May 2010 TrustLaw

This newsletter is produced by Brookfields' Trusts and Management Services Team to keep you up to date on recent cases and information in the fields of trusts management and asset planning.

Trustee Obligations - The Extent of Trustee Liability

Legal Owners

At law, a trust is not a separate legal entity. That is why the ownership of trust assets is not recorded in the name of the trust but in the individual names of the trustees. The trustees are the legal owners of the assets. If there is more than one trustee, the trustees own the property jointly. On the death of a trustee the surviving trustees take ownership of the property by survivorship. However, although the trust assets are legally owned by the trustees, such assets do not form part of their personal assets. The trust assets are owned by the trustees for the benefit of the beneficiaries. The trustees in making decisions about the trust assets must consider the needs and requirements of the beneficiaries.

Signing Contracts

In as much as the assets cannot be held in the trust's name, equally any liabilities cannot be entered into under the name of the trust. It is the trustees who sign any contracts, loan agreements, mortgages, guarantees and any other documents for the trust. When entering into any liabilities, the trustees must be doing so for the benefit of the beneficiaries and cognisance must be taken of the asset value of the trust and the ability of the trustees to service and repay the debts.

Personal Liability

The trustees are personally liable for all obligations they enter into as a trustee. Sometimes the documents may include a limitation of liability clause, typically for the independent/professional trustee. These clauses limit the liability of the trustee to the assets of the trust.

Joint and Several Liability

Trustees are severally and jointly liable for any trust debts. A creditor can initiate proceedings against any one of the trustees. If the creditor is successful against a trustee, that trustee may seek contribution from the co-trustees but this may require legal proceedings to be issued against them. This action may have to be funded personally by the "out of pocket" trustee.

Exoneration Clauses

Most trust deeds contain exoneration clauses. These clauses limit the liability of trustees to the assets of the trust except where loss has occurred as a result of trustees' dishonesty or breach of trust. These exoneration clauses do not limit liability to a third party, as any limitation of liability must be agreed to by the third party. The exoneration clause does however limit a trustee's liability to a beneficiary of the trust who makes a claim, for example, because of a loss to the trust fund through a poor investment.

Limiting Liability

The limitation of liability for the non-beneficiary trustee becomes very relevant when the value of the trust assets decline for any reason. For example, if the trustees have borrowings of $650,000 but the total trust assets are now only worth $400,000 the liability of the independent/professional trustee in most circumstances will be limited to the value of the trust assets ($400,000) if there was a limitation of liability clause in the loan agreements. The beneficiary trustees will be liable for the full $650,000. That is, the lender may seek payment from the personal assets of the beneficiary trustees to repay the outstanding portion of the debt.

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What Liabilities can't be Limited?

There are some liabilities where there is no differentiation between a trustee who can benefit from a trust and an independent/professional trustee who cannot benefit. For example, all trustees are liable for income tax, GST and property rates. The trustees, as the legal owners of the trust property, are also liable for any legal action that results from, for example, illegal buildings or an inadequately fenced swimming pool where someone drowns.

The IRD can demand payment of tax liabilities from any one or more of the trustees. A trustee's liability for the tax continues until the IRD is advised that the trustee has retired.

The individual trustee liability was starkly highlighted in the **Chester** case where a professional trustee company was held liable for a GST debt incurred by one of the trusts of which it was a co-trustee. The IRD successfully applied to the Court to have the company placed into receivership as a result of the debt despite the adverse consequences for the other trusts involved.

In the light of the possible liability consequences how do you, as a trustee, view your position as a trustee? You may wish to ask yourself the following questions:

1. **Do you know the exact nature of all the assets owned by the trust?**
   Trustees are the legal owners of trust assets and as such incur liability for any legal proceedings/debts that arise from such property ownership. One of the key duties of a trustee is to know precisely the nature and circumstances of the trust assets. Trustees cannot rely on the actions of their co-trustees to perform their duties. The law does not recognise the difference between an active and passive trustee. So be aware of what is happening with trust assets, whether there have been any improvements to the property and whether the property is being adequately maintained.

2. **What is the current value of the trust assets? Could all the trust liabilities, including obligations under guarantees, be met from the trust assets?**
   Unless you are a non-beneficiary independent/professional trustee and your liability is contractually limited under any contractual arrangements your liability will be personal. You will need to use your own assets to pay any debts that cannot be met from the trust fund. If you are a non-beneficiary trustee your liability is only limited if agreed to by the other party and a specific clause is contained in the contract. Check the terms of this clause - your liability will not be limited if there has been a breach of trust so if the trustees have done something contrary to the terms of the trust deed you will be personally liable. Your liability is not limited by you signing "as trustee".

3. **Is the trust meeting all its tax liabilities?**
   The IRD does not differentiate between the active trustee and the passive trustee, so be involved to ensure all tax payments are being made. If the trust is registered for GST ask for copies of the returns and confirmation of payment. A trustee's personal liability for tax extends to all the trusts tax liabilities including trading activities such as PAYE.

   If the trust is not meeting all of its tax obligations you may wish to resign as a trustee but your obligations remain until the IRD is notified of your resignation and has received a copy of the documentation recording your resignation from the trust.

A trusteeship is a personal obligation. Trustees have this personal obligation in relation to the trust fund, the assets held by the trust and to the beneficiaries of the trust. Be aware of these duties and most importantly be actively involved in the administration and management of the trust. Constant vigilance is your best protection and ultimately the beneficiaries of the trust are likely to be thankful for that vigilance.

Talk to us for advice on any of these matters.

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