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The Fifth Annual Estate Planning & Asset Protection Conference

Session 8: Fireproofing the Family Trust from Third party Attack

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Introduction

The topic for this presentation suggests a return to the "glory days" of trusts. Unfortunately, the word "fireproofing" is misleading. As the topics covered by the other sessions at this conference suggest, there are no guarantees as to whether any particular structuring will protect the assets of a trust from third party attack let alone from the reach of the Family Court (**FC**).

In structuring the family trust, advisers must consider the expansive view of property adopted by:

- the Federal Court of Australia in ***Richstar*** in the context of the *Corporations Act 2001* (Cth)[1]; and
- the majority of the High Court in ***Kennon v Spry***[2]*;*

and the powers of the FC to alter the interests of parties in property under section 79(1)(a) of the *Family Law Act 1975* (Commonwealth) (**FLA**).

The FC also has power to make orders against a third party who is unrelated to the relationship and in control of a trust or company[3]. Therefore, where the FC finds, as in *Spry,* that a trust's assets have been built up over a long relationship and as a result of the contributions or efforts of both partners then the FC may "attack" trust property by making orders against the trustee.

The challenge is to get the right combination of persons as trustees, directors, shareholders, appointors and beneficiaries and, in appropriate cases, to customise the terms of the trust deed and possibly also, the terms of the constitution of a corporate trustee in order to minimise attacks on the assets of the trust without compromising the flexibility and control of the trust from the point of view of asset protection, taxation, business succession and estate planning.

Consequently, it is most important to ensure that structures are set up appropriately and reviewed whenever an opportunity to do so presents itself. However, any restructuring will be subject to the client's personal circumstances and priorities at the time and having regard to the tax and stamp duty consequences of any restructuring and the structuring of any of the client's existing business or investment interests.

1. The Family Trust

1.1. For a variety of reasons, business and investment assets may be owned by a discretionary trust. The reasons may include tax, asset protection or retention of assets (e.g. a business or shares or a holiday home or apartment) for the benefit of one or more members of the next generation.

[1] Australian Securities and Investments Commission; *In the Matter of Richstar Enterprises Pty Ltd ACN 099 071 968 v Carey* (No 6) [2006] FCA 814
[2] [2008] HCA 56
[3] Part VIIIAA FLA; *B Pty Ltd and Others & K and Anor* [2008] FamCAFC 113.22;

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1.2. This paper explores issues affecting what are commonly referred to as "family trusts". That is, the presentation focuses on discretionary trusts which are created "inter vivos" (that is during the lifetime of the settlor and not under a will) the beneficiaries of which are all relatives or related entities of specified primary beneficiaries who are connected by marriage or blood.

1.3. A typical family trust (**trust**) nowadays is established by a family friend (settlor) giving a small amount of money to a trustee to hold for the benefit of the extended family.

1.4. Many clients do not understand that the assets of their family trust are not their own personal assets. That is, clients often believe that by making a will they can determine who will inherit property owned by a trust and that during their lifetime they may use and dispose of the trust assets as they wish without regard to the legal framework which creates the trust relationship.

1.5. Except for tax purposes, a trust is not a legal entity separate from its trustee. That is, the property of the trust is legally owned by the trustee who holds that property on trust for one or more beneficiaries. For a family trust, the relationship between the trustee and the beneficiaries is governed by the trust deed.

1.6. Under the trust deed the trustee will have wide powers of investment and complete discretion as to the distribution of income and capital as between specified primary beneficiaries and a class of general beneficiaries which will include extended family, companies and trusts. If the trust deed appoints an appointor who can remove and appoint trustees then the relationship between the trustee and the appointor will also be governed by the trust deed.

1.7. The paper does not consider discretionary testamentary trusts or binding financial agreements or amendment of the trust deed as a structuring tool (for example, by amending the appointor provisions) as all of these topics have been considered in other sessions. However, it is worth noting that even though the decision in ***Commissioner of Taxation v Clark***[4] decisively held that amendments to a trust as originally constituted including changes to the deed, the trust's assets and its unit holders (beneficiaries) do not cause a resettlement, the power of amendment contained in the trust deed remains of utmost importance in determining whether to amend a trust deed.

1.8. That is no amendments may be validly made to a trust deed unless the amendments are within the power to amend contained in the trust deed and:

1.8.1. the procedure prescribed in the trust deed for making amendments to the deed is strictly complied with (such as the appointor must consent in writing to the trustee amending the trust deed); and

1.8.2. any limitations upon the power of amendment are not breached (such as extending the life of the trust beyond the perpetuity period); and

1.8.3. any conditions to which the exercise of the power of amendment is subject are satisfied (e.g. the amendment must not affect any amount already set aside for a beneficiary).

1.9. Finally, it is noted that a reference in a will to assets owned by a trust may bring those assets within the scope of assets against which a disaffected family member may bring an application for provision under the will pursuant to state legislation for family provision applications (sometimes referred to as testator's family maintenance claims). Although the court's powers are limited to making orders against the estate[5], in making its order, the court may take into account the value of

[4] [2011] FCAFC 5 (special leave application to the High Court)

[5] Pursuant to section 91(1) of Part IV – Family Provision of the *Administration and Probate Act 1958* (Victoria) the court may order that "provision be made out of the estate of a deceased person for the proper maintenance and support of a person for whom the deceased had responsibility to make provision".

trust assets available to other will beneficiaries but not the applicant, just as the FC takes into account trust assets which it considers constitute a financial resource of a party.

2. Issues in structuring

2.1. The series of steps that should be taken to minimise the risks of successful attack against a discretionary trust include:

- choosing your appointors carefully
- choosing your trustees carefully
- choosing your directors carefully
- unpaid present entitlements and loans in the wrong places
- ownership of corporate beneficiaries
- ownership of companies acting as trustees
- width of classes of beneficiaries
- importance of distribution history.

2.2. Further, the terms of the trust deed are relevant to issues of control of the trust and the extent of a beneficiary's right to be considered by the trustee as a person to whom distributions of capital or income of the trust may be made (beneficial interest). Any removal of control or beneficial interest must be automatic because it is certain that restructuring a trust at a time when a key individual is in difficulty will not protect the assets of the trust from their spouse (**partner**) within the meaning of the FLA[6]. The powers of the FC to set aside transactions are very broad.[7]

2.3. Indeed, any restructuring undertaken when a client is in financial difficulty whether with the Australian Taxation Office or other creditors is unlikely to be successful.

2.4. Arlene Macdonald, suggests in an article entitled "Protecting the family assets (trusts and divorce): Part 2"[8] that the trust structure which is most at risk to orders made by the FC is:

> "the "ordinary" family discretionary trust where the trust property has been accrued from the spouse's efforts and one or both of the spouses are the controller and beneficiaries…the less like the "ordinary" family discretionary trust, the more the chance the family courts won't take it into account as property (although it may well still be a financial resource for the controller/beneficiary).
>
> "In addition, if important aspects of the trust are different (outside the ordinary) this may make an attack on the trust assets difficult (and expensive). That combined with very uncertain eventual success, makes it more likely that the case will settle with the least impact on the trust assets." [9]

Undesirable structuring

2.5. The appointment of a sole natural person as trustee makes the trust's assets accessible to court orders in favour of their partner[10] or, where the person is also a

[6] *Kennon v Spry*
[7] S106B FLA; see also article by Amanda Morton, "*A Matter of Trusts Family Court third party powers*", Taxation in Australia Volume 43 No. 10 May 2009
[8] *The Tax Specialist* Volume 14 No. 3 February 2011
[9] Ibid p167
[10] *Spry*

beneficiary of the trust and becomes bankrupt, to that person's creditors[11]. Furthermore, the combination of control of the trustee (whether by reason of being the sole director and shareholder of a corporate trustee or the sole appointor of the trust or the sole natural person trustee) and being a beneficiary of the trust enables the court under the *Corporations Act* to appoint a receiver to the assets of the trust and thus to "freeze" the assets of the trust[12].

2.6. To work out the degree of risk to which a trust's assets may be exposed according to the circumstances, it is instructive to look at some actual examples referred to in ***Richstar*** which are summarised below:

2.6.1. X is the director and secretary of corporate trustee

- X was the original appointor, the appointor is now X's wife
- The trustee has wide discretion including the power to prefer one or other beneficiary to the total exclusion of any other beneficiary.

2.6.2. X is the trustee

- X and his family members are beneficiaries
- No more than 39% of income and capital can be distributed without a unanimous resolution from the appointor
- The appointor is X's wife.

2.6.3. X is the appointor of the trust

- X is a member of the class of beneficiaries
- The trustee has every power as if it were the absolute owner of the trust fund.

In each of the above examples the court was of the opinion that X had an interest in the relevant discretionary trust and, in all but the second example, X had what approached or amounted to ownership of the whole of the trust fund of the relevant trust. In the second example the court was of the opinion that X had only what amounted to ownership of 39% of the trust fund.

3. Criteria governing access to trust assets

Control

3.1. In all jurisdictions in Australia, control is the most important factor in determining whether trust assets constitute an individual's property[13]. However, control is not of itself sufficient for a third party to access trust assets; the controller or their partner must have an interest in the trust assets[14].

3.2. In ***Re Burton ex parte Wily v Burton***[15] the court held an appointor's power of appointment of a new additional or replacement trustee is "a trust or fiduciary power… and must be exercised… in the interests of the beneficiaries" and is not "property" or "a power" "as might have been exercised by the bankrupt for his own benefit"[16].

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[11] Once a link is established between a bankrupt trustee and a creditor of the trust and if the bankrupt in their capacity as trustee is entitled to be indemnified from the trust's assets in respect of the claim by the creditor of the trust then all of the trust's assets become available to all creditors of the bankrupt regardless of whether they are creditors of the trust or of the bankrupt in their personal capacity: *Re Enhill Pty Ltd* [1983] 1 VR 561

[12] *Richstar*; it is noted there have been many applications for extension of the asset preservation orders made by the court in *Richstar* and in the last of the *Richstar* cases (Australian Securities and Investments Commission; *In the Matter of Richstar Enterprises Pty Ltd v Carey* (No 22) [2008] FCA 381) the court accepted undertakings from Carey and others that they would not dispose of trust property beyond distributing living expenses to themselves from the relevant trusts. However, to date no order has been made applying the assets of the trusts in satisfaction of the claims of ASIC, liabilities of directors or creditors of the trusts even though the various protective orders and undertakings appear to have lapsed.

[13] *Richstar, Spry, Hitchcock v Pratt [2010] NSWSC 1508*

[14] Ibid; *Re Enhill*

[15] (1994) 126 ALR 557

[16] *Spry* see Gummow and Hayne JJ[124]

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3.3. ***Public Trustee v Smith***[17] concerned a gift made by Dr Ward in her will of real property to Ms Smith and others. It transpired the property belonged to the corporate trustee of a discretionary trust. During her lifetime, Dr Ward had been the sole director and sole shareholder of the corporate trustee and also the sole appointor of the trust and one of the beneficiaries of the income and capital of the trust. Ms Smith argued that because Dr Ward controlled the selection of the beneficiaries and the distribution of the assets of the trust, Dr Ward beneficially owned the property. The Court rejected Ms Smith's contentions. The Court held the fact that Dr Ward was a beneficiary of the trust did not give her a proprietary interest in any of the assets of the trust or in the trust fund as a whole. Further, the fact that Dr Ward controlled the trustee did not make her the trustee of the trust because such a finding would ignore the separate existence of the company which was in fact the trustee of the trust.

3.4. In ***Pratt***, proceedings in the NSW Supreme Court for a family provision order pursuant to s 59 *Succession Act* (2006) (NSW) (Act) the trial judge held that in order to establish a notional estate the plaintiffs needed to show a power to dispose of the properties in NSW meaning a legal capacity to compel a disposition to be made by the corporate owners not merely de facto power without legal control. It could be said the deceased (Pratt) controlled the trust but as its assets were merely shares in an entity interposed between the registered proprietors and the trust the plaintiffs had to show he had a legal power to control the registered owner. Pratt did not exercise a legal power to control because that power was subject to the fiduciary duties of a director which duties he shared with his co-director. In fact, Brereton J said "In my view, a director cannot be said to be "entitled" to exercise a power to dispose of a company's property to himself or to an eligible person other than for valuable consideration"[18].

3.5. **Facts**: Pratt died domiciled in Victoria. Probate of his will was granted by the Supreme Court of Victoria to his widow Jeanne Pratt, who was the executrix named in the will. His estate comprised no real estate, and all his personal estate (mostly shares) was situated in Victoria. None of his estate was situated in New South Wales. The plaintiffs Sharilea Hitchcock and her daughter Paula commenced proceedings in the NSW Supreme Court for a family provision order in their favour out of the estate. The plaintiffs argued the deceased had sufficient de facto control over the registered proprietors of four properties within NSW so as to allow a family order to be made in NSW.

3.6. Since the deceased died domiciled outside of NSW the plaintiffs had to show assets in NSW in order to trigger jurisdiction. The presence of NSW property which could be designated as notional estate would be equivalent of actual estate and sufficient for jurisdiction. Under the Act there must be a "relevant property transaction" within s 75 and s 76, in respect of which the court could make a notional estate order having regard to s 83 of the Act[19]. Section 76 provides:

(1) The circumstances set out in subsection (2), subject to full valuable consideration not being given, constitute the basis of a relevant property transaction for the purposes of section 75.

(2) The circumstances are as follows:

(a) if a person is entitled to exercise a power to appoint, or dispose of, property that is not in the person's estate and does not exercise that power before ceasing (because of death or the occurrence of any other event) to be entitled to do so, with the result that the property becomes held by another person (whether or not as trustee) or subject to a trust or another person (immediately or at some later time) becomes, or continues to be, entitled to exercise the power…"

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[17] [2008] NSWSC 397
[18] N13 above at [29]
[19] at [24]

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3.7. The Pratt Family Holdings Trust was constituted in Victoria and is governed by the law of Victoria. The trustee Pratt Group Holdings Pty Ltd at all relevant times had two directors, Mr Naphtali and Mr Leibler, and the two shares in it were held, one each by ABL Finance Pty Ltd and Applebay Pty Ltd, on trust for Pratt. All the shareholding in Applebay was held Mr Freeman, who was Pratt's solicitor, and who was also the sole director of Applebay. The shares in ABL Finance were held by Leibler and 19 others (not Pratt), who were also the directors of ABL. The appointor of the trust, and the guardian, was Deansworth Pty Ltd, a company incorporated and with its share register in Victoria. Deansworth had seven directors, and Pratt was not one of them. The shares in it were held by ABL & Co Custodians Pty Ltd, of which Pratt was neither a director nor a shareholder. ABL & Co Custodians Pty Ltd held its shares in Deansworth on trust for members of the Pratt family under deeds dated 5 December 2005, pursuant to which Pratt held a joint life interest with his wife, including a joint power during their lifetimes to appoint the shares absolutely to Pratt, his wife, or both. It follows that during his lifetime Pratt could have exercised that power to appoint the shares in Deansworth to himself, and thus obtain control of Deansworth. With control of Deansworth, he could remove and replace the trustee of the trust, so as effectively to exercise control of the trust. Through his beneficial ownership of the shares in the trustee, he controlled the existing trustee, and could have removed and replaced its directors.

3.8. However Pratt was excluded as a beneficiary of the trust and the trust deed could not be amended to favour or result in any benefit to the excluded class. Therefore, whilst the court found Pratt could control the trust and its trustee, the trust property was limited to shares. "He did not have the entitlement, though his ability to control the trustee of the trust, to appoint or dispose of the real estate assets of the trustees subsidiaries"[20]. In any event, a deed of exclusion excluded the plaintiff as beneficiaries such that even if Pratt had legal power to control the registered proprietors, he could not exercise such a power so as to benefit the plaintiffs.

Beneficial or equitable interest

3.9. Similarly, whether the key individual is a trust beneficiary is another important factor in determining whether trust assets constitute an individual's property[21].

3.10. In ***Gartside v Inland Revenue Commissioner***[22] the court held that a general beneficiary of a trust (not being a default beneficiary) does not have a proprietary interest in any particular asset of the trust or in the trust fund as a whole. *Richstar* and *Spry* have sought to distinguish or limit the application of *Gartside* on the basis that the trustees were independent, that is they were not beneficiaries of the trust.

3.11. The question arises whether a more expansive view will be taken of the interest of a beneficiary of a trust to classify that interest as property under the *Bankruptcy Act 1966* (Cth) (***BA***). The definition of "property" under the BA is very broad[23] and as Gibbs J (then a judge of the Federal Court of Bankruptcy) observed in ***Re Buckle; Ex parte Ogilvie***[24]:

> "The word 'property' is of wide import and in its context in s 166 of the Bankruptcy Act 1966–1968 is to be understood in the light of the principle, established for centuries and still applicable subject to specific statutory exception, that the creditors are to have the benefit of 'every beneficial interest which the bankrupt has', 'every species of right, or which by any possibility profit can be made'."

3.12. In ***Cirillo and Another v Citicorp Australia Ltd and Others***[25] the majority of the full court cited with approval the above observation of Gibbs J and held that:

[20] At [37]
[21] *Richstar, Spry, Hitchcock v Pratt [2010] NSWSC 1508*
[22] [1968] AC 553
[23] S5 BA defines 'property' as "Real or personal property of every description, whether situate in Australia or elsewhere, and includes any estate, interest or profit, whether present or future, vested or contingent, arising out of or incident to any such real or personal property". Ss 5(a) & (b) widen the definition of property to include any rights and power in relation to that property.
[24] (1969) 15 FLR 460 at 466
[25] [2004] SASC 293 Gray J at [78] and [83] with whose reasoning Bleby J agreed

> "The definitions of 'property' and 'the property of the bankrupt' in the *Bankruptcy Act* are sufficiently broad to include the right to apply (to the court) under an undertaking as to damages" (for an assessment of damages).

3.13. In ***Spry*** the majority of the High Court (**HC**) considered the combination of the relationship of the husband as controller of the discretionary trust together with the right of the wife as a beneficiary to the due administration of the trust (**the combined rights**) as property of the parties of the marriage. The husband controlled the trust by reason that:

- he was:
  - the sole trustee and
  - the sole appointor; and
- the trustee had absolute discretion:
  - to vary the terms of the trust and
  - to appoint all of the income and capital of the trust to one beneficiary to the exclusion of the other beneficiaries.

3.14. Even though the HC held the actual assets of the trust were not property of the parties to the marriage or of either of them, by equating the value of the combined rights with the value of the assets of the trust, the court, in effect was able to include assets of the trust in the property settlement payable to the wife.

3.15. The majority of the HC in *Spry* had no difficulty in making orders which affected the interests of the children to the marriage both because of the conduct of the children in concurring in the husband's behaviour and because the husband had shown the extent of his control of the trust by making dispositions of property to the children's trusts in an attempt to defeat an anticipated order under the FLA[26]. Further, the HC in ***Ascot Investments Pty Ltd v Harper*** said it was not doubted that the rights of third parties may be indirectly affected by orders of the FC[27].

3.16. Where a partner does not have substantial or major control of a discretionary trust then the assets of that trust are not treated as an asset of the parties, a relationship or either of them but as a "financial resource" of the partner who indirectly or directly can benefit from the discretionary trust[28].

Contributions

3.17. Contributions made by a key individual to the wealth of a trust or its asset pool are a most important consideration for the FC in determining a financial case between parties to a relationship. However, gifts made to a trust by a key individual for less than full market value may also constitute property of a bankrupt which may be clawed back from the trust assets by a trustee in bankruptcy.

3.18. The following extract[29] succinctly summarises when trust assets may be "attacked" by a trustee in bankruptcy or generally under the BA:

> "Discretionary trusts usually provide asset protection for the trust assets from a beneficiary's creditors because, generally, trust assets are not characterised as the bankrupt's property and so they do not vest in the trustee in bankruptcy to be divisible among the bankrupt's creditors[30].

[26] Spry Gummow and Hayne JJ [138], French CJ [81] and Kiefel J [236]
[27] (1981) 148 CLR 33 Barwick CJ [343], Gibbs J [354]
[28] s 75(2) FLA; *Essex v Essex* 209 FamCAFC 236
[29] A Macdonald, "*Protecting the family assets (trusts and divorce): Part 1*" *The Tax Specialist* Volume 14 No. 2 October 2010
[30] s116 BA. "To the extent that a default beneficiary has an interest, it is usually of minimal value and in any event does not expose the trust assets" (Footnote 3 to article cited at n26 above).

> There are exceptions. For example, the claw back provisions in ss120 (undervalued transactions) and 121 (transfers to defeat creditors) of the *Bankruptcy Act 1966* (Cth) can take particular assets out of a trust which have been transferred to it when the bankrupt was in fact or deemed to be insolvent and cause them to vest in the trustee in bankruptcy. Also, the controlled entity/trust busting provisions in Div 4A of Pt VI[31] are relevant in a business situation where the bankrupt has provided undervalue services to an entity he or she controls and the bankrupt derives benefit from property derived by that entity[32]. However, in general, discretionary trust assets are not the property of the bankrupt object (or trustee or appointor)[33]."

3.19. The case of ***Simmons v Simmons***[34] suggests control is irrelevant to determining whether trust assets constitute property or a financial resource. Instead the relevant facts were contributions to trust assets and at least one of the parties to the relationship being a beneficiary.

3.20. In *Simmons*, the trust was established by the husband's parents and the surviving parent controlled the trust. All of the husband's siblings and his mother received distributions from the trust and were involved in the family council which managed the trust's business and investment assets. However *Simmons* was settled before trial (quite possibly because the other family members of the individual involved in the proceedings did not wish to disclose all of the trust documents to the court) and whilst the judge considered the settlement most appropriate, it is unclear if the case had gone to trial whether there would have been a different outcome.

3.21. *Simmons* concerned an application by a trustee of a discretionary trust for summary dismissal of an application for an injunction and a claim by the wife that the husband's interest in the trust's assets should be in the property pool, such that Pt VIIIAA FLA can be used to order the trustee to transfer trust assets to her as part of the property division.

3.22. Therefore, unlike Spry the only connection between the husband and the trust was his right as a beneficiary to due administration of the trust and the fact the husband had contributed to the wealth of the trust. As Justice Watt said:

> "In my view there are facts in this case that establish a connection between the trust assets and the husband: he has lent the trust the proceeds of his shares in the entity that previously owned and conducted the family business on terms that can only be described as very favourable: no interest is payable at any time, and the initial period for repayment was 25 years. This was recently extended by a further 10 years..
>
> ..the facts …(are)… further supported by evidence that the mission statement of the Simmons Family Council provides, as one of its objects:
>
> iii) Return on an investment to the family
>
> and by evidence that the term 'long term trust shareholders' appears in documents generated by the Simmons Family Council and L Pty Ltd.
>
> One possibility in this case is that further disclosure of documents by L Pty Ld will render those words capable of a more clearly ascertainable meaning. On their face, however they appear to acknowledge that investments were made by family members such as the husband and his siblings, and express the object of providing a return on such investments to the 'long term trust shareholders'.
>
> The facts in this case establish a very significant investment in the trust assets by the husband and his siblings in the form of interest free loans that now do not require repayment until the 35th year since they were advanced.

[31] s139D BA.
[32] For example, *Birdseye v Sheahan* [2002] FCA 1319 (Footnote 5 to article cited at n26 above).
[33] *Wily v Burton* at 560; and *Dwyer v Ross* (1992) 34 FCR 463 at 466 (Footnote 6 to article cited at n26 above).
[34] [2008] FamCA 1088

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Whilst the genesis of the trust assets may be attributable, as L Pty Ltd argues, to the husband's father, his own original corporate structure included the husband as a substantial shareholder. Those shares were clearly property of the husband. Those shareholdings have been converted into loans in circumstances where they represent a reinvestment of the husband's asset in a form that may already be recognised in the L Pty Ltd documentation as a change in form rather than substance."[35]

4. Structuring Strategy - Appointors

4.1. The appointor of a discretionary trust has the power to remove and appoint trustees. If their consent is also required to any capital distributions, winding up or variation of the trust, it becomes apparent that choosing the right appointor for a discretionary testamentary trust is critical.

4.2. To protect trust assets from a trustee in bankruptcy of a client and claims in respect of future or second marriages or relationships of the client or of their spouse or of their children's relationships, no one natural person should ever be a sole appointor. An independent person should be one of the appointors of the trust. However, the independent person must not be the alter ego of the client to avoid a finding by the court that the client controls the trust. Where an independent appointor has sole control of the trust, to ensure the trust is administered in accordance with the client's objectives, their intentions as to who should benefit from the trust over time can be provided for in a well drafted appointor clause.

4.3. The independent appointor:

- Must be independent of the relationship and business risks of the key individual.
- Must be able to turn their own mind to any matter to be determined by the appointor (such as whether to make a capital distribution) and to make a decision free from influence.
- Should be someone in whom the family has absolute faith and confidence to act in their best interests;
- Should not be significantly older than the existing appointors;
- May be a child of the existing appointors (but if more than one child recommend not be the child as this could give the child an unfair advantage over any siblings who are not appointors and could also give rise to a perception of undue influence when the existing appointors become older);
- May be a relative of either of the existing appointors such as a brother or sister;
- May be a trusted friend of the existing appointors;
- May be a professional adviser of the existing appointors such as an accountant.

4.4. Trust deeds (or where changes to the person(s) appointed under the trust deed as appointor are advisable and the trust deed permits this, then deeds of nomination) should ensure that appropriate succession is in place for the appointors upon the key individual ceasing to be an appointor.

[35] At [119] to [121]

4.5. It may be appropriate to insert additional asset protection measures into the trust deed which require the consent of the appointor to the trustee taking the following actions:

- Exclusion of a person named in the trust deed as a beneficiary or nomination of a new beneficiary of the trust;
- Distributions of capital;
- Amending the trust deed;
- Vesting or winding-up the trust:
    - before the expiration of any applicable perpetuity period; or
    - without first obtaining asset protection advice from a lawyer or accountant.

5. Structuring Strategy - Trustees

5.1. The most important factor in determining who should act as trustee is asset protection. Assets of the trust may be attacked by creditors of the trustee pursuant to the trustee’s right of indemnity out of the trust assets. That right is personal property under the BA and the general law. Most trust deeds give the trustee a right of indemnity. In Victoria there is statutory recognition of the right of indemnity[36].

5.2. The High Court in ***Octavo Investments Pty. Ltd. v Knight***[37] clearly proceeded upon the basis that a trustee's right of indemnity out of the assets of the trust gave him a proprietary interest in the trust's assets.[38]

5.3. ***Re Enhill***[39] is authority for the principle that trust assets can be applied to pay all of the creditors of:

5.3.1. a corporate trustee which goes into receivership or liquidation and

5.3.2. a bankrupt trustee.

That is, the right of indemnity being a personal right of the trustee (both existing and former trustees) is not limited to creditors of the trust, or of the company or natural person individual in their capacity as trustee in respect of the period during which they acted as trustee. Instead, the right is unlimited. In Re Enhill Young, CJ said that to hold otherwise:

> “would deny the very purpose of the right to indemnity which is to exonerate the trustee's personal estate. In a case like the present therefore the proceeds of the trustee's lien are available for division among the bankrupt's creditors generally, not only among creditors of the trust business, and in the case of a company in liquidation are subject to the control of the liquidator under s292. Where, however, the trustee's indemnity derives from a party who is concerned with the application of the money which he pays, the situation may well be otherwise: see Liverpool Mortgage Insurance Company's Case, [1914] 2 Ch 617, per Buckley, LJ at p. 633. Creditors of the trust business may be subrogated to the trustee's right of indemnity but they cannot, by subrogation, obtain any greater right than that possessed by the trustee, and when the trustee's estate is separated from the trust estate by bankruptcy they rank with the general creditors of the bankrupt. They can have no better right than the bankrupt trustee.’[40].

[36] s 36(2) of the *Trustee Act 1958* (Vic)
[37] (1979) 144 CLR 360
[38] Per Young, CJ in *Re Enhill* at 563
[39] n11 above
[40] at 564

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5.4. The question in ***Re Enhill*** was whether the liquidator had under his control any assets of the company out of which his costs of the winding up could be paid. The company had no assets in its own name having only acted as trustee. The full court of the Victorian Supreme Court held that the right of indemnity or lien of a trading trustee company over the trust assets is property of the trustee available to its liquidator for division among the trustee's creditors generally, so that pursuant to the corporations law (then s292(1)(a) of the Companies Act 1961) the liquidator is entitled to be paid their remuneration, costs and expenses out of moneys realised from the use or sale of the trust assets. That is, the liquidator is not required to be a trust creditor to recoup their costs charges and expenses and their claim to trust assets ranks ahead of the trust creditors.

5.5. Consequently, any trustee should not conduct a business that is not the business of the trust and ideally, should not engage in any business or investment activities unrelated to the trust business.

5.6. Further, appointment of a corporate trustee is generally recommended.

5.7. If initially it is preferred the trustees be the person or persons intended to benefit from the trust then they should not be the appointors of the trust and there should be at least two natural person trustees.

5.8. Similarly, the shareholders in a corporate trustee should not be the same as the shareholders in any corporate appointor.

5.9. In a blended family situation where disagreement or friction between family members is expected, then consider appointing only independent persons as trustees.

5.10. In ***Dimos (T/As Leo Dimos & Associates) V Dikeakos Nominees Pty Ltd***[41] the full court of the Federal Court applied Re Enhill and held that the trustee's right of indemnity did not cease upon retirement. Heerey J also held that the right of indemnity not only confers a right to retain possession of trust property, but it is also a proprietary right equivalent to, and ranking ahead of, the interests of the beneficiary. In Dimos a creditor of the company served a statutory demand claiming insolvency of the company at a time when the former trustee had not transferred one of the properties which had been registered in its name whilst it was trustee. Previously, in ***Coates v McInerney***[42] it was held that a company trustee's entitlement to indemnity did not cease upon termination of the trusteeship and was available to a liquidator of the company.

6. Structuring Strategy - Directors

6.1. The control of a company rests with the directors and shareholders of the company.

6.2. Although a company has a separate legal existence from its directors and shareholders and even though the assets of a company belong to the company and not its shareholders, a company does not have a physical existence. Therefore, a company can only act through other people who are authorised to act on its behalf, such as its directors. The directors of a company are responsible for managing the company’s business. Although the directors are responsible for signing company documents, some documents can only be signed by directors after the actions, the subject of the documents, have been approved by the company’s shareholders.

6.3. The potential liabilities a director has under the guarantees given on behalf of a company, various licences (for example, liquor licences) and the *Corporations Act* generally are so significant that it may be desirable for only one person to be a director even though more than one person may have a stake in the family

[41] (1996) 149 ALR 113
[42] (1992) 6 ACSR 748

business. If the director were to suffer an event of insolvency such as bankruptcy then the shareholders would be able to appoint another of them to be the director of the company to ensure continuity of the business. In some cases, as for example with liquor licences, it may be that a sole director breaches a condition of holding the licences for reasons not related to the solvency of the business. In those circumstances, another family member could be appointed to be the director thus ensuring the conditions attaching to the licences necessary for the continued operation of the business are not breached.

7. Structuring Strategy - Shareholders

7.1. It is uncontroversial that ownership of shares in a corporation is a most important aspect of structuring.

7.2. As with all structuring, the selection of shareholders depends upon the client's circumstances. In the case of a family business, it may be appropriate for the shares in the trustee company to be held by another trust to ensure continuity of control of the corporate trustee by the family.

7.3. It may be beneficial where a family holds substantial business and or investment assets in a trust to have a family council manage those investments. The trust assets in *Simmons* were managed by the Simmons Family Council and documents generated by the Simmons Family Council were the subject of a disclosure application to the court.

7.4. Irrespective of whether a family council is appropriate for a client, where a trust holds assets for a large family group, issues such as management and succession could be addressed in the constitution for the corporate trustee. Provisions which it may be appropriate to insert into a constitution for the corporate trustee of a large family trust (such as that in *Simmons*) are:

- a right to each shareholder to nominate a director and alternate;
- a right to a shareholder to exercise their powers through a power of attorney;
- transmission of shares on death not to be subject to the directors' consent;
- the number of votes to which each director would be entitled (for example, to reflect differences in shareholding or contribution to the growth of assets);
- quorum for meetings to be reflective of number of family members with interests in the assets;
- unanimous vote for resolutions regarding matters such as:
    - differential distribution of income and/or capital (with a default to perhaps, equal distributions or pro rata per share held);
    - amendment to the trust deed;
    - any change of trustee;
    - exclusion of beneficiaries;
    - sale of substantial assets (for example business undertaking); and
    - buy out or exit terms for shareholders.

7.5. If shares are to be owned personally, consideration must be given to the shareholder either making a will to gift the shares to the person the will maker wishes to hold the shares or, perhaps preferably, executing a declaration of trust under which, as from the death of the shareholder, the beneficial ownership of the shares will pass to that person. Then the will maker may direct the shareholder to exercise their rights as shareholder to appoint themself or another person as director.

7.6. It is recommended the shares in any corporate beneficiary be owned by a trust not just for asset protection purposes but to ensure any unpaid present entitlements are not called up whenever a natural person shareholder dies as this may cause serious cash flow problems for the trust.

8. Loans and UPE's

8.1. It is most important (not just from a tax perspective but for certainty to protect fund assets) that a trust's accounts correctly record loans and unpaid present entitlements (**UPE's**) of beneficiaries. In particular, the accounts should clarify whether an amount is a UPE or a loan and if a loan, whether it is a debit loan or a credit loan from the trust's perspective.

8.2. A claim for interest may be made in respect of a loan. Therefore, trust minutes should be made and kept as to the terms of any loans irrespective of whether the loans are Division 7A loans or not.

8.3. Further, the term of any loan should be recorded, especially if it is a loan from a beneficiary to the trust as, depending upon the documentation, the trust may not have to repay the loan immediately upon it being called up by the beneficiary (ie. by a trustee in bankruptcy or executor or pursuant to order of the FC).

8.4. Subject to tax considerations (specifically Div 7A of ITAA36), consider as an alternative to making distributions of capital, making loans which are fully or partly secured by assets held in the name of the borrower beneficiaries.

9. Width of classes of beneficiaries

9.1. **Permanent exclusion of beneficiaries**
As the FC has held the assets of trusts with both exhaustive and non-exhaustive classes of beneficiaries to be property or a financial resource of a party, limiting the class of beneficiaries is only one structuring tool. If a party to a relationship has never been a trust beneficiary then the trust assets cannot be distributed to them as part of any property settlement. Consequently to ensure control of assets remains with the family, not the FC, it may be appropriate to exclude spouses of family members from being members of the class of general beneficiaries.

9.2. It is becoming more accepted and appropriate that the children who will ultimately benefit from a discretionary testamentary trust should be the only primary beneficiaries (i.e. the surviving spouse can be just a general beneficiary). In addition, many clients are now very keen on keeping assets in the family in which case, non-lineal descendants can be excluded from being capital beneficiaries.

9.3. **Disqualifying events**
In a blended family situation it will be important to ensure that capital is preserved so that all branches of the blended family can benefit in their turn. This can be achieved by including special restrictions in the discretionary testamentary trust provisions to either prohibit all or part of the capital being distributed or by making capital distributions subject to the consent of a trusted independent.

9.4. **Suggested Disqualifying Events**

- The person committing an "act of bankruptcy" within the meaning of section 40 of the *Bankruptcy Act 1966*;
- The person presenting a debtor's petition under the *Bankruptcy Act 1966*;
- A sequestration order is made by a court against the estate of the person under the *Bankruptcy Act 1966*;
- Any application in respect of a person is made for an order under the *Family Law Act 1975*;

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- The person suffering a relationship "breakdown" within the meaning of the *Family Law Act 1975;*
- The person separating from their spouse for any period of time including "separation" within the meaning of section 49 of the *Family Law Act 1975;*
- If the person is a director of a company the company is wound up by order of a court on the grounds of insolvency;
- Judgment is entered against the person.

It may be appropriate to disqualify a beneficiary from receipt of income and capital distributions during certain periods when their assets would be exposed to claims or creditors. After the relevant disqualifying event lapses, distributions could again then be made to the beneficiary.

10. Importance of distribution history

10.1. Of course, where there is a history of trust distributions to a party then it is more likely trust property would be held to be a financial resource and possibly, property of the party. But lack of distributions does not mean the trust's assets will not be held to be a financial resource. Instead, it makes valuation of that resource more difficult for the purpose of the division of property owned by the parties.

10.2. The recent decision of the Full Court of the FC in ***Essex v Essex***[43] illustrates that the *possibility* of benefitting from a trust even in the absence of receiving actual distributions, may suffice to include a trust's assets as part of the financial resources of a party.

10.3. ***Essex*** concerned an appeal by the wife seeking orders that the parties' assets be divided 70%:30% in her favour and that the assets of two trusts (the N Trust and the S Trust) established about four years after the parties separated be treated as a financial resource of the husband. The trust funds were constituted by gifts from the husband's mother and established to provide for the husband's mother's living expenses. The husband had not received any distributions from either trust and only managed the day-to-day affairs of the corporate trustee of the trusts during his brother's (X) absence for about 18 months. The N Trust had loaned money to the husband.

10.4. X was the sole appointor and the sole director and shareholder of the corporate trustee; both trusts had the same trustee. Otherwise, the terms of the trust deeds for the N Trust and the S Trust were different.

10.5. The N Trust was an ordinary discretionary trust of which X and his wife (they had no children) were the capital and income beneficiaries. Consequently, the husband, his wife and their children were, by reason of being relatives of X, included in the class of general beneficiaries of the N Trust.

10.6. On the other hand, the S Trust was a bloodline trust established for the husband's children who were the sole capital beneficiaries, the husband being an income beneficiary only. The husband's wife was not a beneficiary. However, because the husband's children were minors, the S Trust provided that payments of capital could be made to a parent or guardian of the children during their minority. Both the trial judge and the full court found it would be a breach of trust for the husband or wife to use the capital for their own benefit. The power to vary the S Trust prevented any change to the class of capital beneficiaries.

10.7. The FC found it was possible but unlikely that income from the N Trust would be available for distribution to the husband as the trust was primarily set up to provide

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[43] [2009] FamCAFC 236

for the husband's brother's family and that the trusts did not constitute a financial resource of the husband.

10.8. The majority of the Full Court found that the assets of the S Trust should have been treated as a financial resource of the husband as there was compelling evidence the husband would receive distributions from the S Trust and gain control of the S Trust after the conclusion of the proceedings. The full court's reasons were:

- The purpose of providing the husband's mother with an aged pension and preventing her making imprudent investment decisions could have been achieved by the settling of one trust only.

- The difference in the provisions of the two trust deeds was relevant. The beneficiaries named in the N Trust deed evinced a clear intention in the drafting of that trust to benefit the husband's brother and his wife. As they did not have children, the wide class of general beneficiaries (who were not named) was readily appreciable. The S Trust deed evinced a clear intention that the capital of that trust be distributed on vesting, or at such earlier time as the trustee may determine, to the two children of the marriage, the grandchildren of the husband's mother. It also disclosed a clear intent that the husband, as one of the three named income beneficiaries, was entitled to be considered to receive distributions of income until the vesting of the trust.

- The husband had the effective day to day operation of the trusts for a period of approximately 18 months and was well aware of the assets of the trusts.

- The husband's brother's evidence did not demonstrate that the husband would never receive income, or even that he was unlikely to receive income from the trusts.

- When the husband's brother chose to borrow approximately $135,000 from trust assets he did so from the assets of the N Trust, implying that the assets of S Trust were to remain intact for the income and capital beneficiaries of that trust.

- As the sole director of the corporate trustee of the S Trust the husband's brother had control of that trust and was only obliged to consider the husband as one of the three income beneficiaries entitled to the income of the trust, and conceded that, but for the property proceedings the husband should have the benefit of assets in the trusts.

10.9. Given the importance of controlling actual or potential distributions in order to protect trust assets, it may be desirable to review the pattern of distributions in existing trusts if there are any concerns about claims against particular individuals.

10.10. It may also be appropriate to limit the trustee's ability to distribute capital to a fixed percentage per year or to limit capital distributions to lineal descendants as arguably, this may affect any perceived entitlement to future distributions.

11. Preventing partners seeking access to information through the FC

In summary, the disclosure obligations upon a party to a "financial case" in the FC are far reaching.

As stated in the opening paragraph of the brochure published by the FC entitled "Duty of disclosure":

> "Disclosure is a complex area of law. The information here is an overview only of the requirements. You must carefully read Chapter 13 of the *Family Law Rules 2004* (**FLR**) to understand your full obligations. If you are unsure about any of your obligations, you should get legal advice."

Essentially, the duty of disclosure of a party to a financial case requires:

- full and frank disclosure (FLR.13.04);
- written undertakings to be given by each party to the FC prior to any hearing before a judge (FLR.13.15);
- each party to file a financial statement at the commencement of a financial case (FLR.13.04 and FLRR 13.05);
- continuous disclosure of documents including filing an updated financial statement both within 21 days of any significant change in financial circumstances (FLR.13.06) and prior to any trial.

There are significant penalties for all failures to disclose (FLR.13.14) including power to the FC to stay or dismiss a case, order costs against a "guilty" party or fine or imprison the guilty party for contempt of court.

FLR 13.15 requires all parties to give a written undertaking that they:

- have read parts 13.1 (disclosure between parties) and 13.2 (duty of disclosure – documents); and
- are aware of their duty to the court and each other party "to give full and frank disclosure of all information relevant to the issues in the case, in a timely manner".

A party who makes a false undertaking commits an offence.

The financial statement which must be filed in the FC contains a comprehensive list of matters pertaining to the structuring of trusts. The financial circumstances prescribed by FLR 13.04 of which "full and frank disclosure" must be given by a party include details of:

(a) any vested or contingent interest in property (including real or personal property, superannuation and legal and equitable interests); and

……..

(d) any trust:

(i) of which the party is, or has been since the separation of the parties, the appointor or trustee; or

(ii) of which the party, or the party's child, spouse or de facto spouse is, or has been since the separation of the parties, an eligible beneficiary as to capital or income; or

(iii) of which a corporation is an eligible beneficiary as to capital or income if the party, or the party's child, spouse or de facto spouse is, or has been since the separation of the parties, a shareholder or director of the corporation; or

(iv) over which the party has, or has had since the separation of the parties, any direct or indirect power or control; or

(v) of which the party has, or has had since the separation of the parties, any direct or indirect power to remove or appoint a trustee; or

(vi) of which the party has, or has had since the separation of the parties, the power (whether subject to the concurrence of another person or not) to amend the terms; or

(vii) of which the party has, or has had since the separation of the parties, the power to disapprove a proposed amendment of the terms or the appointment or removal of a trustee; or

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(viii) over which a corporation has, or has had since the separation of the parties, a power mentioned in subparagraphs (iv) to (vii), if the party is a director or shareholder of the corporation".

The above paragraphs of FLR 13.04 are clearly directed to issues relating to control of a trust. Therefore, the structuring of the directorship of or shareholding in (ordinary shareholders have the power to remove and appoint directors) a corporate trustee or appointor is also important from the perspective of the FC (see paragraph (d)(viii) above). Further, ownership of shares in a corporate beneficiary is an interest in trust property which may enable a partner to access trust assets (above paragraph (d) (iii)).

12. Trust documents

12.1. The type of trust documents which must be disclosed depends upon whether the application for disclosure is made in the FC or in the ordinary civil courts (***Read & Chang and Anor***[44]). The only proviso to disclosure in the FC is relevance of the document to the partner's financial circumstances (s 75(2) FLA). Whilst in civil proceedings, whether or not confidential trust documents must be disclosed depends upon the nature of the claim (for example, whether it is for removal of a trustee for acting in bad faith) and the entitlement of the person making the application to inspect trust documents (for example, whether the person is a trust beneficiary) or whether the trustee waives any claim of privilege.

12.2. Trust documents which must be disclosed to a trust beneficiary include the trust deed, all variations and changes in trustee or appointors, tax returns and all financial statements for the trust.

12.3. In ***Re: Londonderry's Settlement***[45] a "trust document" was defined to be one which a beneficiary may inspect such as professional advice sought by the trustees on behalf of the trust but does not include those documents which pertain to the exercise of the trustee's discretion such as agenda for meetings and minutes of meetings of trustees or appointors and correspondence received from one beneficiary and not copied to another or correspondence passing between trustees or trustees and appointors. That is, a trustee need not give reasons for its decisions or documents disclosing those reasons or how the trustees should exercise their discretion (e.g. communications with the appointor).

12.4. However, the material upon which the trustees may have based their reasons is not confidential unless it discloses the reasons themselves. Consequently, minutes of resolutions of trustees would not be discoverable.

12.5. However, if a trustee gives reasons and discloses their reasons to the beneficiary or the reasons are given to the court, a court may investigate their validity.

12.6. The duty to give information may be modified by the terms of the trust instrument (***Tierney v King***[46]).

12.7. In ***Hartigan Nominees v Rydge***[47] it was held by the majority of the full court of the Supreme Court of NSW that written wishes given to a trustee by the instigator of the trust as to the administration of a trust if provided on a confidential basis were privileged from production to a beneficiary of the trust. Further the full court held that the beneficiaries' right to inspect trust documents does not entitle them to see all documents which may be relevant to the trustees' exercise of the discretion vested in them. However, that case was distinguished in ***Read***.

12.8. In ***Read*** a corporate trustee of a trust which held more than $630M in assets applied to set aside two paragraphs of a subpoena issued by the husband. The

[44] ((2010) FLC 93-450; [2010] FamCA 846
[45] [1965] Ch 918
[46] [1983] 2 Qd R 580
[47] (1992) 29 NSWLR 405

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wife had received about $18M in distributions and there was a pattern of increasing annual distributions to the wife over many years. The husband issued subpoenas, one to each trustee, to seek production of all memoranda of wishes and or/memoranda of preferences and/or letters of wishes or like documents in relation to the trust. In dismissing the application, Cohen J held:

- Although trustees should primarily regard themselves as having a duty to withhold disclosure of a confidential memorandum of wishes, the trustees and court ought to determine whether countervailing circumstances, including the likely relevance of the wishes of the person at whose request the trust was created, warrants disclosure.

- The court is likely to be, by the disclosure of the memorandum of wishes, in a better position to predict what the trustees are likely to do in the future.

At paragraph 6 of his judgment dealing with the husband's application for costs of defending the trustees' application, Cohen J said:

> "The trustees opposed the subpoena because they said the memorandum was not binding on them in the exercise of their discretion and is therefore irrelevant. They also relied on authority which they submitted is to the effect that if a memorandum of wishes was intended by the instigator of or donor to the trust to be confidential, it should remain confidential from the beneficiaries and, of course, complete strangers to it, as the husband is. I dismissed the trustee's application and permitted both the husband and wife to inspect the memorandum produced in answer to the subpoenas, provided they made an undertaking to the Court not to convey the contents of the memorandum to anyone except to get legal advice or in the conduct of the section 79 proceedings."

12.9. The principle that documents confidential to the trustees are not discoverable to beneficiaries may be over ridden when a beneficiary sues a trustee alleging bad faith. The principles of ***Karger v Paul*** [1984] VR 161 were recently confirmed by a decision of the High Court in ***Finch v Telstra Super Pty Ltd***[48] to apply to the trustees of every type of trust including a superannuation fund where the trustees have discretionary powers. The principles represent the law as it currently stands in Australia. The principles are that the exercise of discretion by a trustee is not subject to review by the courts unless the trustee:

- does not act in good faith;

- does not give real and genuine consideration to the exercise of the discretion and the purposes for which the discretion was granted;

- does not exercise its discretion in accordance with the purposes for which the discretion was granted; or

- provides reasons for the trustee's decision and those reasons are not sound.

13. Production of documents

13.1. The only exceptions to disclosure, subject to order of the FC to the contrary, are stated in FLR.13.13 as being privilege and inability to produce a document.

13.2. Apart from the disclosure obligations of parties, the FC may subpoena documents from third parties such as trust documents from third party trustees.

13.3. Unlike proceedings in most other courts, documents disclosed in a financial case are not a matter of public record. There are strict rules governing access to and the privacy of documents. Where there are privacy or confidentiality issues (for example, where one party controls a family trust which conducts a substantial business and they are concerned to ensure their competitors do not obtain information about the financials of the business) it may be appropriate to obtain a

[48] [2010] HCA 36. The trustees of a superannuation fund have a greater duty properly to inform themselves than other trustees.

court order prohibiting the copying of the documents such that the documents may only be viewed at the court registry or released by further order of the court.

13.4. Another strategy, (subject to ensuring there is no breach of the requirement not to make a false or misleading statement) may be not to include trust documents in the financial statement so they do not have to be produced pursuant to the disclosure obligations but rather to invite the partner seeking access to the information to subpoena the documents. Documents produced pursuant to service of a subpoena are only produced to the court and are then held in the FC Registry. They are released only pursuant to a court order and then for the purpose of inspection/copying and subject to any restrictions imposed by the court.

13.5. However, if a party has possession or control of documents but fails to produce them if demanded to do so by the other side so forcing the other side to issue an application seeking specific orders for discovery or a subpoena, the court may order costs against the party who failed to produce the documents.

14. Structuring strategies

14.1. I proffer a view based on the law that virtually all applications for an order for production of trust documents are successful subject only to issues relating to access to or copying of the documents.

14.2. Given the sweeping powers of the FC, in some cases such as where there is a second marriage and the couple do not intend to have children, it may be appropriate (especially, if one party controls a trust) for the parties to enter into a binding financial agreement (**BFA**) as soon as practicable after wishing to make their relationship permanent. A BFA may prevent any issues regarding disclosure of documents subsequent to the making of the BFA or issues as to the confidentiality of documents arising at a later time as well as quarantining assets acquired before or during the relationship from any property settlement, subject, of course to the terms of the BFA. However, section 90G of the *Family Law Act 1975* (Cth) (**FLA**) empowers the FC to set aside a BFA where a party fails to give full and frank disclosure of their financial circumstances at the time of making the BFA.

14.3. Those cases where it may be possible to contest an order for discovery of trust documents may be where the party is a trust beneficiary:

- but does not control the trust (NB the existence of an independent appointor is irrelevant to the issue of control from a family law perspective);
- has not contributed to the trust fund (for example, has not put any assets into the trust or made any gifts of cash into the trust for the purpose of the trust acquiring assets);
- who has not received any distributions from the trust;
- and the trust fund represents family wealth fully generated from contributions to the trust fund by previous generations; and/or
- the trust fund is managed for the benefit of the trust beneficiary's parents or other siblings but not the trust beneficiary.

14.4. Perhaps, the only situation where a trust's assets would not be taken into account in determining a financial case (and, of course the FC may require production of trust documents to determine this) is where all property used by or benefitting a party is held in one trust which is exclusively controlled by independent trustees and appointors for the benefit of everyone in that party's family. That is for themselves, their siblings and parents. In such a case, if there were no property owned by the party or their partner (for example, if the matrimonial home were owned by the trust)

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then there would be no other property of the relationship against which the value of the financial resource could be offset. Further, the FC does not have power to alter interests in a trust unless the trust's assets are held by the FC to be property of a party to a marriage (section 79(1)(a) FLA) as distinct from a financial resource.

14.5. A more detailed discussion of the provisions in the FLA regarding the duty of disclosure, specifically, full and frank disclosure in financial cases is beyond the scope of the paper. Suffice to say, a person who is a trustee or appointor or a beneficiary or a director or shareholder of a corporate trustee or appointor of a family trust or a director or shareholder of a corporate beneficiary is strongly recommended to obtain legal advice before filing any financial statement or producing or failing to produce any documents in financial case proceedings.

Conclusion

There is no guaranteed method of fireproofing the family trust from third party attack.

However, there are a series of strategies that should be adopted to minimise the risks of successful attack against a family trust which include:

- choosing your appointors carefully;
- choosing your directors carefully;
- ensuring unpaid present entitlements and loans are correctly recorded and managed;
- separating ownership of corporate trustees from their directorship (consider having a trust as shareholder or two shareholders, one of whom may be a director);
- incorporating rights and powers of the directors and shareholders in the constitution of the corporate trustee;
- trust ownership of corporate beneficiaries;
- limiting the width of classes of beneficiaries or capital beneficiaries;
- limiting distributions to persons who have not suffered or are not currently suffering from an event of disentitlement; and
- restricting distributions of capital by instead providing loans which are fully or partly secured by assets held in the name of the borrower beneficiaries.

If a partner seeks access to information through the FC and that information relates to the power of the FC to alter the interests of parties in property under section 79(1) (a) FLA then discovery or disclosure of the information will be ordered by the FC subject to the information being relevant to "the income, property and financial resources of each of the parties"[49].

However, section 79(2) FLA prevents a court from making any order altering property interests unless it is satisfied "it is just and equitable to make the order". Consequently, even though it is extremely difficult to prevent access to information in financial cases, this does not mean that trust assets can be attacked.

First, the FC must determine from the information disclosed whether trust assets constitute "property" of a party and if not, whether the trust assets constitute a financial resource of a party. If trust assets are neither property nor a financial resource then they cannot be attacked by a partner.

The issue of control is central to determining whether or not trust assets constitute property of a person under Commonwealth or State legislation. If a party is neither a trustee nor an appointor, nor a director of nor a shareholder in a corporate trustee or appointor then it is difficult to prove control.

Relevant factors would be whether the trustee or appointor is used to following the instructions of a party or whether the trustee or appointor holds their position pursuant to a bare trust arrangement. ***Pratt's*** case shows that even where there is a trust arrangement, access to trusts assets may still be prevented if, as in Pratt's case, there are a number of interposed entities between the asset sought to be attacked and the trust, especially where the trust assets are only shares in interposed companies which themselves hold the shares in the companies which own the property sought to be attacked.

[49] s 75(2) FLA

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In summary, there is a list of “don’ts” in structuring and administering the family trust including, do not permit a party to be the sole trustee or sole appointor of a trust or the sole primary beneficiary of a trust.

Otherwise, whether the structuring is successful in preventing third party ”attack” will depend upon the particular circumstances of the case. This, in turn, will depend upon the relative importance to the client of competing priorities such as asset protection, flexibility in administration, the degree of control which they wish to retain, for whose principal benefit the trust property is to be administered and, perhaps even, whether the key individual or any of the principal beneficiaries have entered into a binding financial agreement with their respective partner.

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