

Trustbusters

Asset Protection and the Art of the Alter Ego Entity

FEATURE ARTICLE

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The *Richstar* decision

Introduction

A significant question has been raised in recent months regarding the protection offered by discretionary trusts. In the decision of *ASIC v Carey (No 6)* [2006] FCA 814 ("*Richstar*") Justice French in the Federal Court was prepared to look through a trust and see the discretionary objects of the trust having an interest justifying the appointment of receivers to the trusts.

The decision has caused some consternation amongst those who have long sought the shelter of discretionary trusts for the protection of assets from the reach of creditors. The discretionary trust is a widely used asset protection tool on the basis that the beneficiaries of the trust do not (at least on the face of it) have any interest in the assets or income of the trust until they are distributed by the Trustee.

In one sense the *Richstar* decision might be seen as a radical incursion into the private asset structuring arrangements of individuals. On the other hand, it could be argued that the decision merely makes it clear that as in the case of sham transactions, the Court will in certain circumstances look through the **form** of asset protection arrangements. Either way, those seeking protection for assets by placing them in a discretionary trust should consider the decision in the context of their own circumstances.

The Facts

In *Richstar*, the relevant facts were simple:

27 March 2006 ASIC commenced proceedings seeking the appointment of receivers to various property of companies and officers in the Westpoint Property & Finance Group pursuant to s 1323 of the *Corporations Act 2001 (Cth)*.

20 April 2006 Orders made for the appointment of receivers to the property of all Defendants (apart from one already in receivership). Orders also made for the disclosure of the assets of the various Defendants.

8 June 2006 Application by ASIC to extend the receiver orders to bring into the scope of the orders:

"3.6 property held by a Third Party, as trustee for a trust, where the Individual Defendant is a beneficiary of the trust (including as a general beneficiary of a discretionary trust);

3.7 property held by a Third Party on behalf of a superannuation fund, where the Individual Defendant is a beneficiary of the superannuation fund;"¹

The Issue

Justice French in the Federal Court defined the issue raised by ASIC's application as whether it had power, under s 1323 of the Corporations Act, to appoint a receiver to property held by a third party on trust (discretionary or otherwise) of which the relevant person is a beneficiary. If so, a secondary question arose as to whether the court **should** make such an order in the circumstances of the present case.²

The Analysis

The Application by ASIC was brought under s 1323 of the Corporations Act. This section allows the Court to make protective orders where an ASIC investigation or prosecution has begun, or indeed where any civil proceedings have been brought (by ASIC or otherwise).

1. *ASIC v Carey (No 6)* [2006] FCA 814 per French J at [8].
2. *Id.* at [12].

The relevant parts of s 1323 are as follows:

1323 Power of Court to prohibit payment or transfer of money, financial products or other property

(1) Where:

- (a) an investigation is being carried out under the ASIC Act or this Act in relation to an act or omission by a person, being an act or omission that constitutes or may constitute a contravention of this Act; or
- (b) a prosecution has been begun against a person for a contravention of this Act; or
- (c) a civil proceeding has been begun against a person under this Act; and the Court considers it necessary or desirable to do so for the purpose of protecting the interests of a person (in this section called an aggrieved person) to whom the person referred to in paragraph (a), (b) or (c), as the case may be, (in this section called the relevant person), is liable, or may be or become liable, to pay money, whether in respect of a debt, by way of damages or compensation or otherwise, or to account for financial products or other property, the Court may, on application by ASIC or by an aggrieved person, make one or more of the following orders:
 - ...
 - (e) an order prohibiting a person holding money, financial products or other property, on behalf of the relevant person, or on behalf of an associate of the relevant person, from paying all or any of the money, or transferring, or otherwise parting with possession of, the financial products or other property, to, or to another person at the direction or request of, the person on whose behalf the money, financial products or other property, is or are held;
 - ...
 - (h) an order appointing:
 - (i) if the relevant person is a natural person – a receiver or trustee, having such powers as the Court orders, of the property or of part of the property of that person; or
 - (ii) if the relevant person is a body corporate – a receiver or receiver and manager, having such powers as the Court orders, of the property or of part of the property of that person;
 - ...

(2A) A reference in paragraph (1)(g) or (h) to property of a person includes a reference to property that the person holds otherwise than as sole beneficial owner, for example:

- (a) as trustee for, as nominee for, or otherwise on behalf of or on account of, another person; or
- (b) in a fiduciary capacity.

(2B) Subsection (2A) is to avoid doubt, is not to limit the generality of anything in subsection (1) and is not to affect by implication the interpretation of any other provision of this Act.

Section 9 of the Corporations Act defines “property”:

“property means any legal or equitable estate or interest (whether present or future and whether vested or contingent) in real or personal property of any description and includes a thing in action”.

Clearly s 1323(1)(h) allows the appointment of a receiver over property of an individual or corporation. It does not authorise the appointment over property of third parties, unless the relevant person has an “interest” in that property, and that interest falls within the definition of property in s 9.³

Justice French found that a fairly clear example of such an interest would be property held on behalf of the relevant person (ie an express trust). This gives rise to an equitable estate or interest in the property which falls within the s 9 definition of “property” and may therefore be the subject of an order under s 1323.

Subject to the terms of the Fund, the superannuation fund is an example, His Honour held, of a fixed or non-discretionary trust in which a relevant person would hold an interest capable of supporting the appointment of a receiver under s 1323. His Honour was therefore prepared to make the orders sought by ASIC against certain superannuation funds. This was “*subject to satisfaction about the nature of the individual defendant’s interest in the relevant superannuation fund.*”⁴

If the relevant person **holds** property on trust, then the title to the property so held also will clearly support the making of an order under s 1323. This is clear from s 1323(2A), and is so even though the beneficial interest in that property belongs to someone else.

So far so good.

But what of a relevant person who is merely one of a class of **potential** discretionary objects of a discretionary trust? Who will receive nothing and has no claim in the event that the trustee decides to distribute the trust income and assets to any other beneficiary? His Honour agreed that this question was “*less straightforward*”.⁵ A number of cases have held that a mere “*expectancy*” is not a proprietary interest.⁶

3. *ASIC v Carey (No 6)* [2006] FCA 814 at [16].

4. *ASIC v Carey (No 6)* [2006] FCA 814 at [5], see also at [17].

5. *ASIC v Carey (No 6)* [2006] FCA 814 at [19].

6. See the useful list in Powers, L “Breaking Down the Walls Around Discretionary Trusts” (2006) 17 JBFLP 214 at 215.

Discretionary Trusts

By their very nature, a properly drafted discretionary trust grants a discretion to the trustee as to which of the objects of the trust are to receive the benefit of any distribution of income or capital.

However, as the High Court has said, and as Justice French reminded us, the term “*discretionary trust*” has:

*“No fixed meaning and is used to describe particular features of certain express trusts.”*⁷

Justice French referred to the High Court’s decision in *Federal Commissioner of Taxation v Vegners*⁸ in which his Honour Justice Gummow said that a “*discretionary trust*” is an express trust in which:

“unlike a fixed trust, the entitlement of the beneficiaries to income, or to corpus, or both, is not immediately ascertainable”

A trustee of a discretionary trust may have either a:

- general power to distribute to any person including the trustee;
- special power to distribute to a fixed class of beneficiary; or
- hybrid power, which would allow distribution to anyone except a designated list of persons.

A sham trust is no trust at all, and a sham discretion is likewise subject to being ignored by a Court in considering a purported discretionary trust.

*“discretion as to the method in which the whole of the fund shall be applied for the benefit of the particular person does not prevent that particular person from coming and saying ‘Hand over the fund to me’.”*¹¹

In *Vegners* a general power of this kind was said to be:

“tantamount to ownership of the property concerned”.

By analogy, Justice French observed that:

*“A beneficiary who effectively controls the trustee of a discretionary trust may have what approaches a general power and thus a proprietary interest in the income and corpus of the trust.”*⁹

With respect, his Honour is clearly correct in attributing to a controlling beneficiary the effective or de facto ownership of the assets of the trust. However, in such circumstances, the question begs whether there is a trust at all. A sham¹⁰ trust is no trust at all, and a

sham discretion is likewise subject to being ignored by a court in considering the legal effect of a purported discretionary trust. It may not always be necessary to apply a trust analysis to reach this conclusion. Instead, a court will see through, or go behind the trust, and find that in a particular instance the transaction did not have the effect displacing the legal ownership of the trust assets from the controlling beneficiary.

Discretionary Trusts – An Exhaustive Analysis!

Justice French then proceeded to analyse the various types of trust arrangement that might fall within the description “*discretionary trust*”.

His Honour pointed to a distinction between “*exhaustive*” and “*non-exhaustive*” trusts - depending upon whether the trustee has power to withhold distribution of any (or no) part of the income or assets of the trust. The significance of this distinction was apparent from the fact that when the beneficiaries of an exhaustive trust came to the trustee, the trustee’s

His Honour also distinguished between “*closed*” and “*open*” classes of beneficiaries, depending upon whether the beneficiaries of the trust were a defined (closed) group of persons or alternatively a large (open) group.

By way of example His Honour referred to the case of *Re Nelson*¹² where a trustee was bound to apply certain income of a trust fund (ie an exhaustive trust) for the benefit of three individuals (ie a closed class). The Court held that even though the trustees decided how much of a trust fund each of the individuals received a mortgage by the three beneficiaries was still a valid mortgage of a real interest in the trust fund.

The point, Justice French found, was that a closed class of beneficiaries of an exhaustive discretionary trust could together require the trustee to deal with the trust assets - effectively as if the beneficiaries were the absolute owners.¹³

7. *Commissioner of Stamp Duties (NSW) v Buckle* [1998] 192 CLR 226 at [8]; quoted by French J in *ASIC v Carey (No 6)*, at [19].

8. [1989] 90 ALR 547 at 552 per Gummow J.

9. At [19].

10. “‘*Sham*’ is an expression which has a well-understood legal meaning. It refers to steps which take the form of a legally effective transaction but which the parties intend should not have the apparent, or any, legal consequences”: Per the High Court in *Equuscorp Pty Ltd & Anor v Glengallen Investments Pty Ltd & Ors* [2004] HCA 55 at [46].

11. *Re Smith* [1928] Ch 915 per Romer J at 918 cited by French J in *Richstar* at [22].

12. [1928] Ch 920.

13. At [25].

In the end, however, Justice French held that:

*"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' in s 9 of the Act and be amenable to control by receivers under s 1323. I distinguish the 'ordinary case' from the case in which the beneficiary effectively controls the trustee's power of selection. Then there is something which is akin to a proprietary interest in the beneficiary."*¹⁴

Next, his Honour considered ASIC's submissions that beneficiaries of a discretionary trust have a "contingent interest" which is "property" for the purposes of s 9 of the Corporations Act, and which could therefore be the subject of an order under s 1323. Such was argued to have been the view of the High Court in *Craig v Federal Commissioner of Taxation*¹⁵ where McTiernan J held that:

*"In its ordinary or popular sense, the word 'interest' as applied to property may include a contingent interest."*¹⁶

His Honour described a contingent interest:

"broadly as the possibility that a right of a proprietary character will come into existence at a future time is some event occurs".

His Honour was satisfied that a combination of these factors of itself was sufficient control to give the defendants an interest ("at the very least a contingent interest") in the assets of the discretionary trust.

Justice French also had regard to the comments of Nourse J on this issue:

*"A contingency is an event which may or may not happen. If there is no real possibility that it will not happen, so that it is as good as certain that it will, it is a contingency without reality and substance and no contingency at all. But a real possibility is not the same thing as a probability. It may be highly improbable that an event will happen, but there can still be a real possibility that it will. If there is that possibility, however remote it may be, the contingency is one of reality and substance."*¹⁷

His Honour disagreed with ASIC's argument:

"I am inclined to think that a beneficiary in such a case at arms length from the trustee, does not have a 'contingent interest' but rather an expectancy or mere possibility of a distribution. ... On the other hand, where a discretionary trust is controlled by a

*trustee who is in truth the alter ego of a beneficiary, then at the very least a contingent interest may be identified because, in the words of Nourse J, 'it is as good as certain' that the beneficiary will receive the benefits of distributions either of income or capital or both."*¹⁸

French J went on, in the next paragraph, to repeat his earlier observations that a beneficiary who controls a trustee's power of distribution (including because of the power of appointment of a new trustee) has something "approaching a general power and the ownership of the trust property." He developed this analysis with reference to Family Law cases in which the Family Court has considered corporations which are controlled by one or other of the parties to the marriage.

The significance of his Honour's reference to control and the alter ego cases is that it is this principle which allowed him to see through the trust structures set up by the defendants, rather than any novel treatment of discretionary trust principles. His Honour seems to be saying that the law will not be fooled by devices which attempt to mask the **real** ownership of assets.

The question is, how do you know when you are dealing with such a situation?

Perhaps, if anything, his Honour's judgment is significant in the indicia relied upon by his Honour to identify control over the trust assets. Without going through all of the trusts being considered

by ASIC, Justice French reviewed several of the trust structures in which the defendants were either:

- (a) the trustee of the trusts;
- (b) the director and/or shareholder of the corporate trustee; or
- (c) the appointor (or the spouse of the appointor) of the trust.

In each of these cases his Honour was satisfied that a combination of these factors **of itself** was sufficient control to give the defendants an interest ("at the very least a contingent interest"¹⁹) in the assets of the discretionary trust. This in turn allowed his Honour to appoint a receiver to this "property". It is interesting to note that his Honour appears to assume that a spouse, in this case Mrs Beck, would exercise her power of appointment in the financial interests of her husband.

14. At [29].

15. (1945) 70 CLR 441.

16. *Id* at 454 cited in *Richstar* at [33].

17. Nourse J in *Inland Commissioners v. Trustees of Sir John Aird's Settlement* [1984] Ch 382 at 940. Justice French notes that Nourse J's decision was overturned on appeal, though not in respect of this portion of the judgment at first instance.

18. At [36].

As has been noted elsewhere, the facts in the *Richstar* decision meant that his Honour did not have to decide whether the same would apply in reverse – ie that a husband would be presumed to exercise trustee powers in favour of his wife.²⁰

It is important to remember that his Honour was not prepared to make an order in the very general nature ASIC had requested, extending to all trust assets of which the defendants were beneficiaries. It is not the case that his Honour ignored the existence of the discretionary trusts entirely. However, his Honour was prepared to:

*“consider a proposal for orders to be made in relation to trusts of which the relevant defendant is the effective controller, thereby enjoying at least a contingent interest, if not effective ownership, of the trust property. This will require specification of the trusts to be affected.”*²¹

How are such trusts to be identified, let alone specified? His Honour considered the problem of trying to establish which trusts were of a kind which would be caught by his Honour’s consideration of the relevant principles. Justice French was prepared to make orders under s 23 of the *Federal Court Act*, which provides that:

“The Court has power, in relation to matters in which it has jurisdiction, to make orders of such kinds, including interlocutory orders, and to issue, or direct the issue of, writs of such kinds, as the Court thinks appropriate.”

Significantly, therefore, his Honour was prepared to make orders under s 23 which:

- authorised the receivers to require the defendants to provide information to identify trusts in respect of which they are beneficiaries;
- required the defendants to provide, using their rights as beneficiaries, information relating to the trust documents and the managements of the trusts, including their distribution history;²²
- authorised the receivers to obtain information from the trustees, including as to the terms of the trust, the classes of its beneficiaries and its distribution history.²³

In allowing information to be gathered in this way ASIC and the Receivers would be able to identify the particular trusts which fell within the necessary degree of control by the beneficiary.

Implications in Bankruptcy

The implications of the *Richstar* decision for bankruptcy have been briefly considered by another Federal Court Judge, Justice Branson, in a paper delivered at the most recent ITSA Bi-Annual Congress in 2006. In her Honour’s paper entitled “The Bankrupt, His or Her Spouse and the Family Trust: A consideration of Part VI division 4A of the Bankruptcy Act”²⁴ Justice Branson observed the close similarity of the definitions of “property” in s 9 of the Corporations Act, and s 5 of the Bankruptcy Act.

In 2006 the Federal Government passed amendments to Part VI division 4A of the in 2006 squarely aimed at assets held by a third party from which a bankrupt retains a benefit. Branson J queried whether the effect of the *Richstar* decision meant that these reforms were less necessary than had previously been thought.

Conclusion

Sight should not be lost of the fact that each matter will be considered on its own facts, each trust on its own terms, and each question of control and ownership in light of its own circumstances.

For asset protection purposes, the message is clear. Only by clearly removing control of the appointor, trustee, and ensuring the trust is non-exhaustive, can any discretionary trust be seen to avoid the risk of being the subject of a particular beneficiaries control.

But is this practical? Should all discretionary trusts now be controlled by truly independent people who are above being influenced to assume the “*alter ego*” of another person? This answer of course is that the most appropriate structure will, as it always does, depend on the circumstances. What does the trust do? What do the individuals benefiting from the trust do? What are their legal areas of risk exposure?

For insolvency practitioners, it would not be safe to say that *Richstar* creates a landmark decision upon which insolvency practitioners will now rely to launch a wave of litigation against assets held in discretionary trusts. However it would not be unfair to conclude that insolvency practitioners will take some comfort from the willingness of the Court to look behind the mere fact that assets were held in a discretionary trust as a complete protection of those assets. Insolvency practitioners will also look more closely at the way in which discretionary trusts operate to see whether there is a degree of control over the trust equivalent to a proprietary interest. ■■■

19. Ibid.

20. Her Honour Justice Catherine Branson, “The Bankrupt, His or Her Spouse and the Family Trust: A consideration of Part VI division 4A of the *Bankruptcy Act*” Paper delivered at the Sixth ITSA Bankruptcy Congress, 27 July 2006 at page 15.

21. At [46].

22. At [47].

23. Ibid.

24. Paper delivered at the Sixth ITSA Bankruptcy Congress, 27 July 2006.