust principles and essential obligations for trustees and provide mechanisms to resolve trust-related disputes.
- 5.3 The Bill applies to all 'express trusts' and trusts implied by law (such as constructive trusts and resulting trusts) are largely unaffected. The characteristics of an express trust are defined in clause 13 of the Bill as:
- a A **fiduciary relationship** in which a trustee holds or deals with trust property for the benefit of the beneficiaries or for a permitted purpose; and
 - b Where the **trustee is accountable** for the way they carry out the duties imposed on the trustee by law.
- 5.4 The Bill also provides expressly that, in relation to an express trust:
- a A sole trustee of a trust must not be the sole beneficiary of the trust; and
 - b The three certainties must apply to the trust (unless it is enacted by statute).

Age of majority

- 5.5 Clause 19 of the Bill provides that the age of majority for the purpose of an express trust is 18. It also provides that in any trust deed the expressions 'adult', 'child', 'full age', 'infant', 'infancy', 'minor', 'minority', 'full capacity', 'majority' and similar expressions must be read in that context. This means a trust deed which purports to vest assets in a child once he or she becomes an 'adult' will, once the new Act comes into force, be read as if the age was 18 (rather than age 20).

Maximum duration of trust

- 5.6 The common law rule against perpetuities has always presented conceptual and mathematical challenges. Clause 16 of the Bill abolishes the rule against perpetuities and provides simply that the maximum duration of a trust is 125 years. The terms of a trust may also specify a shorter duration.
- 5.7 It may be possible for existing trusts to enjoy a longer duration by the trustee exercising its power to vary the trust deed under clause 114 of the Bill (variation or resettlement of trust by unanimous consent of beneficiaries) or by the trustee or a beneficiary applying to the court to approve such a variation under clause 116 of the Bill (power of court to approve termination, variation, or resettlement of trust). Charitable trusts, which already enjoy the ability to operate in perpetuity, will not be affected by this change but will be subject to the other provisions of the new Act.
- 5.8 It has been suggested by some commentators that there should be a more pragmatic mechanism for trustees of existing trusts to avail themselves of the proposed statutory maximum trust period. This could involve implying an amendment power into the terms of any existing trust deed that expresses an intention for the trust's perpetuity period to be the maximum period permitted by law (whether that is expressed as a set period of 80 years or a life in being plus 21 years), whereby the trustees could simply extend the termination date out to 125 years. Such a mechanism could be stated to require the consent of the person who originally settled the terms of the trust, if still living and mentally capable, but otherwise might reasonably be unfettered.
- 5.9 A problem with the existing statutory amendment powers proposed in the Bill or using any power contained in a trust deed is that unless the perpetuity period has been very flexibly drafted in the trust deed, trustees will invariably prejudice the interests of one generation of beneficiaries by extending out the Maximum duration.

Trustee duties

- 5.10 Extensive provisions regarding trustees' duties are contained in Part 3 of the Bill. Clause 20 provides that there are two types of duties – mandatory trustee duties, and default trustee duties.
- 5.11 The mandatory trustee duties include:
- a The duty to know the terms of the trust (clause 22);
 - b The duty to act in accordance with the terms of the trust (clause 23);
 - c The duty to act honestly and in good faith (clause 24);

- d The duty to act for the benefit of beneficiaries or to further the permitted purpose of the trust (clause 25); and
 - e The duty to exercise powers for a proper purpose (clause 26).
- 5.12 These mandatory trustee duties cannot be excluded or modified by the terms of the trust.
- 5.13 The default trustee duties include:
 - a The general duty of care (clause 27);
 - b The duty to invest prudently (clause 28);
 - c The duty not to exercise a power for a trustee's own benefit (clause 29);
 - d The duty to actively and regularly consider the trustee's exercise of powers (clause 30);
 - e The duty not to bind or commit trustees to future exercise of discretion (clause 31);
 - f The duty to avoid a conflict of interest (clause 32);
 - g The duty of impartiality (clause 33);
 - h The duty not to profit (clause 34);
 - i The duty of a trustee to act for no reward (clause 35); and
 - j The duty to act unanimously (clause 36).
- 5.14 In theory, default trustee duties can be modified or excluded by the express terms of the trust. However, it could be argued that many of the default duties are merely manifestations of certain mandatory duties. For example, in the ordinary course, it would be in the best interests of the beneficiaries for a trustee to invest prudently. It therefore remains to be seen just how effective such modifications and exclusions might be in practice. It seems likely there will remain some residual risk of liability.
- 5.15 A further qualification is that pursuant to clause 40 of the Bill, the adviser who is paid to:
 - a Advise on the creation of a trust; or
 - b Prepare the terms of a trust; and
 - c Recommends that the settlor should, or causes the settlor to, modify or exclude one or more of the default duties in the terms of the trust,

must, before the creation of the trust, take reasonable steps to ensure that the settlor is aware of the meaning and effect of the modification or exclusion.
- 5.16 Advisers will need to be alert to this new provision when using their standard trust precedents and consider whether further advice needs to be given to discharge their obligations. There are significant practical issues with the requirement to alert settlors to modifications or exclusions of the default duties. For example, the modifications or exclusions could be made in various different ways and in multiple clauses within a trust deed. A better approach than that contained in the Bill may be for the law to replace the proposed obligations with a general duty to take reasonable steps to ensure a settlor understands the meaning and effect of the terms of the trust.

Exemption and indemnity clauses

- 5.17 Pursuant to clause 37 and clause 38 of the Bill, the terms of a trust cannot limit or exclude a trustee's liability, or provide an indemnity against trust property for liability, or for any breach of trust arising from the trustee's own 'dishonesty, wilful misconduct, or gross negligence.' The Bill contains no definition of 'gross negligence' and so guidance from other jurisdictions will, at least initially, need to be sought from the courts when interpreting these provisions.
- 5.18 Furthermore, the provisions also provide that where an advisor:
- a Advises on the creation of the trust; or
 - b Prepares the terms of the trust; and
 - c Recommends that the settlor should, or causes the settlor to, include a liability exclusion or indemnity clause in the terms of the trust,
- the adviser must take reasonable steps to ensure that the settlor is aware of the meaning and effect of the clause (clause 40(2)).
- 5.19 A liability exclusion or indemnity clause has no effect for an adviser who is, or subsequently becomes, a trustee of the trust and has failed to take steps necessary to advise the settlor of the meaning and effect of the clause (clause 40(3)).

Trustees' obligations to keep trust information

- 5.20 Pursuant to clause 41 of the Bill, each trustee must keep a copy of the trust deed and all variations made thereto. Further, each trustee must be satisfied that at least one of the trustees also holds the following documents:
- a Records of the trust property that identify the assets, liabilities, income, and expenses of the trust and that are appropriate to the value and complexity of the trust property.
 - b Records of trustee decisions.
 - c Written contracts entered into by the trustees.
 - d Accounting records and financial statements of the trust.
 - e Documents appointing and removing trustees (including court orders).
 - f Letters or memorandums of wishes from the settlor.
 - g Any other documents necessary for the administration of the trust.
- 5.21 Lawyers may wish to advise trustees of this likely requirement soon so that they have time to locate and arrange for the documents to be properly stored before they are required to by law.
- 5.22 The above documents must be kept by the trustees for the duration of their trusteeship (clause 43). At the time that the trusteeship of a trustee ends, the trustee must give at least one replacement trustee or continuing trustee the documents that the trustee holds at that time (clause 44).

Trustees' obligations to give trust information to beneficiaries

- 5.23 The requirement to disclose trust information to beneficiaries is arguably the most contentious part of the Bill. This is a very important area also, because if beneficiaries are not able to obtain information about a trust and their rights, it is difficult for them to hold a trustee accountable. On the other hand, if a beneficiary is armed with information and documentation then the trust may become more vulnerable to the types of risks described in foregoing paragraphs. As a matter of public policy this should, in the ordinary course, be a good thing but there may be unintended and adverse consequences. There are often very good reasons to withhold financial information from beneficiaries. These may include the need to keep private certain commercially sensitive information about a family business or to save beneficiaries who are spendthrifts or have addiction issues (for example) from themselves.
- 5.24 The Bill creates two presumptions in relation to the provision of trust information to beneficiaries. First, clause 47 creates a presumption that a trustee must make available to every beneficiary or representative of a beneficiary (parent, guardian, attorney or property manager of a child or person not competent to act) the following 'basic trust information':
- a The fact that a person is a beneficiary;
 - b The name and contact details of the trustees;
 - c The occurrence of, and details of, each appointment, removal, and retirement of a trustee as it occurs; and
 - d The right of the beneficiary to request a copy of the 'terms of the trust' or 'trust information'.
- 5.25 A trustee is required to consider this provision at reasonable intervals to determine whether they should be making this information available.
- 5.26 Secondly, clause 48 of the Bill creates a presumption that a trustee must, within a reasonable period of time, give a beneficiary or representative of a beneficiary the *trust information* that person has requested. Trust information means any information regarding the terms of the trust, the administration of the trust, or the trust property and any information that is necessary for the beneficiary to have to enable the trust to be enforced (clause 45). Trust information specifically does not include reasons for trustees' decisions (clause 45).
- 5.27 The trustee must consider the following factors to first determine whether the presumptions contained in clauses 47 and 48 apply:
- a The nature of the interests in the trust held by the beneficiary and the other beneficiaries of the trust, including the degree and extent of the beneficiary's interest in the trust and the likelihood of the beneficiary receiving trust property in the future;
 - b Whether the information is subject to personal or commercial confidentiality;
 - c The expectations and intentions of the settlor at the time of the creation of the trust (if known) as to whether the beneficiaries as a whole and the beneficiary in particular would be given information;
 - d The age and circumstances of the beneficiary;
 - e The age and circumstances of the other beneficiaries of the trust;
 - f The effect on the beneficiary of giving the information;

- g The effect on the trustees, other beneficiaries of the trust, and third parties of giving the information;
 - h In the case of a family trust, the effect of giving the information on:
 - i The relationships within the family; and
 - ii The relationship between the trustees and some or all of the beneficiaries to the detriment of the beneficiaries as a whole;
 - i In a trust that has a large number of beneficiaries or unascertainable beneficiaries, the practicality of giving information to all beneficiaries or all members of a class of beneficiaries;
 - j The practicality of imposing restrictions and other safeguards on the use of the information (for example, by way of an undertaking, or restricting who may inspect the documents);
 - k The practicality of giving some or all of the information to the beneficiary in redacted form;
 - l If a beneficiary has requested information, the nature and context of the request; and
 - m Any other factor that the trustee reasonably considers is relevant to determining whether the presumption applies.
- 5.28 If, following consideration of the above factors, the trustee reasonably considers that the basic trust information should not be made available to every beneficiary (clause 47), or the information should not be given to the person who requested it (clause 48), then such presumption does not apply (clause 49).
- 5.29 Under clause 50, a trustee has a duty to apply to the court for directions where, as a result of one or more of the following circumstances or events, no beneficiary has any trust information:
- a The trustee cannot identify any beneficiary to whom information can be given;
 - b The trustee decides to withhold all of the basic trust information from all beneficiaries; and
 - c The trustee decides to refuse a request for trust information.
- 5.30 A trustee's application to the court for directions will be in relation to:
- a Whether the trustee's determination that there is no beneficiary to whom information can be given, or to withhold information or refuse a request for information, is reasonable in the circumstances; and
 - b The alternative means by which the trustee can be accountable and the trust can be enforced.
- 5.31 However, pursuant to clause 50(3) of the Bill, the trustee is not required to apply to the court for directions if the period during which no beneficiary has any trust information is less than twelve months and at the end of that period the trustee gives to at least one beneficiary the basic trust information and the reasons for not giving it earlier.
- 5.32 The court in giving directions pursuant to clause 50, must take into account the following principles:

- a Trust information may be withheld from all beneficiaries only in exceptional circumstances.
 - b Alternative means of enforcing a trust pending disclosure of information to beneficiaries must be consistent with the objectives of the trust and not adversely affect its administration.
- 5.33 Pursuant to clause 51 of the Bill, a trustee may require a beneficiary to pay the reasonable costs associated with providing trust information under clause 48.
- 5.34 There is a view amongst certain commentators that the Bill needs to be reconsidered and balanced against the practicality of identifying and providing information to beneficiaries. For example, as currently drafted, there is a requirement for trustees to provide basic trust information to 'every beneficiary or representative of a beneficiary' unless the trustee reasonably considers otherwise.
- 5.35 A better approach may be to restrict the requirement of notification to a defined class of 'qualifying beneficiaries'. These might be defined as the 'settlers during their lifetimes and thereafter their children during their lifetimes' or something to that effect. Alternatively, a new sub-clause could be included to provide a definition of 'beneficiary' in this context, with the definition excluding any person where the trustees are satisfied there is no more than a remote possibility of the beneficiary receiving a direct benefit from the trust in the foreseeable future, or wording to a similar effect. This approach might be more sensible as it focuses on the trustees providing information to beneficiaries who have a real interest in receiving the information and on holding the trustees to account.

Trustee powers

- 5.36 Express provisions regarding the powers of trustees are contained in Part 4 of the Bill.
- 5.37 Pursuant to clause 52 of the Bill, trustees have all the powers of an absolute owner in carrying out the trust and in managing trust property. The Bill specifically provides that:
- a The investment powers of a trustee (clause 54 – clause 55) replicate those existing powers contained in the Trustee Act;
 - b A trustee may determine whether a return on an investment is to be treated as income or capital (clause 56);
 - c A trustee has certain powers to apportion receipts and outgoings between income and capital (clause 57); and
 - d A trustee has powers to apply trust property for the beneficiary's welfare (clauses 58 – 62).

Limited delegation

- 5.38 Clause 63(1) of the Bill provides that a trustee may appoint a person to:
- a Exercise or perform, on behalf of the trustee, specified powers or functions in relation to the trust;
 - b Make specified decisions in relation to all or part of the trust property; and
 - c Hold or deal with all or part of the trust property as nominee or custodian.

- 5.39 However, a trustee may not delegate any of the following powers or functions (clause 63(2)):
- a Decisions on distributions, payments from income or capital, or fees where the beneficiary's entitlement is affected, or decisions as to whether payments received or made should be treated as income or capital;
 - b Powers to appoint or remove trustees or beneficiaries;
 - c Powers to appoint trust property or change the date of final distribution or other powers of appointment only exercisable by the trustee personally; and
 - d Trustees' right to apply to the court.
- 5.40 Clause 64 of the Bill provides that any delegation must be kept under review. Any delegate who is appointed is liable to the trustee for any failure to comply with the terms of the appointment or any directions of the trustee. Further, clause 65 of the Bill provides that a trustee is not liable for any claim made by, or on behalf of, a beneficiary for any act or default of a delegate, unless the trustee failed to fulfil its trustee duties and failed to keep the delegate appointment under review.

Total delegation

- 5.41 Despite clauses 63 and 64 (see paragraphs 5.38 to 5.40 above), under clause 66 of the Bill a trustee may, by power of attorney, delegate all or any of the trustee's powers and functions under the trust to any person qualified to be a trustee where the trustee is:
- a Absent from New Zealand;
 - b Temporarily unable to be contacted;
 - c Temporarily physically incapable;
 - d Temporarily lacking the capacity to perform their functions as trustee.
- 5.42 Any person is qualified to be a [delegate?] except the following:
- a A child;
 - b An undischarged bankrupt;
 - c A person who lacks the capacity to perform the functions of a trustee; or
 - d A body corporate that is subject to an insolvency event.
- 5.43 The delegation can continue for 12 months (clause 66(3)) and can be extended only once (clause 66(4)).
- 5.44 A trustee may only delegate its powers to a sole co-trustee where that sole co-trustee is a statutory trustee (clause 66(5)). Further, a delegate may exercise the delegating trustee's power to resign (clause 66(6)).
- 5.45 Pursuant to clause 67(1) of the Bill, within 5 working days after delegation commences (or if delegation does not commence immediately, after the date the power of attorney was signed), notice must be given to any co-trustee(s) and to any person who holds the power to appoint and remove trustees under the trust.
- 5.46 Pursuant to clause 67(3) if the delegating trustee is the sole trustee, it must notify the person who holds the power to appoint and remove trustees under the trust, and if there is no such

person, must notify all competent adult beneficiaries or a reasonable sample of such adult beneficiaries if it is impracticable to notify all. The delegating trustee is not required to notify all competent adult beneficiaries if, after taking into account the factors in clause 49(2) (see paragraph 5.27 above), the delegating trustee determines that such beneficiaries should not be notified.

5.47 Any notice which is given pursuant to clause 67 of the Bill should specify:

- a The date of commencement of the delegation;
- b The duration of the delegation;
- c The name of delegate;
- d The reason for the delegation; and
- e What has been delegated.

5.48 By clause 69 of the Bill, where a trustee is unable to perform any functions as trustee for any of the reasons listed in paragraph 5.41 above, and that trustee has not previously delegated their powers, a co-trustee or a beneficiary of the Trust may apply to Public Trust for consent for them to be made the delegate of the trustee. The Public Trust may charge fees for providing services as a delegate (clause 69(4)).

5.49 The Public Trust can refuse its appointment as delegate for any reason. The Public Trust must refuse its appointment as delegate where it reasonably believes that the circumstances relating to the request of its appointment involve a dispute presenting significant complexity (clause 69(3)).

Appointment and discharge of trustees

5.50 Those persons with power to remove a trustee are detailed in clause 86 of the Bill. That same clause also expressly provides who holds the power to appoint a replacement trustee where:

- a A trustee has retired;
- b A trustee has been removed; or
- c A trustee has died in office.

5.51 Those persons with the power to remove or to appoint trustees may apply to the court for directions on the exercise of power (clause 87). Such persons must act honestly, in good faith and for a proper purpose (clause 88). This is express confirmation that the power of removal of trustees is a fiduciary power. A beneficiary may also seek a review of a person's exercise of power to remove or to appoint trustees.

5.52 Pursuant to clause 93 of the Bill, an appointment of a trustee does not take effect until the appointee accepts the appointment. An appointee who gives no express indication of acceptance or rejection of the appointment and who for 90 days after the appointment is inactive in relation to the trust, is taken to have rejected the appointment.

Retirement of trustees

5.53 Clause 95 of the Bill also makes it simpler for a trustee who wishes to retire. A trustee must, in writing, express a wish to retire and may then be discharged in writing by those persons identified in the clause.

Removal of trustees

- 5.54 Clause 97(1) of the Bill is a compulsory removal provision. It provides that an appointor must exercise the power to remove a trustee if a trustee loses the capacity to perform the functions of a trustee and that trustee's powers have not been delegated.
- 5.55 Clause 97(3) of the Bill is an optional removal provision. It provides that an appointor may exercise the power to remove a trustee if it is desirable for the proper execution of the trust and where the trustee:
- a Has repeatedly refused or failed to act as trustee;
 - b Becomes an undischarged bankrupt;
 - c Is a corporate trustee subject to an insolvency event; or
 - d Is no longer suitable to hold office as trustee because of the trustee's conduct or circumstances.
- 5.56 A trustee is no longer suitable to hold office as trustee because of the trustee's conduct or circumstances where:
- a The trustee is convicted of an offence involving dishonesty;
 - b It is not known where the trustee is and the trustee cannot be contacted;
 - c The trustee is prohibited from being a director or promoter of, or being concerned or taking part in the management of, a company under the Companies Act 1993; or
 - d The trustee is prohibited from being a director or promoter of, or being concerned or taking part in the management of, an incorporated or unincorporated body under the Financial Markets Conduct Act 2013 or the Takeovers Act 1993.
- 5.57 Clause 97 of the Bill does not limit the grounds on which a person, nominated in the terms of the trust as having the power to remove trustees, may exercise that power.
- 5.58 Clause 98 of the Bill provides that notice must be given to the removed trustee unless that trustee cannot be located or contacted. Where a trustee cannot be located or contacted, the appointor of the trust must make a statutory declaration to this effect.
- 5.59 A trustee may apply to the court for an order preventing removal as trustee within 20 working days of receiving notice under clause 98 of the Bill. Clause 102 to clause 104 of the Bill prescribes the procedure in making such an application.

Replacement of trustees

- 5.60 Where the sole trustee of a trust dies or is removed as trustee, the sole trustee must be replaced (clause 105(1)). In such a situation, more than one replacement trustee may be appointed (clause 107). If a trustee dies or is removed as trustee, but the number of trustees meets or exceeds the minimum number specified in the terms of the trustee, a replacement trustee may but need not be appointed (clause 105(2)).
- 5.61 Clause 100 of the Bill provides that the court may make an order appointing a new trustee in situations where it is difficult or impracticable to do so without the assistance of the court.

Vesting of trust property

- 5.62 Pursuant to clause 108 of the Bill, a document which appoints, removes and/or discharges a trustee vests the property of the trust in the new trustees. Similarly, a court order appointing or removing a trustee vests the property of the trust in the new trustees and is, for the purposes of the Land Transfer Act 2017, a vesting order vesting the trust property in the new trustees.
- 5.63 Clause 109 of the Bill provides that where the divesting and vesting of trust property has to be notified, registered or recorded under the requirements of another Act:
- a the requirements of that Act must be complied with; but
 - b the execution of the relevant document vests in the new trustees a right to call for the transfer of the trust property; and
 - c a copy of the documents or document and a statutory declaration by a continuing or a new trustee of the trust that each relevant document was validly executed is sufficient proof of the right to call for the transfer of the trust property.
- 5.64 Clause 110 of the Bill requires former, continuing and incoming trustees to do everything necessary to assist in any transfer and any required notification, registration or recording of the divesting and vesting of trust property. Clause 110(2) provides that the persons who become or are the trustees may complete these formal requirements on behalf of a former trustee who either has lost capacity to perform the functions or who fails or refuses to act. In response to this section, Land Information New Zealand will likely implement a procedure for cases concerning a change in land registration. A procedure similar to transmission by an executor on the death of an owner of land seems sensible.
- 5.65 Clause 111 of the Bill provides that anyone who in good faith notified, registers or records the transfer of property in reliance on the relevant provisions is not liable for any loss or deprivation that may result from that act.
- 5.66 Finally, clause 112 of the Bill requires a continuing or new trustee to give to the retiring or removed trustee a copy of any documents that evidence the divesting of the property. These must be given as soon as the transfers have been completed.

Termination and variation of trusts

- 5.67 Clauses 113 to 114 of the Bill are the statutory equivalent to the common law rule in *Saunders v Vautier*⁴. They provide that a trust can be terminated, varied, or resettled, by the unanimous consent of beneficiaries. Clause 115 deals with a beneficiary's right to require a fixed share of trust property which the beneficiary is absolutely entitled to, to be transferred to that beneficiary.
- 5.68 Clause 116 of the Bill allows the court to approve the termination, variation or resettlement of a trust on behalf of a beneficiary who:
- a Lacks capacity;
 - b May acquire a beneficial interest in future; or
 - c Is a future person who may acquire a beneficial interest (e.g. unborn beneficiaries).

⁴ (1841) 41 ER 482.

- 5.69 When the court receives an application for approval, it must take into account each of the following factors:
- a The nature of any person's interest in the trust property and the effect of the proposed order on that interest;
 - b The benefit or detriment that may result to any person with an interest in the trust property; and
 - c The intention of the settlor.
- 5.70 Furthermore, the court cannot make an order for approval where its effect would be to reduce or remove any vested interest in the trust property.
- 5.71 An application to the court for an order approving the termination, variation or resettlement of a trust may be made by the trustees of the trust (or any one of them) or any beneficiary.
- 5.72 Clause 117 of the Bill also provides that the court may waive the requirement for an adult beneficiary's consent to the termination of a trust (under clause 113) or to the variation or resettlement of a trust (under clause 114). Before waiving such requirement, the court must take into account those factors described in paragraph 5.69 above.

Review of trustee decisions

- 5.73 Clause 118 of the Bill gives beneficiaries of a trust greater opportunity to ask the court to review the decisions and actions of trustees. Pursuant to this clause, on application by a beneficiary of the trust, the court may review the act, omission, or decision of a trustee (including a proposed act, omission or decision), on the grounds that it was or is not reasonably open to the trustee in the circumstances. However, the beneficiary making the application must first satisfy the court that there is a valid reason for bringing the application.
- 5.74 By clause 119 of the Bill, the beneficiary must produce evidence that raises a genuine and substantial dispute as to whether the act, omission, or decision in question was or is reasonably open to the trustee in the circumstances. If the court is satisfied that the applicant has done so then the onus shifts to the trustee to establish that what was done or not done was or is reasonably open to the trustee in the circumstances. If the court decides that the act omission or decision was not or is not reasonably open to the trustee in the circumstances, clause 199(3) provides that the court may:
- a Set aside the act or decision or direct the trustee to act in the case of an omission;
 - b Restrain the trustee from acting or decision in such case and direct the trustee to act in the case of a proposed omission; and
 - c Make any other orders the court considers necessary.
- 5.75 The court must not make an order that affects a valid distribution of the trust property that was made before the trustee had notice of the application or any order that affects any right or title acquired by a person in good faith and for value.

Alternative dispute resolution

- 5.76 Clauses 137 to 142 of the Bill set out an alternative dispute resolution procedure available to trustees. Clause 138 provides that a trustee may, with the agreement of each party to a

matter, refer the matter to an ADR process. The Bill defines 'external' and 'internal' matters and provides that a beneficiary is not a party to an external matter.

- 5.77 Where a trust has unascertained or incapacitated beneficiaries, then, in relation to internal matters:
- a The court must appoint representatives for those beneficiaries; and
 - b Those representatives may agree to an ADR settlement on behalf of the unascertained or incapacitated beneficiaries; and
 - c Any ADR settlement must be approved by the court.
- 5.78 Clause 140 of the Bill also creates a power for the court to order an ADR process for an internal matter.
- 5.79 It is noteworthy that, despite clause 31 (the duty not to bind or commit trustees to a future exercise of discretion), clause 141 provides that a trustee may, for the purposes of an ADR settlement, give binding undertakings in relation to the trustee's future actions as trustee.
- 5.80 Finally, clause 142 of the Bill provides that a trustee's liability in relation to ADR settlement is limited unless the trustee has failed to comply with their mandatory duties (clause 24) or any duty specified in the terms of the trust for the purposes of establishing liability under this provision. A trustee will not be liable by reason only that settlement is not consistent with the terms of the trust.

6 Conclusion

- 6.1 The consequences from the traditional approach to trusts in New Zealand may give rise to issues. Tens of thousands of trusts in New Zealand have been set up by Baby Boomers over the past few decades. Many of these trusts are now pregnant with substantial wealth which the next generation of the family are, or will be, keen to get their hands on. It is possible that well advised children of Baby Boomers will scrutinise the decisions of the trustees and may find defects in governance or administration which could lead to legal challenges and, ultimately, transactions being invalidated and trustees being found personally liable.
- 6.2 Furthermore, families are now more likely to be blended and living across different borders, creating additional complexities. Tax is not likely to be a main driver in the establishment of trusts given the relatively benign fiscal environment in New Zealand (there is currently no inheritance tax, stamp duties or wealth tax, which is unusual for an OECD country). In any event, revenue authorities nowadays typically 'look through' trusts and corporate entities to the beneficial owners.
- 6.3 In many cases, succession planning and asset protection objectives might be better achieved through other legal devices such as wills, testamentary trusts, relationship property agreements, limited liability companies and financial products such as insurance and annuities or fixed interest securities.
- 6.4 Be that as it may, there will always be a need for trusts when asset planning for certain clients. Some New Zealanders are now starting to enjoy the benefits of private wealth which has been aggregated over several generations (something that has not hitherto been common in a relatively young country) and many new migrants are bringing substantial wealth into the economy. There will also always be a need for trusts to protect the vulnerable. Where

a trust is appropriate, good governance and proper administration will be increasingly important.

- 6.5 Advisors should consider the impact of the suggested changes contained in the Bill, especially those concerning the mandatory disclosure of basic trust information to beneficiaries. It may be premature to design new trusts to fit the Bill given further changes to the current wording of the Bill may happen before the new Law is enacted. However, it could be worthwhile to include in the terms of new trusts a wide power of variation which gives express authority to the trustees of a trust (with the consent of the settlor, if appropriate) to amend the trust deed following the enactment of the new Law.

Henry Brandts-Giesen and Sarah Kelly

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