



# Asset Protection and the Discretionary Trust

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When trusts are spoken of in the context of asset protection one is usually referring to a trust created by deed of which the beneficiaries are of a nominated class in whose favour the trustee has a discretion to appoint income and property. The validity of a trust structure as a vehicle for asset protection is premised upon the "beneficiary" (the target for creditor claims) having no vested right in property capable of vesting in a trustee in bankruptcy and yet still being able to control the exercise of the trustee's powers through the power of appointment, that is the right to remove and appoint trustees.

What follows is an overview of the importance of correctly establishing the appointment powers of a Discretionary Trust.

## **Control over the Trustee and Asset Protection**

Central to the use of trusts as an asset protection vehicle, is that the beneficiary does not have any ability to exert control over the trustee and the transfer of property to such a trust. Correctly structured a Discretionary Trust should potentially place property beyond the reach of the transferee. Nevertheless without such power one must question how willing people would be to part with family assets.

If the donee holding the power of appointment of a discretionary trust in which the donee is, a mere object of appointment, holding, no vested interest in the income or property, of the trust, any ability of the donee to ultimately receive the benefit of the property is solely dependant upon the trustee's exercise of discretion in his or her favour. It is trust in the literal sense. Otherwise it is not an asset protection mechanism as opposed to a simple disposition of property.

## **Check the Trust Deed**

In determining the extent of a "beneficiary's" interest under a trust deed one should keep in mind the comments of the High Court in *CPT Custodian Pty Ltd .v Commissioner of State Revenue*. In particular the Court reminded parties that the trust deed should be the first port of call in considering the 'extent of a member' interest.

Justice French. of the Federal Court, as he then was, in *Australian Securities and Investments Commission; in the matter of Richstar Enterprises Pty Ltd (No.6)* had cause to consider and analyse the various types of discretionary trusts and the scope of beneficiaries' interest under trusts. In finding that the trustees were no more than the **alter ego of the relevant beneficiaries such**



**beneficiaries had a "contingent interest"**. His Honour held:

*"The difficulty with applying the notion of contingent interests to beneficiaries of a discretionary trust lies partly in the uncertain scope of the distribution be it income or capital, which may be made in favour of any given beneficiary. I am inclined to think that a beneficiary in such a case, at arm's length from the trustee, does not have a "contingent interest" but rather an expectancy or mere possibility of a distribution. In some discretionary trusts, and there is an example among those of which Mr Beck is a beneficiary, charities as a class are included in the class of beneficiaries. It could hardly be said that every charity in Australia has thereby acquired a contingent interest in that trust. On the other hand, where a discretionary trust is controlled by a trustee who is in truth the alter ego of a beneficiary, then at the very least a contingent interest may be identified because, to use the words of Nourse J, "it is as good as certain" that the beneficiary will receive the benefits of distributions either of income or capital or both... the beneficiary who effectively controls the trustee's power of selection because he is the trustee or one of them and/or has the power to appoint a new trustee has something approaching a general power and the ownership of the trust property."*

While this decision was in answer to an interlocutory application for the appointment of a receiver over assets of a series of trusts under s 1323 of the Corporations Act 2001 the conclusions reached by the

Court cannot be ignored. Indeed its conclusions are merely a reflection of the very reason people use trusts as an asset protection vehicle. However the decision appears to presume conduct on the part of a trustee whereas the High Court in CPT Custodians decision suggests we should in fact look to the terms of the trust. If this willingness to look through the trust structures is followed it may well spell the death knell of such structures in the future.

The decision in Richstar has been considered in a number of subsequent decisions.

#### **Family Law**

In Stephens & Stephens the Full Court of the Family Court, constituted by Bryant CJ and Finn & Warnick JJ, Bryant CJ held:

43. *These cases are in my view authority for the proposition that, at least on its face, and absent any other factors, a party who is the trustee of a discretionary trust, or has the capacity to appoint himself as trustee, and is also a beneficiary, or who has the capacity to become a beneficiary or become a majority shareholder in a company (who is or can become a beneficiary) can have the assets of the trust treated as if they are his or her own property. This has been the jurisprudence in the Family Court at least since Kelly & Kelly (No.2) (supra) was decided.*

44. *Were it otherwise, it is obvious that a party could, by simply acquiring or placing assets in a discretionary family trust, effectively avoid an order being made which would enable the other party to share*



in the property owned by the trust.

45. The jurisprudence on this issue is not limited to Family Court authority. In *Re Richstar Enterprises Pty Ltd & Ors; Australian Securities & Investments Commission v Carey and Ors (No.6)* [2006] FCA 814; (2007) 233 ALR 475; (2006) 153 FCR 509, French J had to consider whether the Court had power under s 1323 of the Corporations Act 2001 (Cth) to appoint a receiver to property held by a third party on a trust, whether discretionary or otherwise, of which the relevant person was a beneficiary.

46. French J noted (at page ALR 480) that in *Federal Commissioner of Taxation v Vegners* (1989) 90 ALR 547, Gummow J at page 552 described the power of the trustee in a discretionary trust as a "special or hybrid power" and said:

[A] power exercisable in favour of any person including the donee of the power would be a general power and thus would be tantamount to ownership of the property concerned...

The important matter to note in the context of this decision is that it was made in the Family Law jurisdiction. The express provisions of the Family Law Act 1975 have long permitted the Court to look beyond legal structure to ascertain the underlying beneficial entitlement to assets in the matrimonial context. In this regard it may not be apt in its application to more usual commercial settings. It is also interesting to note that French J relied upon these same family law principles to support his contentions while the Court in *Stephens* refers to French J's

decision. A certain degree of circularity is detected in this argument.

In *ASIC v Burnard* ASIC again, in reliance of French J's decision in *Richstar*, sought an injunction restraining dealing with assets of a trust. Barrett J distinguished the *Richstar* decision finding:

"It was submitted on behalf of ASIC that the several principles on these matters identified by French J should also be applied in this case. I do not consider this to be the correct approach. French J was called upon to decide whether positions occupied, rights enjoyed and powers exercisable by certain persons in relation to trust property were such as to give rise to interests of those persons in that property, so that those interests were themselves "property" of the persons in question, That is not the question before me in this part of the present case. To the extent that any such interests are enjoyed by Mr Burnard, they will be caught by Order 1, if it is made. The separate and different question posed by the application for Order 3 is whether the whole of the property of BDI, including in particular, the whole of the assets of each of the three trusts, is "property of" (or, where relevant, "money of") Mr **Burnard**.

72 That question, as it relates to the assets of the respective trusts, can conveniently be approached by inquiring whether trustee, has any beneficial interest in the trust assets. If such an interest does exist, then it cannot be said that all beneficial interests in the assets as a whole reside in Mr **Burnard** so that the assets as a whole are his property (or money)."



A concise analysis of the Richstar decision is found in the decision of White J in *Public Trustees v Smith*. In this case the Court again distinguished the application of Richstar finding that it involved an interpretation of s 1322 of the *Corporations Act 2001* which permitted (and required) an extended meaning to the concept of ownership of property. His Honour adopted a more orthodox approach to the existence of a beneficial entitlement under a trust holding.

*"In my view, on orthodox principles, neither the fact that Dr Ward was in a position to control the exercise of the trustee's powers, and was in any event entitled to remove the trustee and appoint a new trustee, nor the fact that she could cause the trustee to appoint the income or capital of the trust to herself, would mean that she was the beneficial owner of the trust property prior to causing the trustee to appoint the property to herself. Even a donee of a general power of appointment is not the beneficial owner of the property prior to the exercise of the power, although for many purposes such a donee will be treated as if he or she were the beneficial owner."*

His Honour went on to hold:

*"French J did not say that it followed from the defendants' positions as beneficiaries of discretionary trusts and their control of the trustees that this amounted to actual ownership as distinct from "effective ownership". As with the reference to "db facto ownership" I take the phrase "effective ownership" to mean that the defendants had such control of the affairs of the trust that they were in as good*

*a position as if they were the beneficial owners, but not to mean that they were the beneficial owners of the trust property. In my view, there is very sound reason for construing the expression in s 1323(1)(h)(i) "an order appointing a receiver or trustee of the property of [the relevant person]" as extending not only to property actually owned by the relevant person but property effectively owned by him or her, for the same reasons as discussed in the family law cases concerning s 79 of the Family Law Act. However, I do not understand ASIC v Carey (No. 6) to establish that because a beneficiary of a discretionary trust controls the appointment or removal of the trustee, or controls the exercise of the trustee's powers and can appoint trust property to himself or herself; that the holder of such a power is the beneficial owner of the trust property irrespective of the terms of the trust deed. In the construction of statutory powers such trust property might be regarded as the property "of" such a person (depending of course upon the statute in question) if something short of ownership provides the necessary connection between the person and the property denoted by the word "of".'*

For all of the concerns expressed as to the potential implications of Richstar it is suggested that the analysis undertaken by White J is the preferable one. His Honour restricted the application of the Richstar decision to cases under s 1322 of the *Corporations Act 2001*. While His Honour Justice French has since been elevated to the role of Chief Justice of the High



Court it would be surprising to see that Court adopt a broader approach to trust law beyond that analysis undertaken by White J.

#### **Where to from Here**

Discretionary Trusts should not be structured whereby the appointer who is also a beneficiary potentially controls the Trustee. Following the decision of Richstar all Discretionary Trusts should be reviewed. Nevertheless as noted in last week's Strategy Update in ant Asset Protection strategy - Timing and Intent is paramount. In this respect advice should be sought before establishing or restructuring a Discretionary Trust for Asset Protection.

Furthermore the issues covered in this Strategy Update are covered in depth in ili's next Seminar, Preservation, Succession and Retirement Strategies for Business Owners in Tough Times to be held on 5 March 2009. To register for the ili Preservation, Succession and Retirement Strategies for Business Owners in Tough Times Seminar please visit

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