Meltzer Mason Heath

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UPDATE + NEWS + REVIEW

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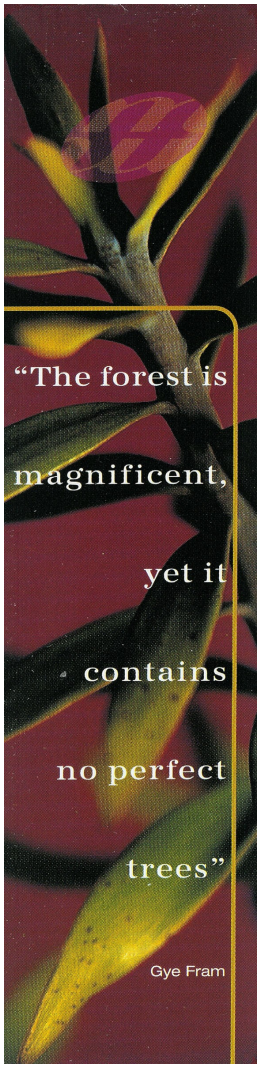

"I think that there is nothing, not even crime, more opposed to poetry, to philosophy, ay, to life itself than this incessant business." ***Henry David Thoreau***

Winding up a trading trust

Rachel Mason and Arron Heath

When determining whether to wind up a Trust, the first step is to consider whether it has any assets remaining. Generally this is readily apparent (we hope!), and may be the impetus for considering winding up in the first place. If the Trust has no assets, then it simply ceases to exist (although there may be practical issues to consider before final termination is achieved). If the Trust continues to hold assets, then a winding up process needs to be worked through, to ensure the proper steps are taken, in order to minimise any potential risk for the Trustee.

Trust with no assets remaining

Once a Trust's property has been realised, from a legal standpoint the Trust ceases to exist. This is because a Trust is not an entity, like a company, rather it is a set of obligations of the Trustees to the beneficiaries (eg, to hold assets on Trust for the benefit of the beneficiaries). Once those obligations cease to exist, so does the Trust. In the Trading Trust situation, debtors and creditors contract with the Trustee, which is usually a limited liability company known as the Corporate Trustee. The Corporate Trustee usually has no assets other than an indemnity against the assets of the Trust.

Where a Corporate Trustee company is in liquidation and is insolvent, in most cases there are no assets remaining in the Trust, and the Corporate Trustee's indemnity is worthless. Trust assets will have been realised and distributed to Trust creditors, and where there is a shortfall to creditors the Corporate Trustee is liable (unless the creditor has agreed to limit liability). This situation has implications for the Corporate Trustee's directors.

A common example is where a Corporate Trustee holds land on trust for the benefit of a the Trust's beneficiaries:

> *City Road Property Limited is the Corporate Trustee of the City Road Property Trust. Its sole asset is a building on City Road, Auckland. There is a rather large mortgage to the JKA Bank. During the recent global financial crisis, it was discovered that the building was overvalued, and the bank became jittery. They had become concerned at the ability of the company to repay the mortgage, and that the market value of the building was well below the balance of the mortgage. The bank "gently persuaded" the directors of City Road Property Limited to sell the building. They luckily found a buyer, however the fears of the bank were realised: a shortfall of $500,000.*
>
> *As all prudent and reasonable directors should, the directors of City Road Property Limited recommended to their shareholder that the company be liquidated, as it could no longer satisfy its debts.*
>
> *The company was duly liquidated and as the sole asset of the Trust, the property, was no longer owned, the Trust simply ceased to exist. The obligation has gone (the holding of the property for the benefit of the beneficiaries), and so the Trust has terminated, and the liability for the shortfall will rest with the Corporate Trustee.*

Continued....

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Winding up a trading trust ... Continued

Some administrative matters may remain, such as deregistering the Trust for GST purposes; however, no formal resolution or winding up process needs to be undertaken where a Trust's assets have been fully realised. Of course, the position is different for the Corporate Trustee.

Trust with assets remaining

Where the Trust is solvent, the Trustees can resolve to wind up the Trust. Once all Trust property has been distributed, the Trust ceases to exist. Two of the methods by which a Trust can be wound up are by consent of all beneficiaries, or by a power under the Trust Deed to distribute and wind up. The ability to wind up may also be provided by settlor's wishes or memorandum of guidance, but these are not binding.

A Trust Deed may provide for the Trust to be wound up. These types of clauses are varied, and range from requiring a 75% majority of Trustees to agree, to requiring the proceeds of Trust property to be distributed in accordance with specific purposes. Most Trust Deeds however, are unlikely to contain such specificity. In those cases, winding up by agreement of the beneficiaries is the best approach.

When we say that all beneficiaries must consent to the winding up, we mean all beneficiaries, even those who are not known to the Trustees. To get round this, and to ensure that all possible beneficiaries are sought, a public advertisement is placed, which provides for a period of not less than one month for any potential beneficiaries to make themselves known, or else miss out on any distribution (if any) . This is the same principle as applies in a liquidation.

Once attempts have been made to obtain the agreement of the beneficiaries, then the Trust's assets (if any) can be realised and distributed to the beneficiaries. Depending on the wording of the Trust Deed there may be no requirement for the beneficiaries to be treated equally, as is the case in a liquidation. The Trustees can distribute the proceeds as they see fit, and previous distributions can be considered in determining the distribution split.

When we act as liquidators of a Corporate Trustee, we can also wind up the Trust in place of the directors of the Trustee. This allows for a more streamlined process, and a more cost effective outcome.

But what if we want to keep the Trust?

If a Corporate Trustee is in liquidation, the Trust does not automatically come to an end (if assets remain). Where there are reasons for the Trust to remain extant, the Corporate Trustee in liquidation should be removed as Trustee and replaced with an appropriate party, in accordance with the Trust Deed's Power of Appointment provisions. Note however that indemnities are enduring: merely changing the Trustee does not protect assets from creditors of the Corporate Trustee in liquidation.

Directors of a Corporate Trustee in liquidation

Directors in this situation are subject to the liquidation provisions of the Companies Act 1993. Although most Trust Deeds contain exoneration clauses limiting the liability of the Corporate Trustee to the assets of the Trust, these clauses do not limit liability to a third party, unless that limitation has been agreed to by the third party. There are some circumstances where limitation of liability is not possible, eg: income tax, GST, and property rates, and statutory demands can be issued against the Corporate Trustee in respect of these liabilities.

Between the professional staff at Meltzer Mason Heath there is over 100 years insolvency experience. This means that any problems or uncertainties facing your clients are likely to have been seen by us before. Please call us, and as always we will offer you and/or your clients a free one hour consultation.

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Specialist legal and/or professional advice should always be sought in relation to any particular circumstances.