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Certain details have been omitted, however, the author acknowledges the contribution of the staff from his prior employer as well as the responsible partner (whose details may be found in the December 2014 paper).

Trusts, powers and default appointment clauses

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Trusts, powers and default appointment clauses

1 Overview

- 1.1 Is a default appointment clause required to have a valid discretionary trust?
- 1.2 This question is subject to differing views, that depends on the interpretation adopted of certain case law as well as the practical considerations of utilising a default appointment clause. It is important to differentiate between the nature and type of power available to a trustee when considering the requirement to have certainty of object for a discretionary trust and the effect it has on the use of default appointment clauses.
- 1.3 This is fundamental to ensure that a trust is valid from a certainty of object perspective and is useful when varying the trust deed either significantly or for administrative reasons.
- 1.4 This paper provides a practical overview of trusts, powers and default appointment clauses and goes on to examine the underlying case law to conclude with practical considerations when dealing with trusts, powers and default appointment clauses. Specifically, whether a default appointment is required depends on the types of trust or power bestowed on the trustee.

2 Introduction

- 2.1 Before considering whether a discretionary trust requires a default appointment clause, it is appropriate to make some general comments regarding discretionary trusts.
- 2.2 The common features of a discretionary trust include:
 - (a) the person who establishes the trust, otherwise known as the settlor;
 - (b) a trustee, who holds the trust property and administers the trust property for the benefit of the beneficiaries of the trust;
 - (c) an appointor or principal, who is the entity that has power to appoint and remove trustees of the trust, and therefore has the ultimate control of the trust. In some older trust deeds, it is common to have a guardian. This is a remnant of the death duties era and was a role that ensured that a trust was ultimately administered for a particular class of beneficiaries but not sufficient to be taxed under that regime;
 - (d) a range of beneficiaries or objects (to whom the trustee may have the discretion to distribute trust income or capital);
 - (e) the term of the trust (in all Australian States excluding South Australia the rule against perpetuities prevents a trust (other than a superannuation fund trust and charitable trust) from existing longer than 80 years. Normally the trust instrument specifies a date on which the trust must be wound up);
 - (f) governing rules, typically found in a trust deed, or will which will include the powers available to the trustee and appointor/principal; and

- (g) trust property.
- 2.3 Of the above features, a discretionary trust requires certainty in relation to three of them being:¹
- (a) certainty of intention (i.e. the settlor intended to create a trust over their property);
 - (b) certainty of subject matter (i.e. the property of the trust must be specified with certainty); and
 - (c) certainty of object (i.e. the beneficiaries or objects of the trust must be sufficiently identifiable).
- 2.4 Failure to have adequate certainty as to any of the listed features at paragraph 2.3 may result in a resulting trust being established to hold the trust property for the benefit of the settlor² and having the trust fund taxed at the settlor's tax rate.³

3 Default appointment clauses generally

- 3.1 As a general statement, discretionary trusts provide the trustee with the discretion to determine which beneficiaries may be entitled to the income or capital of the trust fund.
- 3.2 In addition, and in the alternative, they also provide the trustee the power to accumulate income and apply it to the capital of the trust fund for future distribution.
- 3.3 Common clauses found in a standard discretionary trust deed include:
- (a) clauses giving the trustee the power to either accumulate any income of the trust to form part of the capital of the trust fund or distribute any income of the trust to a particular class of beneficiaries;
 - (b) a clause giving the trustee the power to hold the assets of the trust for the benefit of a particular class of people and upon vesting, the power to decide who from that class may be entitled to the capital of the trust; and
 - (c) clauses that operate should the trustee fail to exercise their discretion to either distribute or accumulate the income, or distribute the capital upon the trust vesting.
- 3.4 The latter are referred to as default appointment clauses as they operate on the default or failure to make an appropriate appointment under the general clauses mentioned in paragraph 3.3. These clauses usually operate such that a smaller class of beneficiaries or named beneficiaries are entitled to the income or capital in the absence of a decision made by the trustee.
- 3.5 A few examples often cited in support of the need for such clauses are:
- (a) to ensure that the trustee is not taxed on the income of the trust at the marginal rate for any accumulation under section 99A *Income Tax Assessment Act 1936* (Cth) (**ITAA 1936**);
 - (b) for default capital appointments to assist in ensuring dispositions would not breach the rule of perpetuities – being 80 years from the date of creation of the trust;⁴ and

¹ *Knight v Knight* (1840) 3 BEAV 148, 160.

² *In Re Sayer* (1957) Ch 423, 436.

³ *Income Tax Assessment Act 1936* (Cth) s 102.

- (c) finally, the failure to have adequate provisions in the trust instrument may result in income of the trust fund neither being distributed nor accumulated and ultimately held under a resulting trust in favour of the settlor⁵ or their estate and being taxed according to section 102 ITAA 1936.

4 Powers of appointment

4.1 Described by Lord Jessel M.R. in *Freme v Clement*,⁶ a power of appointment:

' is a power of disposition given to a person over property not his own by some one who directs the mode in which that power shall be exercised by a particular instrument.'

4.2 Its relevance in the context of a trust is that a power of appointment may dictate how the trust fund may be exercised (or disposed of) by a trustee in favour of a range of objects and should be differentiated from administrative powers that a trustee may possess such as the power to insure, mortgage or invest trust property.

4.3 There are various types of powers of appointment which a trustee may have when disposing a property in favour of a class of objects such as:

- (a) a general power of appointment (i.e. a power allowing the trustee to distribute to any person it chooses (including themselves));
- (b) a specific or special power of appointment (i.e. a power allowing the trustee to distribute to an ascertainable class of persons such that it is possible to decide whether an individual forms part of the class or not); and
- (c) a hybrid power of appointment (i.e. a power allowing the trustee to distribute to any person apart from those included in an excluded class).

4.4 It is important to distinguish between the three powers of appointment as a trustee of a discretionary trust is generally only ever able to utilise a special or hybrid power of appointment (unless it is a trustee of a testamentary trust in which case they may exercise a general power of appointment but not a hybrid power of appointment)⁷. This is often due to restrictions imposed on the trustee limiting their ability to benefit the settlor as well as adverse tax consequences explained above.

5 Mere powers and trust powers

5.1 As the trustee of a trust will generally yield a special or hybrid power of appointment (unless it is a trustee of a testamentary discretionary trust), it is important to appreciate that the nature of these powers of appointment can be further categorised as either 'mere' (or bare) powers or trust powers.

⁴ *Perpetuities and Accumulations Act 1985* (ACT) s 8(1); *Law of Property Act 2000* (NT) s 187, *Property Law Act 1974* (Qld) s 209, *Perpetuities and Accumulations Act 1992* (Tas) s 6, *Perpetuities and Accumulations Act 1968* (Vic) s 5; *Property Law Act 1969* (WA) s 101. That said, the respective State's legislation provides for a 'wait-and see' rule should there be no default capital clause and the capital beneficiaries are uncertain. *Perpetuities and Accumulations Act 1985* (ACT) s 9; *Law of Property Act 2000* (NT) s190, *Property Law Act 1974* (Qld) s210, *Perpetuities and Accumulations Act 1992* (Tas) s 9, *Perpetuities and Accumulations Act 1968* (Vic) s6; *Property Law Act 1969* (WA) s103. South Australia is the only state where the perpetuity period has been abolished.

⁵ *In Re Sayer*.

⁶ *Freme v Clement* (1881) 18 Ch D 499, 504.

⁷ *Tatham v Huxtable* (1950) 81 CLR 639; *Horan v James* (1982) 2 NSWLR 376 but note that some Australian jurisdictions have overcome this restriction.

- 5.2 The difference between the two powers was described by the Right Honourable Sir George Farwell in *A Concise Treatise on Powers*⁸ by referencing Lord Eldon's judgment in *Brown v Higgs*⁹

'Where there is a mere power of disposing and it is not executed, the court cannot execute it; but wherever a trust is created and the execution of that trust fails by the death of the trustee or by accident, the court will execute the trust. But there are not only a mere trust and a mere power, but there is also known to the court a power which the party to whom it is given is intrusted and required to execute; and with regard to that species of power, the court considers it as partaking so much of the nature and qualities of a trust, that if the person who has that duty imposed on him does not discharge it, the court will to a certain extent discharge the duty in his room and place. The principle is that if the power is one which is the duty of the donee to execute, made his duty by the requisition of the will, put upon him as such by the testator, who has given him an interest extensive enough to enable him to discharge it, he is a trustee for the exercise of the power, and has not a discretion whether he will exercise it or not. The court adopts the principle as to trusts, and will not permit his negligence, accident or other circumstances to disappoint the interests of those for whose benefit he is called upon to execute it.'

- 5.3 The above judgment is summarised by stating that mere powers may or may not be exercised, whilst a trust power must be exercised if not by the trustee then by the court, or a trustee appointed by the court.
- 5.4 The rationale behind this is that trust powers look to the initial intentions of the settlor, that a class of objects may benefit from the trust, and that the trustee of a trust should be entrusted to distribute the benefits among the said class, subject to the terms of the settlement.¹⁰
- 5.5 The practical difference, however, between a 'mere' discretionary power and a discretionary trust power is minimal as the objects to both powers:
- (a) only have a 'mere expectancy' to receive any of the trust fund¹¹ and cannot force a trustee to distribute trust funds in their favour, subject to the rule of equity *Saunders v Vautier*,¹² and
 - (b) can only compel the trustee to properly administer the trust (i.e. right of due administration) as found in the matter of *Gartside v Inland Revenue Commissioners*.¹³ In that case, the court held that '[n]o object of a discretionary trust has, as such, any legal right to or in the capital. His sole interest, if it be an "interest" within the scope of these provisions is with regard to the income: he can require the trustees to exercise, in bona fide, their discretion as to how it shall be distributed, and he can take and enjoy whatever part of the income the trustees choose to give him. I cannot see any ground for holding that he can have any "interest" in the capital if he has no interest in the income.'

6 Tests of certainty

- 6.1 Historically there was a need to clearly identify the nature of a power (due to the differing application of tests of certainty regarding the class of objects of the relevant power). Given *Re*

⁸ C. J. W. Farwell assisted by F. K. Archer, *A Concise Treatise on Powers* (Stevens & Sons 3rd ed 1916)

⁹ *Brown v Higgs* 8 Ves.Jr. 561

¹⁰ *In Re Weekes' Settlement* (1897) 1 Ch 289

¹¹ *Pearson v Inland Revenue Commissioner* (1981) AC 753

¹² *Saunders v Vautier* (1841) EWHC Ch J82

¹³ *Gartside v Inland Revenue Commissioners* (1986) AC 553 at 606

*Gulbenkian's Settlement Trusts*¹⁴ (**Gulbenkian**) and *McPhail v Doulton*¹⁵ (**Re Baden**), the relevant certainty tests have now aligned for both mere and trust powers.

'Mere' powers

- 6.2 As stated already, a mere power is a power which the trustee may apply at its discretion, but is not required to exercise it.
- 6.3 In the case of *Gulbenkian*, the Court considered the relevant powers for a trust established in 1927 by Mr Calouste Sarkis Gulbenkian for the benefit of his son, Nubar Sarkis Gulbenkian.
- 6.4 The question posed to the Court was whether the following powers under the trust deed was void for uncertainty:

2(i) *The trustees shall during the life of the said Nubar Sarkis Gulbenkian at their absolute discretion pay all or any part of the income of the property hereby settled and the investments for the time being representing the same (hereinafter called the trust fund) to or apply the same for the maintenance and personal support or benefit of all or any one or more to the exclusion of the other or others of the following persons namely the said Nubar Sarkis Gulbenkian and any wife and his children or remoter issue for the time being in existence whether minors or adults and any persons or persons in whose house or apartments or in whose company or under whose care or control or by or with whom the said Nubar Sarkis Gulbenkian may from time to time by employed or residing and the other persons or person other than the settlor for the time being entitled or interested whether absolutely contingently or otherwise to or in the trust fund under the trusts herein contained to take effect after the death of the said Nubar Sarkis Gulbenkian in such proportions and manner as the trustees shall in their absolute discretion at any time or times think proper.*

2(ii) *Subject to the discretionary trust or power hereinbefore contained the trustees shall during the life of the said Nubar Sarkis Gulbenkian hold the said income or so much thereof as shall not be paid or applied under such discretionary trust or power upon the trustee and for the purposes for which the said income would for the time being be held if the said Nubar Sarkis Gulbenkian were then dead*.¹⁶

- 6.5 Importantly, the Court noted that clause 2(i) of the trust deed was '*not a trust power...In so far as the power is not exercised by the trustees or if it is void for uncertainty, the income falls to be held upon the trusts declared by clause 2(ii)*'.¹⁷
- 6.6 In this regard, *Gulbenkian* was a case relating to the certainty of a 'mere' power as opposed to a trust power but is still important in determining the relevant test to apply when considering whether a mere power is void for uncertainty.
- 6.7 There was a default appointment clause which was not quoted in the case but which their Lordships considered in their judgment.
- 6.8 It was argued that the power at paragraph 2(i) of the judgment would be void for uncertainty if it was not possible to compile a list of the potential beneficiaries at the time the power failed to be exercised. This followed the reasoning in a recent line of cases at the time, the most prominent being *Inland Revenue Commissioners v Broadway Cottages Trust*¹⁸ (**Broadway Cottages Trust**), stating a trust power for income to be invalid for certainty (such that a court would not

¹⁴ *Gulbenkian's Settlement Trusts* (1970) AC 508

¹⁵ *McPhail v Doulton* (1971) AC 424

¹⁶ (1970) AC 508 520

¹⁷ (1970) AC 508 521

¹⁸ (1955) Ch. 20

be able to enforce it) *'unless the whole range of objects eligible for selection is ascertained or capable of ascertainment'*.¹⁹

6.9 This 'list certainty' approach was rejected in relation to mere powers in *Gulbenkian* and replaced with the 'criterion certainty' approach.

6.10 Lord Reid held that:

*'If the classes of beneficiaries are not defined with sufficient particularity to enable the court to determine whether a particular person is or is not on the facts at a particular time, within one of the classes of beneficiaries, then the power must be bad for uncertainty. If the donee of the power (whether or not he has any duty) desires to exercise it in favour of a particular person it must be possible to determine whether that particular person is or is not within the class of objects of the power. And it must be possible to determine the validity of the power immediately it comes into operation. It cannot be valid if the person whom the donee happens to choose is clearly within the objects but void if it is doubtful whether that is so. So if one can reasonably envisage cases where the court could not determine the question the power must be bad for uncertainty.'*²⁰

6.11 Similarly, Lord Upjohn (Lords Hodson and Guest concurring) held that:

*'It is curious that there is no long line of decided case to what is the proper test to apply when considering the validity of a mere power when the class of possible appointees is or may be incapable of ascertainment, but there is a body of recent authority to the effect that the rule is, that provided there is a valid gift over or trust in default of appointment (which was fundamental to the decision of Clauson J. in *In re Park* [1932] 1 Ch. 580), a mere or bare power of appointment among a class is valid if you can with certainty say whether any given individual is or is not a member of the class; you do not have to be able to ascertain every member of the class.'*²¹

6.12 Lord Upjohn undertook an analysis of the clause in the context of the settlor's intention before construing clause 2(i) after the words *'the said Nubar Sarkis Gulbenkian and any wife and his children or remoter issue for the time being in existence whether minors or adults'* (imperfectly as he admitted, but sufficient for the purposes of the decision) to read as follows:

*'and any person or persons by whom the son may from time to time be employed and any person or persons with whom the son from time to time is residing whether in the house or apartments of such person or persons or whether in the company or under the care or control of such person or persons.'*²²

6.13 His Lordship consequently held the above clause was certain enough for a court to enforce but noted ambiguous terms that may cause difficulty in its' interpretation but commented that *'[i]f the trustees feel difficulty or even doubt upon the point the Court of Chancery is available to solve it for them'*.

Trust powers

6.14 Prior to *Re Baden*, a line of English cases supported a 'list certainty' approach in determining whether a trust power was void for uncertainty.²³

¹⁹ *Ibid* at 35 and 36

²⁰ (1970) AC 508, 518

²¹ (1970) AC 508, 521

²² *Ibid* at 522

²³ (1995) Ch. 20

- 6.15 Gulbenkian rejected the 'list certainty' test in favour of a criterion certainty for mere powers before *Re Baden* subsequently adopted the criterion certainty test for trust powers.
- 6.16 In a narrow judgment, Lord Wilberforce with whom Viscount Dilhorne and Lord Reid assented (Lord Hodson and Lord Guest dissenting) held that the test applied to mere powers in *Gulbenkian* should apply to trust powers, being that, the trust will be valid if it could be said with certainty that any given individual was or was not a member of the class.
- 6.17 The issue for the Court in *Re Baden* related to the establishment of a fund with which the trust powers contained within were argued to be void for uncertainty.
- 6.18 The relevant trust clauses for the Court's consideration were as follows:

'9 (a) The trustees shall apply the net income of the fund in making at their absolute discretion grants to or for the benefit of any of the officers and employees or ex-officers or ex-employees of the company or to any relatives or dependants of any such persons in such amounts at such times and on such conditions (if any) as they think fit and any such grant may at their discretion be made by payment to the beneficiary or to any institution or person to be applied for his or her benefit and in the latter case the trustees shall be under no obligation to see to the application of the money.

(b) The trustees shall not be bound to exhaust the income of any year or other period in making such grants as aforesaid and any income not so applied shall be dealt with as provided by clause 6 (a) hereof. [Clause 6. (a) All moneys in the hands of the trustees and not required for the immediate service of the fund may be placed in a deposit or current account with any bank or banking house in the name of the trustees or may be invested as hereinafter provided.]

(c) The trustees may realise any investments representing accumulations of income and apply the proceeds as though the same were income of the fund and may also (but only with the consent of all the trustees) at any time prior to the liquidation of the fund realise any other part of the capital of the fund which in the opinion of the trustees it is desirable to realise in order to provide benefits for which the current income of the fund is insufficient.¹⁰

All benefits being at the absolute discretion of the trustees, no person shall have any right title or interest in the fund otherwise than pursuant to the exercise of such discretion, and nothing herein contained shall prejudice the right of the company to determine the employment of any officer or employee.¹²⁴

- 6.19 In particular, the Court unanimously held that clause 9(a) of the trust deed constituted a trust power but disagreed on which test should apply to determine whether the trust power was sufficiently certain.
- 6.20 In his dissenting judgment, Lord Hodson emphasised the difference between a trust and mere power and therefore different treatments that should apply between the two types of powers:
- 'In my opinion a mere power is a different animal from a trust and the test of certainty in the case of trusts which stems from *Morice v Bishop of Durham*, 10 Ves.Jr. 522 is valid and should not readily yield to the test which is sufficient in the case of mere power.¹²⁵*
- 6.21 That is, the test of certainty for trust powers should remain as decided in *Broadway Cottages Trust*, being the ascertainment of the whole range of objects of the trust, rather than adopting the *Gulbenkian's* argument for trust powers.

²⁴ (1971) AC 424, 428

²⁵ (1971) AC 424, 442

- 6.22 In contrast, Lord Wilberforce considered the decision in *Broadway Cottages Trust* and disagreed with the list certainty approach:

*'So I think that we are free to review the Broadway Cottages case (1955) Ch. 20. The conclusion which I would reach, implicit in the previous discussion, is that the wide distinction between the validity test for powers and that for trust powers is unfortunate and wrong, that the rule recently fastened upon the courts by Inland Revenue Commissioners v. Broadway Cottages Trust ought to be discarded, and that the test for the validity of trust powers ought to be similar to that accepted by this House in In re Gulbenkian's Settlements (1970) A.C. 508 for powers, namely, that the trust is valid if it can be said with certainty that any given individual is or is not a member of the class.'*²⁶

- 6.23 In reaching their respective opinions, Lords Hodson, Guest and Wilberforce considered the effect of the test of certainty for trust powers in circumstances when a court would be required to enforce the trust power due to the failure of a trustee to exercise the power.

7 Enforcing a trust power

- 7.1 The key difference between a mere power and a trust power in relation to a discretionary power is the ability of a court to enforce the trust power if a trustee fails to exercise their discretion.

- 7.2 This was reiterated by the judgments of Lords Hodson, Guest and Wilberforce and formed the basis of their respective arguments as to what test of certainty should apply for trust powers. That is, if a trustee has not exercised their discretion with a trust power, the court must be able to ascertain how to exercise the trust power with clear certainty.

- 7.3 The two views submitted to ascertain whether a trust power has not been exercised were as follows:

- (a) the court must be able to ascertain all the objects of the power so that it can make an equal distribution to each object of the trust; or
- (b) the court must be able to distribute in accordance with the settlor's intention and is not required to ascertain all the objects but rather the objects which the settlor intended to benefit.

- 7.4 Lord Hodson asserted that:

'in applying the principal that where there is a trust the court must be in a position to exercise it, the court cannot exercise the trustees' discretion in the event of their failing to do so. The discretion being conferred on and exercisable by the trustees alone, the court cannot do other than authorise a distribution in equal shares. This, in cases comparable with the present, must lead to a result tending towards absurdity and makes the strict test of certainty open to serious criticism. This disability of the courts to exercise the discretion reposed in trustees was referred to in the recitation of the argument for the Crown in the judgment of the court in the Broadway Cottages Trust case [1955] Ch. 20, 30...In what are called the relations cases...the court did exercise its own discretionary judgment against equal division...These cases may be explained as cases where there were indications which acted as pointers or guides to the trustees and enabled the court to substitute its own discretion for that of the trustees. This practice, however, has fallen into desuetude and the modern, less flexible, practice has, it appears, been followed since 1801, when Sir Richard Arden M.R. in Kemp v. Kemp (1801) 5 Ves.Jr. 849 stated that the court now disclaims the right to execute a power and gives the fund equally. The basis of this change of policy appears to be that the court has not the same freedom of action as a trustee and must

²⁶ Ibid at 456

*act judicially according to some principle or rule and not make a selection giving no reason as the trustees can. The court, it is said, is driven in the end to the principle that equity is equality unless, as in the relations cases, the court finds something to aid it. Where there is no guide given the court, it is said, has no right to substitute its own discretion for that of the designated trustees.*²⁷

- 7.5 Lord Guest largely followed Lord Hodson's reasoning but further commented that '*trusts of the nature of the present [i.e. the trust in Re Baden Case] (own emphasis) should be saved, if possible...but if this is desirable the remedy is by legislation and not by judicial reform.*'²⁸
- 7.6 In contrast, Lord Wilberforce argued against the requirement for a court to exercise a trust power by equal division:
- 'As a matter of reason, to hold that a principle of equal division applies to trusts such as the present is certainly paradoxical. Equal division is surely the last thing the settlor ever intended: equal division among all may, probably would, produce a result beneficial to none. Why suppose that the court would lend itself to a whimsical execution? And as regard authority, I do not find that the nature of the trust, and of the court's powers over trusts, calls for any such rigid rule. Equal division may be sensible and has been decreed, in cases of family trusts, for a limited class; here there is life in the maxim "equality is equity," but the cases provide numerous examples where this has not been so, and a different type of execution has been ordered, appropriate to the circumstances.*'²⁹
- 7.7 His Lordship then listed various cases where a court executed a trust power disproportionately:³⁰
- (a) *Mosely v Mosely* – the court assumed power ...to nominate from the sons of a named person as it should think fit and most worthy and hopefully, the testator's intention being that the estate should not be divided;
 - (b) *Clarke v Turner* - on a discretionary trust for relations, the court decreed conveyance to the heir-at-law judging it "most reputable for the family that the heir-at-law should have it";
 - (c) *Warburton v Warburton* – on a discretionary trust to distribute between a number of the testator's children, the House of Lords affirmed a decree of Lord Keeper Wright that the eldest son and heir...should have a double share, the court exercising its own discretionary judgment against equal division; and
 - (d) *Richardson v Chapman* - there was a discretionary trust of the testator's "options" (namely, rights of named or specified persons, including present and former chaplains and other domestics; also "my worthy friends and acquaintance, particularly the Reverend Dr. Richardson of Cambridge." The House of Lords...ordered the trustees to present Dr. Richardson as the most suitable person.
- 7.8 Of the above cases, Lord Wilberforce commented that '*the court can in a suitable case execute a discretionary trust according to the perceived intention of the truster.*'³¹
- 7.9 In addition, his Lordship noted that it was interesting that the words 'my worthy friends and acquaintance' was not found to void a trust due to uncertainty in *Richardson v Chapman*.

²⁷ (1971) AC 424, 442 and 443

²⁸ Ibid 446

²⁹ Ibid 451

³⁰ Ibid 451

³¹ Ibid 451

- 7.10 That said, Lord Wilberforce did note the stricter approach enforced in the case of *Kemp v Kemp* but argued that that he 'did not think that this change of attitude, or practice, affects the principle that a discretionary trust can, in a suitable case, be executed according to its merits and otherwise than by equal division'.³²
- 7.11 His Lordship, after considering the arguments in *Broadway Cottages Trust* and *Gulbenkian*, reiterated that 'in the case of a trust power, if the trustees do not exercise it, the court will and commenting that 'if called upon to execute the trust power, [the court] will do so in the manner best calculated to give effect to the settlor's or testator's intentions'.³³
- 7.12 The key aspect of Lord Wilberforce's analysis is that a court will exercise a trust power (when a trustee has failed to exercise it) to reflect the intentions of the settlor which may range from an equal distribution to disproportional distributions.

8 Australian cases

- 8.1 *Re Baden* and *Gulbenkian* were English law cases, and in the absence of any cases in Australia dealing with the issues above, would be influential in cases dealing with certainty of objects in Australia. In this regard, the Australian courts adopted a similar approach as the English courts prior to *Re Baden* in relation to trust powers. That is, list certainty would be required to have a valid trust power.³⁴ Since *Re Gillespie*,³⁵ however, cases suggested the courts have adopted the criterion certainty approach from *Re Baden*.
- 8.2 This shift in approach first appeared in the dissenting judgments of Brennan, Dawson and McHugh JJ in *Registrar of the Accident Compensation Tribunal v Commissioner of Taxation (Commonwealth)*.³⁶
- 8.3 Although their Honours accepted the view that the failure to exercise a trust power would result in each object obtaining an equal share in the benefit,³⁷ they recognised other potential avenues that the court may undertake where a trustee failed to exercise a trust power. These included:
- (a) appointing a new trustee; and
 - (b) the court determining the appropriate distributions,³⁸
- which appreciated Lord Wilberforce's comments in *Re Baden*.
- 8.4 The subsequent cases of *Horan v James*,³⁹ *Re Blyth*⁴⁰ and *West v Westor*⁴¹ suggested acceptance of the *Re Baden* principles by State Courts, subject to any rejection from the High Court.
- 8.5 Although the issue in *Horan v James* was whether a trust power of appointment of hybrid nature in a will was valid, their Honours commented that the relevant hybrid trust power was not void for uncertainty whilst applying the criterion certainty test from *Re Baden*.⁴² Referring to Mahoney J.A.'s judgment in *Horan v James*, Justice Thomas (in *Re Blyth*) applied the criterion certainty test

³² Ibid 452

³³ Ibid 457

³⁴ *Re Gillespie (dec'd)* (1965) VR 402

³⁵ (1965) VR 402

³⁶ (1993) HCA 1

³⁷ Ibid 183

³⁸ Ibid

³⁹ (1982) 2 NSWLR 376

⁴⁰ (1997) 2 Qd R 567

⁴¹ (1998) 44 NSWLR 657

⁴² Ibid 37 at 382

from *Re Baden* to hold that a special power of appointment in the nature of a trust was sufficiently certain.⁴³ It is important to note that *Horan v James* and *Re Blyth* dealt with discretionary trust powers and therefore the acceptance of the criterion certainty test from *Re Baden* from English law was of logical sense.

- 8.6 In contrast, the acknowledgment of a modified *Re Baden* test in the case of a fixed trust in *West v Weston*, supports the idea that even fixed trust powers may be exercised by courts when all objects are not identifiable. In that case, Justice Young had to consider the validity of a fixed trust where the objects of the trust were consistently increasing as they were being identified. The relevant clause in question was as follows:

I GIVE to my Trustee the residue of my real and personal estate...upon the following further trusts...

(b) To divide the balance then remaining equally (per capita) amongst such of the issue living at my death of my four grandparents, THOMAS CASTLES, MARY CASTLES nee WEBB, JOHN ALBERT COGHLAN and ANNIE COGHLAN nee CARR as attain the age of twenty-one (21) years.

- 8.7 The executor had initially identified 1,385 potential beneficiaries (which the help of a genealogist and historical researcher) before the number of beneficiaries increased to 1,675. The issue was whether that the fixed trust established was void for uncertainty – which would have been the case if ‘list certainty’ applied as there may have been additional beneficiaries not yet identified. Justice Young acknowledged that although *Re Baden* did not relate to the relaxation of list certainty required for fixed trusts, his Honour found it justifiable that there should be some relaxation in relation to list certainty such that:

‘The rule [list certainty] will be satisfied if, within a reasonable time after the gift comes into effect, the court can be satisfied on the balance of probabilities that the substantial majority of the beneficiaries have been ascertained and that no reasonable inquiries could be made which would improve the situation.’⁴⁴

- 8.8 Although his Honour relaxed the requirement for certainty in relation to fixed trusts, it should be noted that a fixed trust will still fail if the objects are defined by uncertain concepts (in *West v Weston*, Justice Young was able to quantify the ‘issue’ concept), but that it would not fail simply if there are doubts as to whether an object meets the criteria.⁴⁵

- 8.9 The driving theme from the above Australian cases is such that a trust power can be enforced by Australian courts, even where all beneficiaries are unable to be ascertained. In enforcing a trust power, the courts will consider whether replacing the trustee of the trust power is acceptable as well as other methods in determining the appropriate distribution.

- 8.10 That said, while there has been a relaxation in what is required to have certainty of objects for discretionary trusts, trusts powers may still fail the criterion certainty test if:

- (a) identifying the beneficiaries is administratively unworkable;⁴⁶ or
- (b) the class of beneficiaries has been selected capriciously by the settlor.⁴⁷

⁴³ Ibid 38 at 576

⁴⁴ (1998) 44 NSWLR 657, 664.

⁴⁵ Peter Creighton, Senior Lecturer, Law School, University of Western Australia ‘*The Certainty of Objects of Trusts and Powers: The Impact of McPhail v Doulton in Australia*’ (2000) 22(1) Syd LR 93, 98.

⁴⁶ (1971) AC 424 per Wilberforce J where the beneficiaries do not constitute a coherent class and *R v District Auditor, ex parte West Yorkshire Metropolitan County Council* (1986) RVR 24 where the beneficiaries are too numerous to have their claims properly considered.

⁴⁷ Ibid 45 at 104

9 The case for default appointment clauses

- 9.1 The argument for having a default appointment clause in a discretionary trust is based on the notion that in relation to a discretionary specific or hybrid power, there is potentially no trust at all. This stems from the fact that a trustee would be able to have the full discretion (subject to the rule in *Saunders v Vautier*) to determine which beneficiaries may be entitled to the trust income or fund and therefore none of the objects are truly entitled to the trust fund such that they can force a trustee to make a distribution. In this regard, it is important to note that this argument can be distinguished between the use of a discretionary mere power and a discretionary trust power.
- 9.2 That is, does the trustee have the power to make a discretionary distribution to a class of objects or is the trustee obliged to make a distribution with the discretion to select the intended beneficiary within a class of objects?
- 9.3 In the case of a discretionary mere power, no beneficiary from the class of objects would be able to force the trustee to make the distribution, nor would a Court as the power would be a 'mere' power.
- 9.4 In this situation, the income or capital of a trust fund would be at risk of falling on a resulting trust for the benefit of the settlor as there was no trust at all, as there would have only been a 'mere' power to deal with the income or capital.
- 9.5 The use of a default appointment clause in this situation would therefore ensure that the failure to exercise the 'mere' power would result in the income or capital of the trust automatically falling on trust for the default income or capital beneficiaries.
- 9.6 A historical case which highlights the effect of a trust power over a mere power is *In re Park*,⁴⁸ which was relied on by the Court in *Gulbenkian*. In that case, a testator gave his residuary estate to his trustees on trust to:
- 'pay the income thereof to any person, "other than herself," or persons or charitable institution or institutions, and in such shares and proportions as his sister, J.A., should from time to time during her lifetime direct in writing, and from and after her decease in trust as to both capital and income for the Imperial Merchant Service Guild for the benefit of their stress fund absolutely.*⁴⁹
- 9.7 The 'mere' discretionary power in this case was with the deceased's sister, Jane Armstrong, to distribute as she may dictate. The default appointment clause, and trust power in this case was for the benefit of the Imperial Merchant Service Guild if Jane Armstrong did not exercise her discretion or if she had passed away. This was noted by Justice Clauson, as if *'there was no such direction [from Jane Armstrong] the charitable gift to the stress fund of the Imperial Merchant Service Guild will operate.*⁵⁰ A similar default appointment clause was discussed in *Gulbenkian* at paragraph 6.5.

10 The case against default appointment clauses

- 10.1 In contrast, where there appears to be a valid discretionary trust power in place, it would be unnecessary to have a default appointment clause.

⁴⁸ *In Re Park; Public Trustee v Armstrong* (1932) 1 Ch. 580

⁴⁹ *Ibid* 580

⁵⁰ *Ibid* 583

- 10.2 This follows the underlying reasoning of Lord Wilberforce in *Re Baden* being the notion that a court will try to execute the intentions of a settlor.⁵¹
- 10.3 That is, with a valid trust power, a court will be able to execute the intentions of a settlor and there would be no risk of a resulting trust arising in favour of the settlor and there would be no need to have a default appointment clause.
- 10.4 That said, the inclusion of a default appointment clause (in a situation where there is a valid discretionary trust power) may influence what the intentions of the settlor are in relation to trust property such that the initial discretionary power is considered a 'mere' power by the court as inclusion of the default appointment clause suggests that the settlor acknowledged the scenario where trustee may not in fact exercise their initial discretionary power to distribute trust property to beneficiaries.
- 10.5 Although referenced in the dissenting judgements by Lords Hodson and Guest in *Re Baden* (as discussed in paragraphs 7.4 and 7.5 above) that it would not be possible to have a valid trust power where the entire class of beneficiaries were unascertainable as it would not be possible for the Court to subsequently enforce the trust power by acting on the principle that equality is equity,⁵² the majority judgment in *Re Baden* as well as subsequent Australian cases discussed above, suggests that a trust power does not require a trust power to be fixed in nature in that all the beneficiaries must be identifiable and entitled to an equal amount but rather the trust power must be certain enough such that a court may be able to exercise the trust power for the benefit under the settlor's intentions.
- 10.6 This may be achieved by any of the following:
- (a) suggestions that particular beneficiaries are intended to be the primary receivers of the trust income or capital;
 - (b) clauses which a Court or a trustee should consider before exercising the trust power for the benefit of the beneficiaries;
 - (c) in conjunction with the above, references of the settlor's intention on how the discretionary power is to be exercised; and
 - (d) suggestions as to what happens with particular trust property if a trust power is not exercised (i.e. whether it is accumulated to form part of another trust in the trust deed).
- 10.7 It is therefore important to consider the interpretation of a trust deed as a whole, as long as a Court is able to interpret the trust deed and ensure the trust power is exercised, then there is no need to have a default appointment clause in the deed.

11 Default appointment clauses – practical considerations

- 11.1 Whether a trust deed requires a default appointment depends if the trust deed contains appropriate trust powers for the income and capital of the trust fund.
- 11.2 If the trust deed already contains trust powers, then inserting a default appointment clause will merely shift the 'trust' nature of the power from the initial discretionary power to the default appointment clause.

⁵¹ (1971) AC 424

⁵² *Burrough v Philcox* (1840) EWHC Ch J62

- 11.3 Alternatively, where a trust deed does not contain appropriate trust powers (due to a lack of appropriate drafting), then it would be prudent to include a default appointment clause to 'save' the trust property from any adverse consequences in having a non-existent trust.
- 11.4 Practically and as previously mentioned, the consequences of having an invalid trust would be that the property would be put on resulting trust for the benefit of the settlor and taxed at the settlor's marginal rate.⁵³
- 11.5 That said, considerations when including a default appointment clause will include:
- (a) who are the appropriate default beneficiaries from a tax planning and asset protection perspective;
 - (b) whether the default appointment clause has been drafted appropriately;
 - (c) what will be considered the default amount; and
 - (d) opening the trust up to potential stamp duty consequences should the default appointment clause be amended at a later date.
- 11.6 The above considerations are important as a lack of thought may result in adverse tax consequences occurring for the default beneficiaries, or even having the default appointment clause rendered ineffective.
- 11.7 In particular, it is important to remember that by including a default appointment clause, it will not only take effect when a discretionary mere power is not exercised but also where there is a failed trust distribution.
- 11.8 While it may be beneficial to have a default appointment clause to 'save' a failed trust distribution such as to avoid the potential accumulation of the trust property under section 99A ITAA 1936 (noting that in some circumstances this may not be abhorrent), if inappropriate people are defined to be the default beneficiaries, such as a high income earner, then the inclusion of the default appointment clause may undermine commercial objectives.
- 11.9 In this case, an alternative may be to have a corporate beneficiary included as a default beneficiary.
- 11.10 The cases of *BRK (Bris) v Commissioner of Taxation*⁵⁴ and *Hopkins v Commissioner of Taxation*⁵⁵ also highlights the additional care required to be taken into consideration when utilising default appointment clauses. In *BRK (Bris) v Commissioner of Taxation*, the default distribution clause required that the trustee on default 'divide the Fund equally among the beneficiaries named in the Schedule heretofore' on a date after the end of a tax year. The Court held, therefore that as the trustee would not in fact make the distribution to the default beneficiaries until after the end of a tax year, the income was accumulated for tax purposes in the previous tax year and in accordance with section 99A ITAA 1936, the trustee was taxed on the entire default amount at the top marginal rate.
- 11.11 Care must also be taken to ensure that default clauses are drafted so that the recipient beneficiaries are ascertainable, otherwise the default appointment clause will not be considered a trust power. The tribunal's findings in *Hopkins and Anor and Commissioner of Taxation* are particularly relevant. Specifically, the tribunal considered the certainty as to the objects of the

⁵³ Ibid 3

⁵⁴ (2001) FCA 164

⁵⁵ (2012) AATA 324

Hopkins Family Trust. The following clauses in relation to the definition of primary beneficiaries, as well as the default income provision, were considered:

'The "Primary Beneficiaries" means and includes RONALD JAMES HOPKINS, KATHLEEN CLARE ADAM, SAMUAL ALAN JOHN HOPKINS, DONNA MAREE HOPKINS, TONY TROY HOPKINS and any other the children and grandchildren, spouses of children and spouses of grandchildren of either of the said RONALD JAMES HOPKINS or the said KATHLEEN CLARE ADAM the parents, brothers and sisters of the said RONALD JAMES HOPKINS and KATHLEEN CLARE ADAM and the children and grandchildren of such brothers and sisters and any company in existence at the Vesting Day incorporated in any country throughout the world the shares in which are owned by any one or more of them or by a Trustee upon trust of any trust or trusts in existence at the Vesting Day under which any one or more of them is a beneficiary present or contingent.'

'...the Trustee shall pay or apply the whole or any part of the income in any year of income of the Trust Fund for the benefit of all or such one or more of the Primary Beneficiaries...PROVIDED that such Deed or oral declaration be made on or before the last day in any year of income and in the event of such Deed or oral declaration not being so made any income not so paid or applied shall be deemed to have been paid or applied for the benefit of the Primary Beneficiaries in equal shares and in such an event the Trustee shall credit such proportions of such income to the account of the respective Primary Beneficiaries in the books of account of the Trustee and shall hold the same absolutely on behalf of each such Primary Beneficiary.'

- 11.12 The tribunal rejected the Commissioner's claim that there was *'uncertainty in the objects'* of the trust and held that as all the primary beneficiaries could be ascertained, there being 46 in total, it was possible to say with certainty that *'any given individual was, or was not, a'* primary beneficiary of the trust thereby affirming the criterion certainty test from *Re Baden*.

12 Trusts and powers - practical considerations

- 12.1 Lastly, a separate issue to be addressed from this paper relates to the distinction between a trust power and a mere power when dealing with a variation power of a trust deed. Whilst unlikely to be a problem in more recent trust deeds, this issue may commonly arise when reviewing older trust deeds. That is, the variation power in the trust deed is prepared such that they restrict the ability to vary a trust power (often referred to as a trust), a mere power (often referred to as a power) or both in the trust deed itself.

Example 1

- 12.2 An example of a variation power restricting the power to vary a trust and power is as follows:

18 The Trustee for the time being may at any time and from time to time by deeds revoke add to or vary all or any of the trusts hereinbefore provided or the trusts provided by any variation or alteration or addition made thereto from time to time any may by the same or any other deed or deeds declare any new or other trusts or powers concerning the Trust Fund or any part or parts hereof the trusts whereof shall have been so revoked added to or varied but so that any law against perpetuities is not thereby infringed and so that such new or other trust powers discretions alterations or variations...[standard restrictions then applied for the variation power such as the inability to let a trustee or settlor benefit from the trust fund or extend the vesting date past the perpetuity period].

- 12.3 In this example, the variation power seems to limit any revoking, adding to or varying of a trust in a trust deed to the trusts listed before clause 18. The variation power is then explicit in flagging that the powers of the trust fund can only be added to and not varied. This may be troublesome if any of the powers in the trust deed require amending or deleting, however, it can

equally be suggested that the trustee then choose not to exercise the particular power in question or merely insert an 'amended' power.

Example 2

12.4 A slight variation to example one is as follows:

9.2 *The Trustee may by Deed revoke add or release or vary all or any of the trusts or powers hereinbefore declared or any trusts or powers declared by variation, alteration or addition made hereto from time to time and may by the same or any other Deed declare any new or other trusts or powers concerning the Trust Fund or part or parts thereof provided that...[again, the standard restrictions apply].*

12.5 In this case, while the trust and power may be amended, revoked or added to, any variation to the trust deed can only be made to the trusts and powers before clause 9.2. This may, therefore be difficult where a power needs to be amended after clause 9.2.

Example 3

12.6 The last example to consider was drafted as follows:

18 *From time to time and at any time until the distribution date the Trustee shall have power by deed or deeds revocable or irrevocable to alter or vary or absolutely revoke all or any of the trusts herein declared concerning the Trust Fund or any part thereof or the income or any part thereof to arise therefrom and in lieu of the trusts so revoked to appoint and resettle in such manner and upon such trusts and subject to such conditions and in such proportions and to such ends intents and purposes as the Trustee may in its absolute discretion from time to time think fit the Trust Fund or any part thereof to or among the persons or any one or more of them named or described in Clauses 2 and 3 hereof.*

12.7 Clause 2 was a default appointment clause distributing the income of the trust to Mr and Mrs X, whilst clause 3 was, despite being called a trust of income (discretionary), the power for the trustee at their discretion to distribute the income of the trust fund.

12.8 There was also a trust power relating to the capital of the fund under clause 5.

12.9 This variation power would therefore seem to restrict the ability of a trustee from varying any powers contained in the trust deed including the discretionary mere power provided to the trustee under clause 3 (clause 3 was a mere power by virtue of clause 2 being a default income appointment clause).

13 Conclusion

13.1 Coming back to the initial question, are default appointment clauses required to have a valid discretionary trust? The answer is, unfortunately, that it depends.

13.2 It depends whether a trust deed contains a mere or trust power over the income or capital of the trust fund as well as various practical considerations for a client's circumstance.

13.3 For those who prefer simple principles, it may very well be summarised by saying that if the ultimate destination is clear, default appointments are unlikely to be necessary.

13.4 From a big picture perspective, it needs to be appreciated that a lot of the previous cases were born from drafting and language that is comparatively ambiguous and loose compared to modern

day drafting so that a settlor's intentions are likely to be more easily ascertained under a modern deed.

- 13.5 Furthermore, in appreciating the fact that a power can be classified as a mere or trust, it offers additional practical considerations when reviewing a trust deed, especially in relation to a deed's variation power.

15 Disclaimer

This paper covers legal and technical issues in a general way. It is not designed to express opinions on specific cases. This paper is intended for information purposes only and should not be regarded as legal advice. Further advice should be obtained before taking action on any issue dealt with in this publication.

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