



Précis Paper

Trust Structures and Asset Protection

Introduction

In this edition of BenchTV, Chris McCaffery, Consultant, and Peter Kramer, Senior Associate, engage in an illuminating discussion of trust structures and asset protection, with a special focus on discretionary trusts.

Key areas of presenters' discussion

1. Discretionary trusts
2. The *Richstar* decision
3. Family law and discretionary trusts: *Kennon v Spry*
4. How trust assets can be deemed to be part of a notional estate
5. Fraud on the power
6. Lost trust deeds
7. Foreshadowed changes in legislation concerning trusts

Discretionary trusts

The discussion begins with attention to family discretionary trusts (**family trusts**). Family trusts are commonly used to hold assets and distribute benefits among families: the trustee of a family trust typically holds the trust assets for a broad

class of beneficiaries, and thus it is difficult to establish an interest of a beneficiary in the trust assets. Strictly speaking, the beneficiaries only have a right to the due administration of the trust. For this reason, family trusts are considered safe vehicles to house family assets and are fairly difficult to attack. There have been cases challenging this perception and perhaps that the clearest threat to discretionary trusts arises out of the Richstar decision.

In the Matter of Richstar Enterprises Pty Ltd (ACN 099 071 968) v Carey (No 6) [2006] FCA 814

The presenters discuss the Richstar decision, explaining that it showed there was a mechanism by which aggrieved persons could attack the assets in a trust. That mechanism is s1323 *Corporations Act 2001* (Cth). The case established the principle that where a trust is clearly under the control of an individual (called the 'relevant person' under s1323) then that trust may be considered the relevant person's alter ego. It was on that basis that Justice French made an order appointing a receiver to the trust assets. The Richstar decision has not been followed since being handed down in 2006. The question is posed: how significant is the decision to the safety of trust assets in a discretionary trust? A principle arising from the decision is that if you 'wear too many hats' in a trust context (i.e. occupy too many control positions and also benefit from the trust), you may be exposing your trust assets. Limitations on actions under s1323 are explained. It is noted that a matter of significance relevant to mounting an action under s1323 is that there have to be conditions precedent that ASIC has commenced investigations or prosecution against the relevant person. The other limitation is that it an action under the section may only be instigated by ASIC or an aggrieved person.

Family law and discretionary trusts: *Kennon v Spry; Spry v Kennon* [2008] HCA 56

There have been decisions of the Family Court where the Court has made orders in favour of parties to the marriage with respect to assets in a family trust. The case of *Kennon v Spry* is discussed. In this case, Mr Spry established a family trust, then married and had four children. Mr Spry was the trustee of the family trust, and his wife and children were beneficiaries. Mr Spry then removed himself a beneficiary,

and subsequently removed his wife as a beneficiary. As his marriage was disintegrating, Mr Spry transferred all assets from the trusts into four trusts for his children. In the family law proceedings, Mrs Spry sought orders in relation to the trust assets, and the Court by majority found that property in the trust was property of parties to the marriage for the purposes of s79 *Family Law Act 1975* (Cth). The Court based its decision on two factors: 1. Mr Spry had legal title to the assets because he was the trustee of the trust, and 2. Mrs Spry had a right to be considered as a beneficiary.

How trust assets can be deemed to be part of a notional estate

The concept of notional estate is the major area under which family trusts may be open to attack. Two prominent cases on the concept of notional estate are *Hitchcock v Pratt*, and *Wardy v Salier*. The case of *Hitchcock v Pratt* is a fascinating case which was decided on jurisdictional grounds. When Mr Pratt died he was resident of Victoria and all of his assets were situated in Victoria. The only nexus with NSW was that the family trust had shares in two companies which owned land in NSW. Mr Pratt controlled the family trust but wasn't a beneficiary. Notional estate, however, is a concept only in NSW succession law. If the plaintiff wished to obtain an order declaring that the trust property was notional estate, and that provision for her should be made out of that notional estate, she could bring proceedings only in NSW. Brereton J found that there was no nexus with NSW. The case was thus decided on a jurisdictional basis and the plaintiff lost.

An eligible person may apply for a notional estate order if the deceased's estate does not have sufficient assets to satisfy their family provision claim. The concept of notional estate enacted by s75, and then s76(2)(a) of our Succession Act is very wide. In the case of *Wardy v Salier* it is explained that Mr Wardy was sole shareholder in the trustee company of a family trust, and also one of two directors of the trustee company. The other director was Mr Wardy's son. Mr Wardy's son was also the sole appointor of the trust. Mr Wardy and his family were members of a broad class of beneficiaries of the trust. The trust had significant assets. The Court found that Mr Wardy had power as the sole shareholder of the trustee

company to remove his son as director and become its sole director. Consequently Mr Wardy had the power to appoint trust assets to himself. In this way the 'relevant property transaction' was Mr Wardy's failure to appoint the assets to himself. Justice White explained that *"The placing of assets in a family discretionary trust with a corporate trustee controlled by the deceased is a paradigm case for the intended application of the notional estate provisions. In most such cases it would be the failure of the deceased to exercise his or her power to cause trust assets to be appointed that will constitute the relevant property transaction, albeit that the assets will continue to be held by the corporate trustee with no change as to how the assets are held."*

The situation of a joint tenant failing to take steps in his or her lifetime to sever a joint tenancy is raised in the context of notional estate. If a joint tenant does not sever the joint tenancy, it means that the property will go, upon his or her death, to the surviving joint tenant. This would be a 'relevant property transaction' for the purpose of the notional estate provisions.

Fraud on the power

The case of *Austec Wagga Wagga Pty Limited v Rarebreed Wagga Pty Limited* is discussed in relation to fraud on the power. It is explained that the case involved a family trust called the Cullen Family Trust. Mr Cullen was the appointor of the trust and Mrs Cullen was the sole director and shareholder of the trustee company. The trust carried on an electrical wholesaling business. There was a breakdown in Mr and Mrs Cullen's relationship, and the Family Court ordered that business be sold. It is further explained that during proceedings it came to light that there was a significant tax debt owed by the business, and that Mrs Cullen wanted the company to be wound up and liquidated. However, before Mrs Cullen could appoint a liquidator, Mr Cullen exercised his power of appointment under the trust deed to change the trustee to a company controlled by Mr Cullen's associate. The Court identified that the trust instrument said that the power of appointment could not be exercised in the appointor's favour. The Court found that Mr Cullen's appointment of a company controlled by Mr Cullen's associate as trustee constituted a fraud on the power of appointment. The case shows that the powers

of appointors may be limited by the trust deed and that the terms of the trust deed are paramount.

Lost trust deeds

The problem posed by lost trust deeds is discussed. It is incumbent on a trustee to ascertain the terms of a trust deed and to administer the trust according to its terms. A trustee is 'flying blind' in attempting to administer a trust without a trust deed. A trustee who is unable to locate the trust deed might be tempted to pass a resolution to adopt a new set of provisions for the trust but the difficulty is that the trustee is not to know whether the original deed had powers of variation or not. The issue of lost trust deeds is amplified with older trusts as it is less likely an electronic copy of the trust deed would be kept. Trusts often hold valuable real property and other assets, and the duties and capital gains tax issues posed by executing a deed of confirmation or by adopting a new set of trust provisions are often significant.

There may be an absence in continuity of the trust regime if a trust deed is lost. Clark's case and the Commercial Nominees case indicate that there needs to be a continuing class of beneficiaries, a continuity of trust property and a continuity in the trust regime in order to have a continuing trust. It is imperative that the trustee obtains legal advice if they lose the trust deed. A practical and prudent course of action for a trustee who has lost the trust deed may be to collate as much evidence about the trust as possible and seek judicial approval from the Supreme Court to administer the trust in accordance with the evidence on hand about the trust and the provisions of the Trustee Act.

Foreshadowed changes in legislation concerning trusts

It is noted that the Attorney-General has proposed some legislative changes, and foreshadowed that new legislation would concern oppression of minority beneficiaries and the limitation of rights of indemnity which beneficiaries may have

against an erring or deficient trustee. It is also noted that the area of trading trusts is one which needs intervention.

Bibliography

In the Matter of Richstar Enterprises Pty Ltd (ACN 099 071 968) v Carey (No 6) [2006] FCA 814

Corporations Act 2001 (Cth)

Kennon v Spry; Spry v Kennon [2008] HCA 56

Family Law Act 1975 (Cth)

Hitchcock v Pratt [2010] NSWSC 1508

Wardy v Salier; Wardy v Salier; Wardy v Estate of late Wardy [2014] NSWSC 473

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Austec Wagga Wagga Pty Limited v Rarebreed Wagga Pty Limited [2012] NSWSC 343

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Commissioner of Taxation v Commercial Nominees of Australia Limited [2001] HCA 33

Presenters' Biographies:

Chris has over 40 years of experience in commercial law and specializes in commercial agreements, as well as corporate and trust restructuring. Chris' areas of expertise and focus include compliance and governance advice, mergers and acquisitions, commercial agreements, trusts, business and family succession

planning and TGA compliance. Chris also sat on the Fidelity Fund Committee of the Law Society for a period of many years. Chris holds a Bachelor of Laws and Bachelor of Arts from the University of Sydney.

Peter advises clients on a range of matters relating to estate planning, taxation, superannuation, trusts and asset protection. Peter is an Associate of the Tax Institute of Australia as well and a member of the Self-Managed Super Fund Association. Peter also presents on topics associated with his practice for a number of tax discussion groups. Peter holds a Bachelor of Laws and Bachelor of Business (Finance) and is currently undertaking a Masters of Law (specializing in tax law) at the University of Sydney.