

Settlement of Trusts

AILEEN PTY LTD V ONE HAWKER HOLDINGS PTY LTD [2006] VSC 135



INTRODUCTION

Ensuring that a trust is validly settled is one of the most important considerations when establishing a trust. There may be many unexpected and unintended consequences stemming from a trust deed not being properly settled; it can result in the trust not being established at all or alternatively being established by a subsequent transaction which could result in the various elements of the trust being different to those originally intended. This in turn may result in significant taxation consequences.

This article will look at the recent single judgement of Williams J of the Supreme Court of Victoria in which the issue of the validity of a trust where the settlor's signature on the trust deed was forged and he was unaware of the existence of the document was considered. This article will primarily analyse the consequences of the Court's decision, including a consideration of s 102 of the *Income Tax Assessment Act 1936* (Cth).

A secondary issue that will be considered and which was examined in the judgement of Williams J is the ability of an external document to appoint a new appointor and limit or alter the powers of the appointor.

SUMMARY OF CASE

Williams J held that the One Hawker Holdings Trust was a validly established trust despite key elements of a trust not being present due to fraud and forgery.

The deceased, who was the owner of real property, wanted to establish a discretionary trust, primarily for asset protection purposes in relation to the real property. This was regardless of any capital gains tax consequences.

The necessary documents to establish the trust were prepared. There was however

a substantial flaw in the establishment of the trust, being that the settlor of the trust who was stated to have gifted the settled sum of \$10.00 to the trust, was unaware of the existence of the trust. The settlor did not sign the trust deed and, importantly, did not pay the settled sum to the trust. The signature of the settlor was not his but instead was forged. The issue of the validity of the trust as a result of this was considered by the Court.

IMPORTANCE OF VALIDLY ESTABLISHING A TRUST

Williams J held that despite the trust not being settled effectively and the settled sum not being provided by the named settlor, the trust was valid. Williams J asserted that the trust was valid on the basis that it was the intention of the deceased to establish the trust. His Honour held that it was irrelevant that there was no sufficiently constituted trust as a result of the stated settlor not accepting this role and providing the settled sum. Instead, Williams J considered that it was sufficient that the deceased intended that the relevant real property be held by the corporate trustee as trustee for the beneficiaries stated in the trust deed.

Although Williams J did not specifically address the issue of the identity of the trust property and the settlor, he did refer to the requirement that a trust be evidenced in writing under s 53(1)(b) of the *Property Law Act 1958* (Vic). Section 53(1)(b) requires that a declaration of trust in respect of any land or any interest therein must be manifested and proved by some writing signed by some person who is able to declare such trust or by his will. His Honour considered that this requirement had been met as a result of the trust deed being signed by the trustee company. Williams J also considered that there was further evidence of the trust in writing in various loan applications which were made by the trustee company in its capacity as trustee of the trust.

Despite Williams J assertion that the relevant intention to establish a trust was present and that the trust was evidenced in writing, his judgement does not consider the implications of the settlor not being the person named, and the settled sum not being paid in accordance with the terms of the trust deed as those issues were beyond the scope of the issues to be determined in the case.

Settlor and Trust Property

The decision of Williams J that the trust was validly established, gives rise to a need to analyse the concept of the trust, including a consideration of the key elements required to establish the trust. In particular, the identity of the settlor, what is the first property settled upon the trust and the consequences that arise from each of these elements needs to be considered.

Given that the settlor in this case cannot be the person named, and the settled sum of \$10.00 was not paid, arguably the deceased is the settlor of the trust as he had the relevant intention to establish the trust and this role was assumed upon his transfer of the real property to the trustee company. One element of the facts of the case that causes difficulty with this presumption is that the transfer of the real property to the trust was expressed to be for consideration. If this was the case then was the trust established at an earlier point in time and if so what was the trust property at that time? Can a trust come into existence by the simultaneous borrowing of funds and acquisition of property, and if so how does a trust that has not yet come into existence borrow funds? There is insufficient information in the case to begin a meaningful exploration of these issues however the identity of the settlor alone is worthy of consideration. If the deceased is the settlor it gives rise to a number of consequences.

Timing

His Honour's decision that the trust deed is sufficient to satisfy the requirements under the Property Law Act gives rise to a timing issue. The trust deed was executed on 2 January 2002, whereas the transfer of land relating to the real property forming the trust property took place on 20 June 2002. Given this is the case, the question arises as to whether the trust was in fact manifested and proved by some form of writing. Arguably there are problems with the fact that the written declaration of trust took place some time before the trust was actually established by the transfer of land.

Further to the issue of timing, one may be able to argue that the terms of the trust deed are not congruous with the trust that was subsequently established upon the transfer of land by the deceased to the trustee company as trustee of the trust, and that there were two totally separate transactions, the first being ineffective as a result of the fraud. Whether this would be the case or not if the matter was appealed is unknown. If this was the case, for the transfer of property to result in the effective establishment of a trust, s 53(1)(b) of the Property Law Act would need to be complied with, and whether the loan applications alone as referred to by Williams J would amount to sufficient evidence of an intention to create a trust as is required by the Property Law Act would need to be considered. If they were not sufficient, there may be grounds to claim that the trust was not validly created at all.

Section 102(1) of the Income Tax Assessment Act 1936 (Cth)

The second and significant issue that arises as a result of the decision of the Court that a valid trust was established, are the consequences of the trust being created by the deceased upon his transfer of the property to the trust. By the deceased assuming the role of settlor and also being a capital and income beneficiary and the appointor of the trust, the issue of a revocable trust is raised. This taxation issue was not considered by His Honour.

Section 102 of the *Income Tax Assessment Act 1936* provides:

"Where a person has created a trust in respect of any income or property (including money) and:

- (a) he has power, whenever exercisable, to revoke or alter the trusts so as to acquire a beneficial interest in the income derived by the trustee during the year of income, or the property producing that income, or any part of that income or property; or
- (b) income is, under that trust, in the year of income, payable to or accumulated for or applicable for the benefit of a child or children of that person who is or under the age of 18 years;

the Commissioner may assess the trustee to pay income tax, under this section, and the trustee shall be liable to pay the tax so assessed."

The key part of s 102, which is particularly relevant to the facts of this case, are the words "**where a person has created a trust**". As stated above, by the trust not being established as a result of the fraud, the deceased, as the owner of the real property, created the trust upon his transfer of the real property to the company as trustee of the trust. This clearly invokes the operation of s 102(1). This situation can be distinguished from the well established principles that arise where property is gifted to a trust after its establishment, as was the case in *Truesdale v Federal Commissioner of Taxation* (1970) 120 CLR 353 where the Court held that the words "created a trust" did not include the making of contributions to a trust already created.

Whether this case will be appealed or not on the issue of the validity of the trust is currently unknown. As it stands the case illustrates the importance of ensuring that a trust is validly settled. As a result of the trust deed not being settled properly, the Court has held the trust was established by the gifting of the property to the trust, which may result in significant tax consequences as it potentially invokes the operation of s 102.

In establishing a trust, in most cases the settlor as the creator of the trust, is not related to the beneficiaries of the trust. Whether or not the terms of the trust deed in this case provide that the settlor is excluded as a beneficiary or not is unknown. Even if the trust deed did include such a provision whether that reference was to a defined specific person or merely the role would need to be determined.

NOMINATION OF APPOINTOR BY WILL

The Court also considered the powers of and means by which an appointor can appoint an alternate appointor and any restrictions which can be placed on such an appointment.

On the basis of Williams J's decision that the trust is governed by the trust deed, the deceased was the appointor of the trust. The trust deed provided that the appointor has the powers to revoke the appointment of the trustee and to appoint a new trustee and that this power may be passed on by deed or will. The Court considered the scope of this power in terms of the ability to restrict the powers of the newly appointed appointor. It was noted however by Williams J, that it was his view that:

"the deceased did not have a power under the trust deed to constrain or limit the exercise of the powers of the appointor nominated to replace him; the trust deed did not provide the deceased with a power to nominate an appointor on a conditional basis."

Williams J's comments illustrate that unless the trust deed limits the power of an appointor, any external restrictions on the powers of the appointor will not be valid.

This decision is consistent with the well established principles that terms and operation of a trust are governed by the terms of the trust deed establishing it and may only be altered in accordance with the terms of the trust deed. It again illustrates the importance of properly settling a trust deed to ensure that the trust established is governed by a clear set of rules. This ensures that the intentions in establishing a trust are fulfilled and complied with, and that the beneficiaries of the trust are protected.

CONCLUSION

This case highlights not only the importance of ensuring that a trust is validly settled, but also highlights the need to take appropriate care and exercise diligence in addressing all aspects of the establishment of a trust. Although the Court found in the present case that a trust was established a number of taxation consequences may flow from such a finding if one was made in a case considering taxation matters. Not only does the identity of the true settlor potentially alter the class of beneficiaries of the deed by definition, it also potentially triggers the operation of s 102 of the *Income Tax Assessment Act 1936* (Cth) with its corresponding taxation liabilities.