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Let's chat

'Family trusts' – not just a tax planning vehicle – June 2024

With:

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Information provided is general in nature; precise application depends on specific circumstances



Overview

- About 'standard discretionary family trusts'
- Less tax
- More 'what can go wrong with trust administration'
- More 'what is expected of advisers'
- More 'record-keeping obligations'



Fundamentals

- It's a relationship between trustee (legal owner) and beneficiary (beneficial owner)
- For a beneficiary of a discretionary trust:
 - (a) only have a 'mere expectancy' to receive any of the trust fund and cannot force a trustee to distribute trust funds in their favour - *Pearson v Inland Revenue Commissioner (1981) AC 753* (subject to the rule of equity in *Saunders v Vautier Vautier (1841) EWHC Ch J82*); and
 - (b) can only compel the trustee to properly administer the trust. Specifically (*Gartside v Inland Revenue Commissioners (1986) AC 553 at 606*):

'[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 trustee 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.'



Fundamentals – Australian cases

- Per Owen J in *R and I Bank of Western Australia Ltd v Anchorage Investments Pty Ltd* [1992] 10 WAR 59 at 79:

The trustee has a duty to administer the trust bona fide having regard to the purpose for which it was established. This is a duty which the court will enforce at the behest of the beneficiary. In this way, the remedy defines the nature of the interest of an individual beneficiary.

- Per French J in *Richstar Enterprises Pty Ltd and Others; Australian Securities and Investments Commission v Carey (No 6)* (2006) 153 FCR 509 at 29:

... in my opinion, in the ordinary case the beneficiary of a discretionary trust, other than perhaps the sole beneficiary of an exhaustive trust, does not have an equitable interest in the trust income or property which would fall within even the most generous definition of “property”....

- More recently in *Kestenberg v Kestenberg* [2020] VSC 84 at 7:

[A] discretionary beneficiary has no proprietary interest, vested or contingent, in the assets of a trust but only an expectation...a discretionary beneficiary, is not entitled as of right to disclosure of that which could be properly described as ‘trust document’



Fundamentals

- The above cases reinforces the law that beneficiaries of a discretionary trust have no direct interest in the income and capital of the trust, and that the trustee (being the various companies) has the absolutely discretion to determine how such income and capital of the trust is to be distributed.
- Note prior presentations mentioning a discretionary beneficiary's reduced access to what is considered trust documents.



Fundamentals

- Prior slides do not mean trustee has *carte blanche*.
- Under trust law, various duties and obligations are imposed on the trustee including but not limited to:
 - preserve and safeguard the trust property and assets;
 - distribute trust property and assets in accordance with the terms of the trust deed;
 - act in good faith and in accordance with their fiduciary duties for the benefit of the beneficiaries;
 - act personally and not delegate their responsibilities, except as exempted under the trust deed;
 - keep accounting records (e.g. statements, account information and tax reports);
 - communicate with beneficiaries and provide information when requested; and
 - not be deceitful or personally benefit from the trust.



Fundamentals

- ‘Act in good faith and in accordance with their fiduciary duties for the benefit of the beneficiaries’
- Cases that raised interest
 - *Ying Mui & Ors v Frank Kiang Ngan Hoh & Ors (No 6) [2017] VSC 730*
 - *Callus v KB Investments [2020] VCC 135*
 - *Owies v JJE Nominees Pty Ltd [2022] VSCA 142*



The need to 'get it right'

- Trust disputes will rise over the coming years/decades
- Old trust deeds come to light:
 - Consider the trust deed from the 80s and 90s and the drafting of such provisions
 - Consider initial persons establishing the trust dying and passing control on
 - Consider children 'seizing control' over trust
 - Old trusts with significant wealth



Things advisers need to care for

- Who is the client?
 - Trustee
 - Appointor or similar role
 - Beneficiary
- Appreciate the legalese in the document
 - Take on risk of advising the terms are appropriate
 - Missed provisions in trust deed (i.e. second wife not a beneficiary; changing the trustee excludes original primary beneficiary)
 - Take on risk of settlor which effectively states you intend for a trust to be established based on certain terms (note a recent case which did not allow a rectification to a trust document due to the settlor and director of trustee company specifically considering the beneficiary class)



Things advisers need to care for

- Appreciate that clients just need to pay more due to the added complexity:
 - Tax planning considerations
 - Succession planning considerations
 - Asset protection considerations
- Record-keeping obligations:
 - Ensuring clients keep everything in relation to the trust
 - What happens if a dispute arises many years after the fact
 - Appropriately explaining record keeping obligations
 - Retaining copy of trust deed, variations and changes
 - Retaining all relevant ancillary documents such as any change of name, evidence for CGT and trust losses
 - Records of important declarations and elections such as family trust elections and **settlor wishes**



Things advisers need to care for

- Reading the deed – do you want this on you?
 - Distribution provisions (what is income and who are beneficiaries)
 - Succession provisions
 - Appointor/Protector provisions
 - Trustee powers
 - Amendment powers
 - Ability for trustee to self-deal and remunerate
- Every provider is different and some include provisions due to personal client experience
- Complexities arise regarding construction and interpretation of some clauses



When acting as settlor

- Trusts are created by Settlers (or a Willmaker in the case of a testamentary trust)
- The intentions of settlors are often then considered in understanding how a deed should be interpreted
- In some circumstances, the client's instructions to a settlor may influence the settlor's intention on drafting of the terms of the trust deed
- Consider whether evidence exists of such intentions



When acting as settlor

- Cardaci v Filippo Primo Cardaci as executor of the estate of Marco Antonio Cardaci [No 5] [2021] WASC 331:
 - Dispute between brother of deceased managing a trust and wife of deceased who did not want the brother involved
 - Case considered (among many other issues) role of a settlor's intention in determining who should fulfil the role of controller
 - Considered drafting of trust deed, amending documents and original persons in relevant roles
 - Also considered a memorandum of the deceased's wishes noting:
"327 ... The trustee is not legally bound to give effect to the wishes set out in the memorandum, but the trustee is bound to give consideration to the memorandum."
 - Also noted that although the deceased was not the settlor, he was considered the 'economic settlor'



When acting as settlor

- Other tidbits of interest from the case:
 - [325] *The authors of the 19th edition of Underhill and Hayton Law Relating to Trusts and Trustees distinguish three classes of letters or memorandums of wishes: those which are legally binding, those which are legally significant and those which are morally binding only.[32] A legally significant letter is intended to have legal significance but not to be legally binding. Underhill and Hayton says that a legally significant letter has to be considered by the trustees because it normally is the key document to guide the trustees in exercising very broad flexible discretions in a fairly standard form trust deed. It will make clear to the trustees what are the purposes and expectations of the settlor in conferring such immense discretions upon the trustees*
 - [327] *The Memorandum of Wishes was not executed at the time of the creation of the trust deed. Nor was it executed by the settlor. However, the trust was established at Marc's instigation as the vehicle to hold, control and distribute Marc's wealth and was controlled by him during his lifetime.*



Following the deed

- Advanced Holdings Pty Limited as Trustee for The Demian Trust v Commissioner of Taxation [2021] FCAFC 135
 - Case involving whether a change of trustee was effective
 - ATO involved as there were tax consequences in the transaction
 - Court scrutinised whether there was appropriate change of trustee documentation put in place
 - Found minutes were lacking
 - Found an email trail evidencing document backdated to give an impression change of trustee occurred years earlier
 - Further found backdated documents sought to create the desired tax outcome
 - Professional discipline?



Following the deed

- Say no to backdating – it'll be found out and may have an effect on penalties in certain circumstances:

[186] Her Honour had also said in the primary judgment that Mr Demian was aware that LCI Partners had created backdated documents to provide to the Commissioner. Her Honour said at [113]:

Mr Demian denied that he was aware that LCI Partners had created backdated documents to provide to the Commissioner but I find it implausible he did not know. After all, he had signed the 2013 tax return for the Demian Trust as a director of Demian Holdings on the basis that Demian Holdings was the trustee of the Demian Trust, and the backdated documents were consistent with the return as lodged. ... The versions that Mr Demian signed were not correct in many details, and the evidence was that Mr Amorello prepared revised documents. A comparison of the documents supplied to the Commissioner and the versions signed by Mr Demian suggests that the documents supplied to the Commissioner were doctored from the actual documents which Mr Demian had signed. Whether that is so or not need not be decided, as what is salient is that Mr Demian signed a unit certificate and a transfer of unit document in circumstances that have no apparent explanation, other than for the purpose of providing such documents to the Commissioner in response to the s 264 notice. It is telling that, other than saying he signed the documents as part of a bundle, Mr Demian's evidence left wholly unexplained why he signed any such documents at all in 2015. Absent such evidence, the reasonable inference is that Mr Demian knew of the intended purpose of the documents he signed.



Court guidance

- When dealing with significant assets and no clear evidence – consider Court guidance to correct trust deficiencies
 - Lost trust deeds
 - Lost trust amending documents
 - Disputes or uncertain ability to enter documents/effect variations
- Not going to consider lost trust deed cases again
 - Differentiate, however, between lost trust deed where:
 - Settlor prepared to executed unsigned electronic copy
 - Settlor and unsigned document cannot be found but original instructions can be found
 - Signed document can be found
 - Signed certified document can be found
 - and all the variations in between



Trustee discretion

- Courts will generally not question the merits of a discretionary decision taken by a trustee as they seek to abide by a '*principle of non-interference*' - G Thomas, *Thomas on Power* (1st edn), Sweet & Maxwell, London, 1998, at [6-204]
- This is generally due to Courts being reluctant to overturning the valid choice of persons to utilise such a discretionary structure – *[I]t is to discretionary of the trustees that execution of the trust is confided...[However, the discretion must be exercised] within an entire absence of indirect motive, with honesty of intention, and with fair consideration - Re Beloved Wilkes Charity (1851) 3 Mac & G 440; 45 ER 330 at 333*



Trustee discretion

- McMillan J in *Re Marsella; Marsella v Wareham (No. 2)* [2019] VSC 65 considers some of the following factors in how decisions are to be made:
 - In accepting to be a trustee, the trustee is bound by duties to exercise their power in the best interest of beneficiaries.
 - Where a trustee is provided ‘unfettered discretion’, such discretion must be exercised in good faith, upon real and genuine consideration and in accordance with the purposes for which the discretion was conferred.
 - In determining whether such discretion was exercised appropriately, a Court may look at the inquiries the trustee made, the information they had, and their reasons for, and manner of, exercising their discretion.
 - It is not the Court’s role to determine the weight of such matters in the trustee exercising its discretion.
 - A lack of good faith can include the taking account of irrelevant considerations and a refusal to take into account relevant considerations.
 - The trustee must inform themselves of the relevant matters to exercise the discretion. Where the consideration is not properly informed, then it is not genuine.
 - Finally, the purpose for which a power is conferred on the trustee must be inferred from the trust deed.
 - Whether a trustee exercised a power for a proper purpose is a question of fact to be decided on the evidence. A trustee is not bound to disclose her or his reasons in reaching a particular decision, and a negative inference cannot be drawn from the non-disclosure by a trustee of the reasons for his or her decision



Trustee discretion – more quotes

- Owies v JJE Nominees Pty Ltd [2022] VSCA 142 at [110]
 - *In considering the nature of the power to distribute annual income, the starting point must be the nature and purpose of the trust having regard to the terms of the trust deed*
- Owies v JJE Nominees Pty Ltd [2022] VSCA 142 at [111]
 - *premise on which the trustee would be expected to discharge its duties is that it would generally be informed about the differing circumstances, needs and desires of each beneficiary as an incident of the familial bonds that underpin the trust and explain its purpose*
- Monaghan v Monaghan [2016] NSWSC 1316 at [49]
 - *Trustee is entitled to take into account this memorandum of wishes in exercising its discretions conferred under the Trust Deed, just as the Trustee is entitled to take into account the views of beneficiaries'*



Trustee discretion – more quotes

- Hartigan Nominees Pty Ltd v Rydge (1992) 29 NSWLR 405 at [62]
 - “[62] *But as Campbell JA said speaking extra-judicially, established principles of trust law would appear not to require the application of rules of natural justice to the decisions of discretionary trustees: see JC Campbell “Exercise by Superannuation Trustees of Discretionary Powers” [2009] 83 ALJ 159, at 175. As Campbell JA said, the private law context in which trustees make their decisions usually does not give rise to an obligation to adhere to the rules of natural justice but this is really as a matter of construction of the constitutive documents of the trust. **But his Honour also pointed out that the well-known obligation of trustees to give “genuine consideration” to the exercise of a discretion will sometimes mean the trustee will be required to gather information the trustee does not then hold and that such a procedure, though not identical to affording rights of natural justice or procedural fairness, covers at least some of the same ground. But Campbell JA also observed in the common case of a family discretionary trust the trustee will frequently already know enough about the circumstances in life of the various potential objects of the power of appointment to be able to make an appointment without gathering extra information.**”*



Trustee discretion – more quotes

- Hartigan Nominees Pty Ltd v Rydge (1992) 29 NSWLR 405 at [63]
 - *“the Trustee’s obligations in this area are well established: Karger v Paul [1984] VR 161 at 164, 166 and 178. It can be assumed that the Trustee will follow established law in respect of the degree of inquiries the Trustee has to make in order to give “genuine consideration” to the exercise of its discretion to reach the decision that the Trustee contemplates”*



Trustee discretion – tips

- No restriction on who can benefit, but need to ensure process to come to conclusion is made in the proper manner
- Reasons for why decision made does not need to be in writing so long process to reach decision was done in good faith and without an ulterior purpose and on real and genuine consideration
- Appropriate paper trail should be maintained to enable trust to withstand third-party scrutiny (i.e. if undertaking transactions in certain manners that may be considered as adversely affecting the beneficiaries)
- Ensure trustees aware of fiduciary duties
- Ensure corporate documentation complied with if trustee company
- Any paper trail retained should be objectively correct and real



Trustee discretion – tips

- Appreciate that primary beneficiaries may have a different ‘right’ compared to discretionary beneficiaries as failing a trustee exercising a discretion, they will stand to benefit (usually)
- Therefore, additional thought may be required to the primary beneficiary:
 - Note trust v power comparison – trust law considerations
 - This may require additional consideration for such primary beneficiary as they do differ from discretionary beneficiaries
 - Query whether evidence should be retained from any considerations of primary beneficiaries
- Ensure trustee exercises powers in neutral and dispassionate manner
- Avoid ‘just use last year’ mentality as each distribution requires considered decisions
- Consider whether right persons acting as trustee (they have capacity)

Trust distributions – more cans of worms



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- Disclaiming trust interests
- Section 100A
- Rectifying/amending defective beneficiary classes
- In Queensland – effecting land tax home exemption
- Affecting payroll tax grouping
- Affecting income tax provisions such as SBCGT Concessions (connected with and significant individuals)



Resulting trust or advancement

- Equity assumes people do not usually intend to make gifts of property except in certain circumstances
- Look out for upcoming case: <https://buymeacoffee.com/dariuschats>
- Purchasing property with lottery winnings
 - Property acquired under brother's name
 - Beneficial owner evicted following family relationship breakdown
- Consider proper and contemporaneous documentation to just avoid doubt



Trusts and family law

- Not a family lawyer
- Question of whether property or financial resource
- Some factors to consider, noting preference will be treated as property if either:
 - Wealth came from one party to the marriage.
 - Trust controlled from one party to the marriage.
- Situation where less likely to be property:
 - Wealth came from a third party.
 - Trust not controlled by party to the marriage.
 - Distributions not made to party to the marriage.
- Easier for testamentary trusts to be structured properly – *Bernard v Bernard* [2019] FamCA 421



Trusts and family law

- Some key considerations:
 - whether either or both of the parties are beneficiaries of the trust, by name or as a member of a defined class;
 - if a party is a beneficiary, the nature of their interest, including whether they are a beneficiary as to income only, or income and capital, and what their interest is on the trust vesting;
 - if a party is not a beneficiary, the identity of the other beneficiaries and their connection to the parties, and, in particular, whether a party could benefit indirectly from the trust via a related company or trust that is a beneficiary;
 - whether either or both of the parties are a trustee of the trust, or a shareholder and/or director in a corporate trustee;
 - whether either or both of the parties hold the role of appointor and/or guardian, or other controlling roles, and the nature and extent of those roles;
 - how the trust has been operated in the past, and, in particular, who has exercised the effective control and decision making in relation to it, and who has benefited from it and how;
 - whether the trust was settled before or during the relationship, and related questions as to whether the trust property has been acquired and/or built up before or during the relationship, and whether and to what extent the parties have contributed to the property of the trust; and
 - the nature, value and income potential of the trust property



Structuring considerations

- Family law
- 'Bankruptcy' law
- Foreign Investment Review Board
- Foreign surcharge
- Payroll tax
- Family circumstances
- Tax planning
- Centrelink
- Family trust election needed



Structuring considerations

- Who should be the:
 - Settlor
 - Primary Beneficiary
 - Appointor
 - Trustee
 - Director
 - Shareholder
- Should beneficiary class be limited?
- Should persons be specifically excluded and entrenched?
- Should the trust deed include specific provisions
- What happens if the Appointor/Trustee dies – or is this something for the client to obtain legal advice

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