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Let's chat

I [don't] believe in a thing called asset protection – November 2024

With:
Darius Hii – Tax and estate planning lawyer; Chartered Tax Advisor; and Director at Chat Legal

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

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Overview

- Asset protection for all the wrong reasons
- Possible to have protection, but heavily dependent on circumstances
- Better to start earlier
- Managing risk

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Types of asset protection

- Litigation risk
- Creditors
- Relationship breakdown
- Children
- Estate planning

- Relevant issue depends on reason for 'asset protection'

In practice

- Best practice
  - Managing dispute
- Insurance
  - Actions fall within insurance requirements
- Structure
  - Mediation
  - Settlement
  - Litigation
  - Costs
  - Bankruptcy
- A lot of steps to get to the end
- Some say asset protection is *"like an onion"*

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Best practice

- Segregate risk
- High risk, low asset; low risk, high asset
- High risk:
  - Director role
  - Trusteeship
  - Running a business
  - Doing anything where there are regulations [and you don't want to follow the regulations]
  - Property investing (?)

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Where there's two of you

- High risk spouse carries responsibility
- Low risk spouse owns the assets
- Issues:
  - Financier requirements (directorships or personal guarantees)
  - How do we get assets into the low-risk spouse name (see later on)
  - Do you trust your spouse

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Where there's one of you

- You carry all the risk
- Can structures even prove an effective 'asset protection' tool?

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Issue 1: Clawback provisions

- Sections 120 and 121 *Bankruptcy Act*
  - Section 120:
    - Undervalue transactions where consideration given for transfer was nil or 'less…than the market value of the property'
    - Pre-bankruptcy transaction will be void if it 'took place in the period beginning 5 years before the commencement of the bankruptcy'
    - Does not apply if transfer to a related entity took place more than four years before the commencement of bankruptcy, or two years in the case of a transfer to an unrelated entity, **provided in each case the transferee can prove that at the time of the transfer, the bankrupt was solvent**
  - Section 121:
    - Pre-bankruptcy transfer of property is void if property 'would probably have become part of the transferor's estate or would probably have been available to creditors if the property had not been transferred' **and** the main purpose was 'to prevent the transferred property from becoming divisible amongst the transfer's creditors' or 'to hinder or delay the process of making property available for division among the transfer's creditors'

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Issue 1: Clawback provisions

[The amendments are] based on the premise that gifts designed to dissipate assets rendering them unavailable to creditors are in practice more likely to be made to relatives and associates rather than to strangers. Further, it is common for people to be aware they are likely to become bankrupt more than 2 years before they become bankrupt or even become technically insolvent. If transfers in this early period can't be declared void, it is open to a person to dispose of their assets in a way that will leave little for creditors (e.g. gifts to relatives). It is appropriate to extend the bar to doing this to 4 years, not 2, because in the period between 2 and 4 years there is too much scope for a person to deliberately divest themselves of assets.

Explanatory Memorandum, Bankruptcy Legislation Amendment (Anti-Avoidance) Bill 2005 (Cth)

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Issue 1: Clawback provisions

It does not seem to me that… a barrister who transfers assets in order to keep them out of the hands of clients or potential clients who, at some stage in the future might sue for professional negligence, is outside the scope of s121(1)(b) of the Bankruptcy Act should the transfer be subsequently impugned. It must be borne in mind that s121(1)(b) may be satisfied even if the transferor was solvent at the time of the transfer and even if the transferor had no creditors at that time.

Prentice v Cummins (No.5)

Note relevant section in this case was narrower than the current section 121

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Issue 1: Clawback provisions

- Can't just gift assets away – risk of clawback
- Can't just sell asset away for market value – you are left with market value cash of the property transferred, that you can't just gift away
- Solvency at the time of transfer can be relevant in the time frame
- Intent is also relevant in the case of section 121 and arguably transferring whilst insolvent would blur the lines between section 120 and 121
- Note section 121 can still apply even if there is no existing creditors, no contingent liabilities and no litigation threatened against them

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Issue 1A: Clawback provisions

- Property law legislation has similar 'clawback provisions:
  - Section 228 of *Property Law Act 1974 (Qld)*:
    - *Subject to this section, every alienation of property, made whether before or after the commencement of this Act, with intent to defraud creditors, shall be voidable, at the instance of any person prejudiced by the alienation of property.*
  - New Property Law Bill for QLD includes a similar provision:
    - *A disposition of property by a person (the transferor) is voidable against the transferor, by a person prejudiced by the disposition, if the transferor made the disposition with intent to defraud the transferor's creditors*
    - Exceptions included if transaction made 'in good faith', for valuable consideration and '*at the time when the person became a party, had no notice of the transferor's intent to defraud the transferor's creditor*'.

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Issue 1: Clawback provisions

- Well if we can't gift things, why don't we loan things (?)
- Still doesn't solve where asset held
- Issue relevant where high incoming earning spouse pays off home solely under name of other spouse

Issue 2: Presumption of advancement

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- Assumption that transfers of assets from husbands to wives, male fiancés to female fiancés and parents to children are gifts in the absence of evidence to the contrary.
- Rebuttable with written evidence.
- Confirmed in *Bosanac v Commissioner of Taxation [2022] HCA 34* being a case where:
  - Husband had a tax debt ($9 million).
  - Wife had a property in her name only.
  - Deposit for the property paid by joint funds from Husband and Wife.
  - Remainder of property paid by loan taken out by Husband and Wife.
  - During marriage, Husband and Wife acquired assets in separate names.
  - ATO sought to argue that property was partially held by Wife for Husband as Husband contributed to purchase of the property.
  - No evidence to rebut presumption of advancement

Issue 2: Presumption of resulting trust

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- Premise is that equity assumes that people do not usually intend to make gifts of real property.
- Accordingly, a recipient can be said to hold a property on trust for a person who contributes unless the presumption can be rebutted.
- Consider:
  - Person A acquired house in his name.
  - Purchase price of house paid from Business Company controlled by Person A and Person B.
  - Person A subsequently wishes to sell the house and retain 100% of proceeds.
  - *Wu v Yu & Ors* [2018] QDC 169
  - Note relationship between certain family members may have a different result.

Issue 2: Presumption of resulting trust

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- Both presumptions not helpful for a high-earning spouse, however, a presumption of advancement allows for clawback provisions to apply rather than an asset being deemed in a spouse's name
- Consider if documentation is preferred

Issue 3: Discretionary trust issues

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- Personal services income
- Section 100A
- 'Due care and consideration' – *Owies* case
- Access to trust documents and records
- Trust litigation risk – *Hitchcock and Pratt* case
- Disgruntled children disputing discretionary trusts

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Issue 4: Unit and fixed trusts

- Who holds the trust interest
- Individual lacks protection from individual risk
- Discretionary trust holds certain tax risks (specifically, NSW land tax)

Issue 5: Asset protection strategies

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- Gift and loan back arrangements:
  - *Re Permewan (No 2)*
  - Clawback provisions
  - Risk of loan enforcement
  - Is it legitimate
- PPR held in a discretionary trust:
  - CGT main residence exemption where there is a long term lease
  - Long term lease implies a stronger interest in the property for an individual that may expose the property to litigation risk

Issue 6: Family provision applications

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- Will challenges if testamentary trust utilised
- Note obiter comments in *Re Permewan (No 2)* in relation to 'moral duty' in relation to sham arrangements under QLD family provision applications

Issue 6: Notional estate rules (NSW)

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- Gifting assets out of name to reduce assets that form part of an estate may be unwound in the event of an NSW estate challenge
- Examples can include:
  - Arranging for assets to be held as joint tenants with another
  - Transferring assets into other entities/other persons
- Note obiter comments in *Re Permewan (No 2)* in relation to 'moral duty' in relation to sham arrangements under QLD family provision applications

Issue 7: Relationship breakdown and trusts

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- Property of marriage v financial resource
- Depends on various factors including level of control and historical benefit/input into the discretionary trust
- Best protection may often not be appropriate as it requires person to have less control
- Need to weigh who are Named Beneficiaries (i.e. Default Beneficiaries) as well given the context of *Owies*
- *Bernard v Bernard* as a case where it can work

Issue 8: Freezing orders

- *Deputy Commissioner v Wang* [2019] FCA 1759
  - Taxpayer had a tax liability totalling over $103 million
  - Property developers in China known as Shandong Hengyi Group
  - Taxpayer and children migrated to Australia and undertook property development work
  - Taxpayer failed to disclose extent of overseas assets and understated taxable income
  - Taxpayer owned various discretionary trusts and due to the risk the taxpayer had in non-payment, freezing orders were made over such trust assets (which included a loan receivable of $106,621,685, 2014 Aston Martin and 2016 Rolls Royce)
  - Freezing orders lifted in 2020
  - Of note, case referenced the *Richstar* (trust as alter ego) decision

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Issue 8: Freezing orders

- *Deputy Commissioner v Wang* [2019] FCA 1759

  As each of the trusts in question are discretionary trusts, there is a question as to whether Ms Wang has a sufficient interest in the assets of those trusts to support the orders sought. Senior counsel for the DCT brought to my attention a number of authorities on that question. It is fair to say that the law is not finally settled but the decision in ***Australian Securities and Investments Commission v Carey & Ors (No 6) (2006) 153 FCR 509; [2006] FCA 814*** *is strong authority supporting the proposition that the power exists in the present case. In that case, French J (as his Honour then was) held that the* ***beneficiary who effectively controls the trustee's power of selection because he or she is the trustee and/or has the power to appoint a new trustee has something approaching a general power and the ownership of the trust property because "it is as good as certain" that the beneficiary will receive the benefits of distributions*** *either of income or capital or both: at [29], [36]-[37], [41]. In Deputy Commissioner of Taxation v Vasiliades (2014) 99 ATR 799; [2014] FCA 1250, Gordon J applied French J's reasoning to conclude that the Commissioner had* ***a good arguable case that the taxpayer in that case had a contingent interest of the kind identified by French J sufficient to found a restraining order against the taxpayer from exercising any power of distribution in respect of the trust*** *including any power as a director of any trustee of the trust.* ***In the present case, the evidence shows that Ms Wang is a beneficiary who controls each of the trusts both through her control of the corporate trustees and through her power of appointment under the trusts****. Accordingly, on the strength of those authorities, I was satisfied that there is a good arguable case that the orders sought could be made.*

Issue 9: Contractual arrangements worth the paper?

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- Binding financial agreements, mutual Wills, letter of wishes/memo of directions and family agreements
- Most of the above are contractual arrangements between parties
- Question is how legally binding they can be in the event of a dispute

Issue 9: Contractual arrangements worth the paper?

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- Binding financial agreements
- Stringent process required (i.e. full and frank disclosures of **all property** and the value; each party having their own independent advice and independent certificates signed)
- Worthwhile as it offers clarity and upfront agreement
- May not be worthwhile as it can be set aside by a Court or reworked in the event of complex arrangements or a bargaining imbalance
- Even in the event BFA is disputed in Court, the Court may place weight on it (even in the context of a family provision application)

Issue 9: Contractual arrangements worth the paper?

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- Mutual Wills
- Agreement between two people where each of them will execute a Will incorporating particular agreed provisions and neither of them will revoke that Will without the consent of the other.
- Where in existence will operate *subject* to family provision legislation.
- Whether in existence depends on evidence, so get it contemporaneously in writing!
- Breach of agreement results in equitable relief in the form of a constructive trust to those who were to benefit.
- Generally irrevocable once one party dies, unless otherwise contemplated in the original mutual agreement.

Issue 9: Contractual arrangements worth the paper?

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- Letter of wishes/memo of directions
- **Not** legally binding.
- May be taken into account by Court as evidence of testamentary intentions.
- Should be taken into account of trustees exercising due care and consideration.
- Importance on who is in control, otherwise, worthless.

Issue 9: Contractual arrangements worth the paper?

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- Family agreements
- Different from bespoke constitutions or trust amendment documents.
- Rather, a document outlining:
  - Desired direction for the family business.
  - Family view on philanthropic efforts.
  - Intended involvement of spouses or others outside the bloodline.
  - Intermediate plans for the succession of family entities.
- Rather 'wishy washy', but still a useful tool in determining who may be appropriate in the succession of a family business and a play on an individual's 'sense of entitlement'.
- Another document appropriate trustees should take due care and consideration.

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So can asset protection work?

- Separating asset holding risk
  - Multiple entities for multiple businesses
  - Separating high value assets (IP/goodwill) from trading risk
- Protecting from relationship breakdown (if structured correctly)
- Protecting from spendthrift beneficiary (if structured correctly)

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Not meant to be used for

- Doing dodgy things and disclaiming all responsibility
- Not paying back creditors

- At the end of the day, it's about layers…like an onion.

Contact details

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