

4. FACT SHEET ON TRUSTS AND CHARITABLE TRUST BOARDS



This fact sheet explains the structure and operation of:

- charitable trusts
- charitable trusts and societies that are incorporated under the Charitable Trusts Act 1957 as charitable trust boards.

INTRODUCTION

Two organisational forms, which a charitable organisation can take, are a trust and a charitable trust board.

- A **trust** is a legally recognised arrangement where property is legally owned by certain people (the trustees), but the trustees are legally required to manage the property for the purposes or beneficiaries of the trust. A trust does not have a separate legal identity.
- A **charitable trust board** is a group of people that agrees to hold money or assets and carry out activities for charitable purposes, and that, as a body, is incorporated and registered under the Charitable Trusts Act 1957. It may be either the trustees of a charitable trust or the members of a society. By becoming a charitable trust board, the organisation acquires a legal identity that is independent of the trustees or members.

This fact sheet explains the laws that apply to all trusts and also the laws that apply to charitable trusts and societies that are charitable trust boards. If a charitable trust board is based on a trust, rather than on a membership-based society, the trustees will be subject to both the usual laws that apply to trusts and trustees and also the laws in the Charitable Trusts Act that apply to charitable trust boards.

TRUSTS GENERALLY

Requirements for a valid trust

The common law sets out the following requirements for a valid trust:

- The person creating the trust (the “settlor”) must demonstrate a clear intention to create the trust. This is called “certainty of intention”.
- The settlor can create the trust either by transferring the trust property to another person on trust, or declaring that the settlor holds the property on trust. The trust must clearly identify the property that is to be held in trust – this is called “certainty of subject matter” (or sometimes called “certainty of purpose”). Trusts also require

identified people or classes of people as beneficiaries – this is called “certainty of object”. Charitable trusts are an exception to this requirement, in that they can identify a charitable purpose instead.

- The trust deed must be signed or sealed by the settlor and is usually signed by every trustee appointed under the deed. The trust deed must be executed in “proper form”, which means it must be in writing and witnessed by someone who records his or her address and occupation on the deed.
- Trusts can also be set up under a valid will.
- Charitable trusts may exist in perpetuity – that is, they do not require an end date, unlike other trusts.

Duties of trustees

Whether or not they are also subject to the Charitable Trusts Act as a charitable trust board, it’s vital that the trustees of a trust are well informed about the duties imposed on them by the common law and the Trustee Act. These duties require trustees to:

- keep accurate accounts of trust property
- invest money held on trust
- be impartial towards beneficiaries in the case of person trusts (unless the trust deed provides otherwise). For charitable trusts, although trustees must act impartially, they can legally favour one charitable purpose over another
- act only for the benefit of the trust, consistently with the trust rules and powers
- act unanimously in making decisions about trust property, unless the trust deed allows majority decisions (however, in trusts of a public or charitable nature, the majority of trustees may, as a rule, bind the minority)
- act personally and not delegate responsibilities, unless the trust deed explicitly allows this (recognising that trustees may need expert advice)
- exercise due diligence (reasonable care) and prudence in managing the trust
- be familiar with the terms of the trust deed, with

the trust property and with the actions of previous trustees

- adhere strictly to the current trust deed, unless the trust deed itself permits the trustees to vary it, the Court varies it, or the beneficiaries agree to a variation
- not be in a position of conflict of interest.

Powers of trustees

Under the Trustee Act, and under the powers granted in many trust deeds, trustees will generally be authorised to do such things as:

- buy, lease, hire or otherwise acquire any real or personal property
- sell, lease, mortgage, hire out or otherwise dispose of or deal with any of the trust's property
- construct, maintain or alter any buildings or property
- borrow, raise or invest money on such terms as the trustees think fit
- insure any trust assets, for amounts and on conditions decided on by the trustees
- enter into any contract or arrangement with any individual, government agency or corporate body
- pay expenses (to themselves or others) incurred in establishing and running the trust
- employ or engage staff, advisers or other people, whether or not they are trustees, and pay their wages, salaries or expenses on terms suitable to the board
- alter the powers and rules of the trust, provided no alteration or addition detracts from the trust's charitable purposes (where applicable).

The Trustee Act will override provisions in the relevant trust deed if there is a conflict between them.

Personal liability of trustees

A trust that is not incorporated under the Charitable Trusts Act 1957 does not have a separate legal identity – this means that the trustees are personally liable for the trust's debts and any penalties awarded against it. Usually the trust deed will grant the trustees a right to be indemnified out of the trust property for those expenses.

Because being a trustee involves significant responsibilities, it's critical that trustees minimise their potential personal liability by clearly understanding:

- the charitable objects of the trust (if applicable)
- their powers as trustees
- the trustees' investment powers and duties,

including the need to be prudent and diligent in carrying out their duties

- the operational procedures of the trust
- the provisions for appointing trustees and retirement
- the conditions for having a charitable tax exemption.

Trustees generally will not be held personally responsible for inadequately managing the trust, provided they act honestly and do not breach the trust's objects, powers and rules. However, trustees will be held personally and strictly liable to make good to the trust any losses arising from:

- using trust money for their own purposes
- the destruction of any trust property
- selling trust property without authority
- negligently allowing others to misappropriate trust property.

Trustees can insure themselves against their potential liability as trustees. This may depend on the nature of the trust and the extent of its assets. The power to insure should be included in the trust deed if the trustee is to pass on the costs of insurance.

What happens to trustees who breach the trust deed?

Trustees generally are liable (jointly and severally) for the trust property and the assets of the trust. The beneficiaries can sue any trustee(s) for any loss incurred by improper or negligent acts of the trustee(s).

In the case of charitable trusts where beneficiaries may not be readily identifiable, an action can be taken by the Attorney-General following a complaint from the public that trustees have breached the trust deed. The matter is heard in the High Court, which has jurisdiction over charities. An individual can begin Court proceedings but is likely to be joined by the Attorney-General in the proceedings.

The Court will be severe with trustees who wilfully, corruptly or negligently misapply trust funds or fail to exercise proper diligence in their duties. The Court may also find against trustees when they have acted honestly and reasonably but the Court considers they should have sought directions from the Court.

As well as ordering a trustee to make good any losses suffered by the trust, the Court has the power to remove a trustee if clear misconduct is proved (see section 51 of the Trustee Act). However, the Courts are reluctant to exercise any ongoing supervisory role over a trust.

Payment for services

Under the Trustee Act, a trustee is entitled to be reimbursed for actual and reasonable out-of-pocket expenses and given honoraria, but is generally not entitled to any salary, remuneration or compensation for their time in administering the trust. The power to charge may be expressly authorised by the trust deed, but is usually for professional trustees such as lawyers and accountants.

If the trust deed does entitle trustees to be paid for their services, they can be paid only what is reasonable and no more than would be paid for the services if the body was dealing with a third party at arm's length.

If a trustee becomes a paid employee of the trust, it is good practice for them to resign as trustee to avoid a conflict of interest. Alternatively, they must not vote or participate in discussions on any matter concerning their salary, terms of employment, or any contract in which they may be interested.

CHARITABLE TRUST BOARDS

What is a charitable trust board?

A charitable trust board can be either:

- the trustees of a charitable trust who have incorporated as a charitable trust board under the Charitable Trusts Act 1957, or
- a charitable society that has incorporated as a board under that Act with the authority of the society's members.

As a charitable trust board, these people agree to hold money or assets and carry out activities for objects recognised by the law as charitable, or for the benefit of recognised charitable purposes (education, religion, relief of poverty, or other charitable classes).

The main statute governing charitable trust boards is the Charitable Trusts Act 1957, which is administered by the Registrar of Incorporated Societies at the Ministry of Economic Development. The Act provides for trusts with trustees and societies with members to register as charitable trust boards, provided their purpose is charitable and they are not registered under another Act. Trusts, but not societies, are also governed by the laws relating to the administration of trusts under both the common law and the Trustee Act 1956.

In the case of a charitable trust, the members of the board are the trustees. In the case of a society, the members of the board are the members of the society. Sometimes a society will establish a trust and appoint trustees to be incorporated as a charitable trust board under the Charitable Trusts Act, in which case the board members are the trustees.

Registering a trust or society as a charitable trust board under the Charitable Trusts Act is achieved by applying to the Registrar.

What are “charitable purposes”?

Trusts or societies registered as charitable trust boards must act exclusively or principally for charitable purposes. Under the current law, charitable purposes are:

- a) the advancement of education
- b) the advancement of religion
- c) the relief of poverty, sickness or disability
- d) any other purpose that benefits the community.

A charitable organisation with a purpose falling under (d) must also be able to demonstrate “public benefit”. This means the organisation must show that its purposes can produce a benefit that is recognised by law as beneficial, and that this benefit is available to the public or a sufficient section of the public. The Registrar may register the trust or society even if it has ancillary purposes that are not charitable.

Registration as a board under the Charitable Trusts Act is not compulsory for income tax purposes. Registration with the Charities Commission is required for an organisation to obtain tax-exempt status with the Inland Revenue, but the final decision on tax exemption will still be made by Inland Revenue.

See Fact sheet 7: Charities Commission and Fact sheet 8: Taxation.

Registering the trust deed or constitution

A charitable trust board must lodge a copy of its trust deed (if it's a trust) or constitution or rules (if it's a society) with the Registrar of Incorporated Societies when the board applies to be registered. The copy must be certified by one of the applicants as a correct copy.

The application for incorporation requires a board to have a name and a registered address. A board's name does not have to include the words “trust board”, “trust”, “board”, “society” or “incorporated”. It must not be identical or misleadingly similar to the

name of any other corporate body.

The Charitable Trust Act has minimal requirements for rules for a board to follow, but the Registrar will require the board's rules to contain similar restrictions to those required of incorporated societies under the Incorporated Societies Act 1908.

See Fact sheet 3: Incorporated societies.

As well as the requirements for trust deeds that apply under the common law, trusts incorporated under the Charitable Trusts Act must also have:

- a date on which the trust is established – that is, the date on which the trust deed is signed
- the names of the trustees
- provision in the trust deed for appointing new trustees and advisory trustees (if any)
- the requirement that every appointment, resignation or removal of a trustee be formally documented by deed.

It is highly desirable that the powers of trustees are included in the trust deed.

The effect of registering as a charitable trust board

Once registered and incorporated, the trustees or members become a body corporate under the name of the board. This means that the charitable trust board takes on a separate legal identity distinct from its members or trustees. The board also enjoys a perpetual succession independent of changes to its membership (until it is wound up) and a common seal (official stamp).

When a board is registered, all property held by the trustees or members is vested in the board for the same purposes as when it was held by the trustees or members. The liability of the board is limited to the assets of the trust or society. The board is liable for any transactions that are entered into in the board's name and that the board is authorised to enter into by the trust deed or constitution.

Although a charitable trust board takes on a separate legal identity when it incorporates as a board, the trustees continue to be bound by the general duties of trustees under the common law and the Trustee Act (see p1).

Seeking charitable status for tax-exempt purposes

Although charitable trust boards are registered and incorporated under the Charitable Trusts Act 1957,

they must still have the approval of the Inland Revenue for tax-exempt status. Eligibility is based on the board:

- being exclusively charitable
- giving no benefit or pecuniary gain to individual settlors, trustees, donors or board members
- being unable to alter the exclusively charitable nature of the trust deed or society constitution
- limiting its objects to applying within New Zealand
- being required to distribute surplus assets for approved charitable purposes if wound up (liquidated) voluntarily or by the High Court.

Charitable trusts must be registered with the Charities Commission to obtain or, from 1 July 2008, retain charitable status, but the final decision on tax exemption is made by Inland Revenue.

See Fact sheet 7: Charities Commission and Fact sheet 8: Taxation.

Management of charitable trust boards

Management of society-based charitable trust boards

If a society incorporates as a board under the Charitable Trusts Act, best practice suggests that a committee of a few of the members should be responsible for managing the board. In effect, this should be no different from the way in which the society managed itself before incorporation or if it had been registered under the Incorporated Societies Act 1908.

See Fact sheet 3: Incorporated societies.

Management of trust-based charitable trust boards

A board consisting of the trustees may not need to have a committee, because all the trustees will be entitled or required to participate in the decision-making of the board.

Rules in the trust deed or constitution

The trust deed or constitution should include rules about the following topics so that the board operates smoothly.

The number of trustees or members

For a trust, there is no minimum number of trustees under the Trustee Act, but under the Charitable Trusts Act a minimum of two trustees is required. The trust deed should specify the number of trustees required for the trust, it may be more than two. The trust deed may recommend the qualifications of trustees - for example, by residency, occupation, skill-set or

representation of community interests.

For a society, there must be at least five members.

Age and contractual capacity of trustees

All trustees should be aged 18 or older and should have full legal capacity to enter into contracts.

The election of office holders

Office holders include the chairperson (or “convenor”), secretary and treasurer.

It may be unnecessary for a trust-based charitable trust board to have a committee if all the trustees are entitled or required under the trust deed to participate in the decision-making of the board. A society-based charitable trust board may elect a committee in accordance with its rules.

Responsibility will need to be taken for the charitable trust board’s official stamp (the common seal), keeping minutes of all meetings, managing correspondence, and meeting any requirements of the Companies Office, Inland Revenue, the Charities Commission or funders.

Board meetings

The board should meet at least twice a year. One of these meetings is usually an annual general meeting to consider the annual report and accounts, to appoint new trustees and an accountant or auditor, and to discuss any other general business. Board meetings need not be open to the public. However, a board can make meetings public if it sees this as a good way of making its work known or accountable to the community.

Decision-making, quorum numbers and notice of board meetings

These should be set out in the rules.

Board’s finances

The trust deed or rules should cover requirements relating to finances – including cheque-signing, keeping proper accounts, preparing annual accounts of all income and expenditure, and auditing. The Charitable Trusts Act does not impose any requirements in this area, but many funding bodies ask for accounts to be audited. The Attorney-General can investigate the operation of any charitable trust board, and a trust must comply with Inland Revenue requirements for GST and PAYE.

If proper accounting records haven’t been kept, officers may be personally liable if the board is liquidated.

Reporting requirements

There is no requirement for trusts and societies registered under the Charitable Trusts Act 1957 to file any form of annual financial statement with the Registrar.

Trusts and societies registered with the Charities Commission have to file an “Annual Return”.

See *Fact sheet 7: Charities Commission*.

There may also be reporting requirements for non-profit entities as a result of the review of the Financial Reporting Act 1993. However, if new laws are passed as a result of this review, they are not expected to come into affect until 2010.

Powers of a charitable trust board

The powers of a society established as a charitable trust board, which are found in the society's constitution, are likely to be the same as those for an incorporated society.

See *Fact sheet 3: Incorporated societies*.

The powers of a charitable trust established as a charitable trust board, which are found in the trust deed, give the trustees authority to carry out the aims, and can be very wide or quite narrow depending on what suits the group. If a power is not in the trust deed, the trust cannot act on it, even though it may be desirable for the trust to do so. For example, if a trust wants the trustees to have the power to borrow money, this must be included in the trust deed. See p2 for information on what happens to trustees who breach the charitable trust deed.

Duties and liabilities of trustees and officers of charitable trust boards

The Charitable Trusts Act does not impose any general duties on the trustees or officers of a board. The trustees or officers are in a similar position to company directors and owe duties to the board in the same way as directors owe duties to the company. These duties are to:

- act in good faith and according to the rules of the board
- exercise their powers for a proper purpose and with reasonable care
- not cause, allow or agree to the board's affairs being carried out in a way that creates a substantial risk of loss to the board's creditors
- not agree to the board incurring an obligation unless there are reasonable grounds for believing

- the board will be able to perform it when required
- not make any unauthorised personal pecuniary gain from their position as officer of the board or make any unauthorised use of confidential information.

Limitations on charitable trust boards

A board must act in accordance with its rules, as follows:

- If the board breaches its rules, its controlling members, officers or trustees may be personally liable to reimburse the trust for any loss the trust suffers.
- A member of the board may be able to get an injunction to stop the board doing something that would breach the board's rules, or obtain damages against the board or its officers for past unauthorised actions.
- An unauthorised transaction entered into by the board may be invalid and not enforceable by or against the board. If the transaction is not enforceable against the board, the officers who caused the transaction to be entered into may themselves be liable to perform the board's obligations. An aggrieved party may apply to the High Court to put the board into liquidation.

Despite its rules, a board may use all or part of its property for any public purpose with the consent of the High Court. But a board may not sell or exchange any part of its property that is subject to a trust unless:

- the trust allows the board to sell or exchange the property, or
- the High Court consents to the sale or exchange, if it is essential to the trust that the particular property be used for the trust's purpose.

Payment for services

The trust deed or constitution should specify whether trustees or members can be paid for their services. If trustees or members of a charitable trust board are paid for their services, they can be paid only if what is reasonable and no more than would be paid if the body was dealing with a third party at arm's length. In the case of a trust, the Trustee Act 1956 also applies (see p3).

Where officers of a charitable society or trustees of a trust become paid employees of the society or trust, it is good practice for them to resign from their

position as officer or trustee to avoid a conflict of interest. Alternatively, they must not vote or participate in discussions on any matter concerning their salary, terms of employment, or any contract in which they may be interested.

Indemnifying trustees or officers of charitable trust boards

The trust deed or constitution of a charitable trust board may indemnify its trustees or officers for the liabilities they incur while serving the board. If the board does this, it should clearly identify the limits of the indemnity and make sure the board can adequately cover itself through insurance.

See Fact sheet 17: Insurance as a risk management tool.

Trustees have an inherent right to an indemnity from the trust assets under the general law and section 38 of the Trustee Act.

Liquidation

Voluntary liquidation

If the trustees or members of a charitable trust board wish to wind up the board, they can pass a resolution at a general meeting. This must then be confirmed at a second general meeting held specifically to consider the winding-up.

This second meeting must be held no earlier 28 days after the resolution was passed, but before 42 days after the resolution.

Compulsory liquidation by the High Court

The High Court may put a charitable trust board into liquidation if it thinks it would be "just and equitable" to do so – for example, if the board can't pay its debts.

An application to have a board put into liquidation may be made by the board itself or a board member, the Attorney-General, a creditor of the board, the Registrar of Incorporated Societies, or any other person whom the Court permits to apply.

The Companies Act 1993 (Parts 16 and 17) applies to a liquidation of the board as if the board were a company. The board's debts must be paid from its funds or assets. If there is any surplus, this must be distributed to another charitable organisation in New Zealand. A charitable trust board may want to specify in its trust deed or constitution that any surplus assets

should go to a charity with similar aims to its own.

Liabilities of trustees or officers of charitable trust boards on liquidation

Under the Companies Act, an officer of a charitable trust board may be personally liable if:

- he or she has misapplied money or property of the board
- he or she has been guilty of negligence, default, or breach of duty or trust in relation to the board, or
- proper accounting records for the board haven't been kept.

Changes to the board's name, rules and registered office

If the charitable trust board wants to change its name, it must pass a resolution at a meeting of the board and then apply to the Registrar of Incorporated Societies to change its name. If the Registrar approves the change, he or she will enter the new name in the register.

The board must notify the Registrar of the change of a board's address within a month of the change.

Any alteration of trusts or rules of a society must be permitted by the trust deed or constitution. A copy of the altered provisions must be lodged with the Registrar within a month of it being adopted; the copy must be certified by a trustee or a member of the society's committee or governing body.

Although there are no particular requirements under the Charitable Trusts Act for registering documents filed under the Act, in practice the Registrar expects boards to follow the requirements set down under the Incorporated Societies Act 1908.

See *Fact sheet 3: Incorporated societies*.

Each officer of a board will be liable for a fine for every day that the board does not comply with the requirements in the Charitable Trusts Act for the board to notify the Registrar of changes to its trust deed or constitution.

RESOURCES

Fact sheets

Fact sheet 3: Incorporated societies

Fact sheet 7: Charities Commission

Fact sheet 8: Taxation

Fact sheet 17: Insurance as a risk management tool

Websites

www.charities.govt.nz

The Charities Commission is responsible for registering charities. This website provides more detailed fact sheets on the registration process.

www.community.net.nz

The "How-to Guides" section has a community development resource kit covering all aspects of establishing and running an organisation.

www.creativenz.govt.nz

Creative New Zealand has information on effective governance.

www.dia.govt.nz

The Department of Internal Affairs has information about administering lottery grants and community grants schemes.

www.ird.govt.nz

Inland Revenue's website has information on not-for-profit groups. Download a copy of the brochure *Smart business – An introductory guide for businesses and non-profit organisations* (IR320).

www.lawaccess.lsa.govt.nz

This website offers a catalogue of law-related information resources, with over 140 New Zealand organisations listing their resources on the site.

www.lsa.govt.nz

The Legal Services Agency has information on community law centres throughout New Zealand.

www.societies.govt.nz

Societies and Trusts Online provides an information library with forms and fact sheets. It enables incorporated societies to maintain organisational details and provides access to a register of incorporated societies and charitable trusts.

www.tpk.govt.nz

Te Puni Kōkiri's website has information on effective governance.

Publications

Von Dadelszen, M – *Law of Societies in New Zealand* (2000, Wellington, Butterworths)

Von Dadelszen, M – *Members' Meetings in New Zealand*, 2nd ed (2004, Wellington, LexisNexis)

