Discretionary Trusts as an Asset Protection Strategy in Family Disputes: Their Uses and Limitations

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Craig Wilson

Barrister

13 Wentworth Selborne Chambers

174-180 Phillip Street

SYDNEY NSW 2000

INTRODUCTION

Planning to protect pre-existing family wealth from a future ex-spouse (or ex-domestic partner) is often a priority for people in circumstances where the future ex-spouse (or ex-domestic partner) is a subsequent spouse or domestic partner and there are children to previous relationships. (For convenience I will refer to the relationship between two parties whether spouse or domestic partner as a 'marriage'). [1]

Discretionary trusts have long been used as an asset protection strategy. Discretionary trusts provide protection for the trust assets from a beneficiary's creditors because the trust assets are not generally characterised as the property of the beneficiary. So, for example, (with exceptions) in the case of bankruptcy the assets do not vest in the trustee in bankruptcy to be divisible among the bankrupt's creditors.

Despite the utility of discretionary trusts as part of an asset protection strategy they frequently fail to provide protection against ex-spouses and ex-domestic partners in family court disputes.

This paper explores:

a. The different ways trusts and trust assets are considered and treated in the usual general law jurisdictions and in the Family Court [2] under the ***Family Law Act*** 1975 (Cth) (**FLA**);
b. How the notion of 'control' of a trust and trust assets are treated in the two jurisdictions;
c. How benefit and beneficiary of a trust are viewed in the two jurisdictions; finally
d. How trusts may be structured and maintained to maximise their usefulness as an asset protection strategy in family law disputes.

Throughout this paper when referring to a 'trust' I am referring to a discretionary trust and particularly the type of discretionary trust often used in a family discretionary trust.

ORTHODOX PRINCIPLES OF TRUST LAW

It is well settled trust law that a trustee owes a fiduciary obligation to the objects of the trust to faithfully administer the trust for their benefit. Further the objects of a discretionary trust have the right of due administration of the trust, but not the assets of the trust until the trustee determines to make a distribution of the assets (whether capital or income). It is also well settled trust law that neither the trustee's fiduciary duty nor the object's right of due administration is capable of making the object of a power of appointment into a 'beneficial owner' of the subject matter of the trust. [3]

[1] Since 1 March 2009 parties in a de facto relationship that has broken down are caught in the Family Law Act with regard to property matters: Section 90SB ***Family Law Act***
[2] and Federal Circuit Court
[3] ***Lygon Nominees Pty Ltd v Commissioner of State Revenue*** [2007] VSCA 140; 66 ATR 736 at [75].

Further the orthodox view of trust law is that a mere interest in the due administration does not amount to a proprietary interest in any of the assets of the trust or in the trust fund as a whole. [4]

Under orthodox principles of trust law a person is not a beneficial owner of the assets of a trust even if that person is in a position to control the exercise of the trustee's powers (that is entitled to remove the trustee and appoint a new trustee) or cause the trustee to appoint the income or capital of the trust to herself. [5] A donee of a general power of appointment is not the beneficial owner of the property prior to the exercise of the power, although for many purposes such a donee will be treated as if he or she were the beneficial owner. As Fry LJ wrote in ***Ex Parte Gilchrist; Re Armstrong***: [6]

> "*The question is, whether the general power of appointment given to the bankrupt is her 'separate property' within the meaning of sub-s. 5 of s. 1 of the Act of 1882. To my mind the question is one of the most elementary description, and, if it had not been argued as it has, I should have thought it unarguable. No two ideas can well be more distinct the one from the other than those of 'property' and 'power'. ... A 'power' is an individual personal capacity of the donee of the power to do something. That it may result in property becoming vested in him is immaterial; the general nature of the power does not make it property. ... Not only in law but in equity the distinction between 'power' and 'property' is perfectly familiar.*"

THE FAMILY LAW WAY

When parties to a marriage (or domestic relationship) fall into dispute and (typically) the relationship ends and the parties are unable to resolve the dispute by agreement they come before the Family Court or Federal Circuit Court to have the dispute adjudicated. These matters, including disputes involving trusts, are dealt with pursuant to the ***Family Law Act*** *1975 (Cth)* (**FLA**), rather than under the general law.

Pursuant to section 79 of the FLA the Family Court has the power to alter the property interest of the parties in their property (referrable to s4(1)(ca)). These interests may include business assets, property inherited by one of the parties, separate investments and pre-maritally owned property. [7]

Section 79(1)(a) of the FLA provides:

> *"In property settlement proceedings, the court may make such order as it considers appropriate:*
>
> *(a) in the case of proceedings with respect to the property of the parties to the marriage or either of them – altering the interests of the parties to the marriage in the property."*

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[4] ***Gartside v Inland Revenue Commissioners*** [1968] AC 553 at 617-618; ***R & I Bank of Western Australia Ltd v Anchorage Investments Pty Ltd*** (1992-1994) 10 WAR 59 at 79; ***Lygon Nominees Pty Ltd v Commissioner of State Revenue*** [2007] VSCA 140; 66 ATR 736 at [76]-[78].
[5] ***Public Trustee v Smith*** [2008] NSWSC 397; (2008) 1 ASTLR 48, at [108].
[6] (1886) LR 17 QBD 521 at 530-531
[7] ***Carter and Carter*** (1981) FLC 91-061

Section 4 of the FLA defines "property" as '*property to which those parties are, or that party is, as the case may be, entitled, whether in possession or reversion.*'

The word "*property*" as it appears in s 79 of the FLA has been construed by reference to its ancestry in matrimonial causes statutes and has been given a wide meaning. If an asset is property the court has a wide power to vary its legal interests and to make orders for a settlement of property in substitution for any interest in the property.[8]

Despite the wide definition of "property" under the FLA the definition in the FLA does not extended to include powers. Property is defined to mean property to which the parties or a party to the marriage are entitled whether in possession or reversion. Section 79 of the FLA applies where the court finds that any assets, including those of a particular trust, are property of a party to the marriage. It is not the end of the matter if property is not caught under the broad definition in the FLA. Parties may find that if they have access to a 'financial resource', such as assets in a trust, those assets may become a significant factor for consideration in the family law dispute, this issue is discussed below.

DIVISION OF MARTIAL PROPERTY: S79 FLA

The Family court typically takes *"a four step approach"* when dealing property division. [9] The steps are:

a. determine the pool of assets and liabilities;
b. evaluate each of the parties' financial and non-financial contributions during the marriage and post separation;
c. determine if that contribution figure requires adjustment in light of the relevant s.75(2) factors;
d. consider whether the proposed result is just and equitable in all of the circumstances having regard to the actual result in dollar terms.

SETTING ASIDE TRANSACTIONS: s106B FLA

On occasion when a party to a marriage becomes concerned that the marriage may not continue that party, fearing any dispute over the division of the marital assets may be adjudicated by the Family Court, may seek to dispose of the assets he or she has possession or control over so as to keep the assets from the purview of the Family Court and reach of the other party.

[8] ***Kennon v Spry*** (2008) 238 CLR 366 at [10] and [54].
[9] For example see ***Pastrikos v Pastrikos*** (1980) FLC 90-897, 6 Fam LR 497; ***Lee Steere v Lee Steere*** (1985) FLC 91-626, 10 Fam LR 431; ***Ferraro v Ferraro*** (1993) FLC 92-335, 16 Fam LR 1; ***Davut v Raif*** (1994) FLC 92-503; ***In the Marriage of Hickey*** (2003) FLC 93-143; *C & C* (2005) 33 Fam LR 414. ***Milankov and Milankov*** [2002] FamCA 195; (2002) FLC 93-095 at [112] – [115]

As a way to manage such a scenario the Family Court has the power to set aside dispositions so as to bring assets of the relationship back into the 'marital pool' if it considers property has been disposed of with the intention of defeating an order of the court or to defeat third party creditors.

Section 106B FLA relevantly provides that:

> *"(1) In proceedings under this Act, the court may set aside or restrain the making of an instrument or disposition by or on behalf of, or by direction or in the interest of, a party, which is made or proposed to be made to defeat an existing or anticipated order in those proceedings or which, irrespective of intention, is likely to defeat any such order.*
>
> *(2) The court may order that any money or real or personal property dealt with by any instrument or disposition referred to in subsection (1), (1A) or (1B) may be taken in execution or charged with the payment of such sums for costs or maintenance as the court directs, or that the proceeds of a sale must be paid into court to abide its order.*
>
> *(3) The court must have regard to the interests of, and shall make any order proper for the protection of, a bona fide purchaser or other person interested."*

In summary s106B FLA may be enlivened if the circumstances are such that:

a. assets have been removed from the marital pool of assets; or
b. assets have been removed from a trust under the control of a party of the marriage; or
c. a party to the marriage has been removed as a beneficiary of a trust; or
d. a trust deed had been varied to the detriment of a party to the marriage.

The party who considers the other party has acted so as to take the assets out of the reach of the Family Court that party may seek an order to set aside the disposition. Such an order under s106B FLA will have the effect of bringing the assets dealt with by that disposition back into the pool of assets to be made available for division between the parties.

'DE FACTO' PROPERTY: the *"as If" position*

There is a strong line of authority in family law cases where property held in a discretionary trust has been treated ***as if*** it were the property of one of the parties and brought into the marital pool under s79 FLA. Not insignificantly this line of authority was reviewed by French J, both when he was a Justice in the Federal Court and after his elevation to the High Court. [10] In family law proceedings property of a trust may be treated *as if* it were the property of at least one of the parties if the court finds that the trustee was the "alter ego" or "puppet" or "creature" of the party. The terms alter ego", "puppet" and "creature" of the party are a way of saying that the relevant party controls, or is in a position to control, the exercise of the trustee's powers; and should be treated *as if* it amounts

[10] ***Kennon v Spry*** (2008) 238 CLR 366; ***Australian Securities and Investments Commission: In the matter of Richstar Enterprises Pty Ltd (ACN 099 071 968) v. Carey*** **(No 6)** [2006] FCA 814.

to ownership and in this way be included as 'property of the marriage'. If the court determines that trust assets are 'property of the marriage' then that property will be, at least notionally added to the pool of marital assets and considered under section 79 of the FLA. This is in stark contrast to the orthodox principles of trust law which says that if A controls B (that is B is the "alter ego", "puppet" or "creature" of A) the fact that A controls B does not mean that A owns the trust property.

The Family Court has introduced interesting language when dealing with the tension between the orthodox treatment of trust law and the statute based family paradigm. In ***Ashton & Ashton*** [11] the Full Court of the Family Court held that:

> *"in a family situation such as the one here this Court is not bound by the formalities designed to obtain advantages and protection for the husband who stands **in reality** in the position of the owner. He has de facto legal and beneficial ownership..." (**bold added**)*

In ***In Marriage of Goodwin*** [12] the Full Court of the Family Court held that trust property held by a corporate trustee of which the husband was a director was "in reality" the husband's property because the husband controlled the trustee and the trust for his own purposes, and the trustee acted as his "creature".

In ***In the Marriage of Harris*** [13] the husband was the appointor and guardian of a trust. The Full Court of the Family Court said that the trustee was under the complete control of the guardian as regards this position of trust property or trust income. It was argued for the husband that his interest in the trust was a chose in action as a beneficiary and although that chose in action was property, it had no real or ascertainable value. The Full Court of the Family Court did not agree and described the husband's position as follows (at 465):

> *"... the husband had the fullest power of disposition over the property and the income of the trust, including the power to cause to have distributed to himself all its income and all its corpus. If he should choose to do so, no person could complain of any breach of trust. If the trustee were to be unwilling to carry out his wishes, he could replace the trustee with another company which was in his effective control or any other person who would do his bidding. The very object of the trust, as appearing from the instrument, was to put the husband as appointor and guardian into the position of complete and unfettered control just as if he were the owner of the property. This arrangement was not a sham. It was a genuine transaction intended to bring about legitimate income tax advantage and may have had other commercial motives*."

In considering the husband's position the Full Court described the question as being whether the husband's interest under the trust was "property" which could be altered under section 79 FLA. After referring to various definitions of property, the Court concluded (at 467-468):

> *"... the husband's interest as a beneficiary under the trust in combination with his rights and powers as appointor and guardian place him, for the purposes of s 79 of*

[11] [1986] FamCA 20; (1986) FLC 91-777
[12] (1990) 101 FLR 386,
[13] (1991) 104 FLR 458

> *the* Family Law Act *into the position of an owner of property which property is constituted by his interest and his rights and powers under the trust. This property is properly evaluated as equivalent to the value of the assets of the trust*."

In ***In the Marriage of Gould*** [14] Fogarty J (with whom Nicholas CJ and Finn J agreed), distinguished acceptable use of an entity as the "alter ego" of a person from a sham and said (at 383):

> "*... the description of an entity as the 'alter ego' or 'puppet' of a person really denotes something different [from a sham]. Correctly described, it is not an assertion that it is a 'counterfeit, a facade or a false front'. Rather, it describes an actual situation although as a matter of law or practicality the actions of the other entity may be capable of and may in fact be controlled by the party in question. For example, a party may establish a trust over which he or she exercises control. That trust* [sic] *may in turn own or control property. It may be correct to describe that trust as the alter ego or even perhaps the puppet of that party, but it would not be correct to describe its existence or its ownership or control of property as a sham.*"

The Family Court's position with regard to assets held in a discretionary trust and controlled by a party to the marriage is perhaps best encapsulated by Bryan CJ in ***Stephens v Stephens*** [15] her Honour wrote (at 375) that:

> "*... a party who is the trustee of a discretionary trust, or has the capacity to appoint himself as trustee, and is also a beneficiary or who has the capacity to become a beneficiary or become a majority shareholder in a company (who is or can become a beneficiary) can have the assets of the trust treated* ***as if*** *they are his or her own property. ...* (***emphasis added***)
>
> *Were it otherwise, it is obvious that a party could, by simply acquiring or placing assets in a discretionary family trust, effectively avoid an order being made which would enable the other party to share in the property owned by the trust.*"

FINANCIAL RESOURCE: S75(2) FLA

If property is held under a trust (arguably) for the benefit of one of the parties but the other party is not able to establish that the trust property is property of the marriage it may still be possible for the court to find that the trust assets (or part thereof) are a 'financial resource' of one of the parties.

The Court's position was set out in ***Essex & Essex (No 2)*** [16] where the husband's mother had contributed assets to two inter vivos trusts to enable her to be eligible to receive an aged pension, ensure she did not dissipate her assets through "unwise or ill-considered investments" and significantly to protect her assets from any claim by the wife for property settlement had she died and left provision for the husband in her will.

With regard to the source of the funds and control of the trust it was found that:

[14] (1993) 115 FLR 371
[15] (2007) 212 FLR 362
[16] [2007] FamCA 369

a. The husband's brother was the sole director of the trustee company;
b. The husband had not received any distribution from either of the trusts;
c. The husband had some role in managing the trusts;

At first instance the trial judge concluded that:

a. the husband had no control over the trust;
b. the assets of the trusts were never assets of the parties;
c. the parties had not themselves divested property into the trusts; and
d. neither trusts were a financial resource,

On appeal the Full Court overturned the trial judge's decision and at [172] held that there was a *"compelling inference"* that the husband will receive distributions form the trusts at the conclusion of the proceedings. The Family Court's position was reaffirmed in ***Leader & Martin-Leader*** [17] where the Court held that the wife's status as a 'potential beneficiary' of the trust was relevant for determining her financial resources.

In summary the significance of a finding that assets are a 'financial resource' of one of the parties is that the cCurt will take into consideration the benefit the relevant party will receive from having access to this financial resource when considering adjustments under s75(2*)* FLA [18] and may make an adjustment of the assets so that the party without the 'financial resource' may receive a greater portion of the marital pool under the principle that it would be 'just and equitable' under s79(2) FLA to do so. [19] If there are significant matrimonial assets outside of the marital property (such as in a trust) and the court finds that this property is or will be used by one party for his or her benefit, that is the court considers it a 'financial resource' the other party may receive all or most of the marital property. The result may be, in certain circumstances, a similar result that would be produced if the court had found the financial resource as an asset to be included in the marital pool. [20]

ENTER THE HIGH COURT: *KENNON V SPRY*

It has been suggested that ***Kennon v Spry*** [21] has widened the Family Court's power to effectively disregard the existence of a trust when considering the division of assets on a property settlement. Perhaps a better rendering is that the High Court has confirmed the Family Court's powers to get behind discretionary trusts by endorsing a 'look through' (or 'as if') approach that it has taken for many years. [22]

The facts, with regard to the trusts at issue in ***Kennon v Spry*** were, in part, as follows:

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[17] [2009] FamCA 979 at [74] – [80].
[18] ***Edgehill v Edgehill*** [2007] FamCA 1102 at [22]; ***Leader & Martin-Leader*** [2009] FamCA 979.
[19] ***Esposito & Coster*** [2012] FamCAFC 118; 48 Fam LR (Coleman, Thackray & Ainslie-Wallace JJ) at [89]; ***Manolis and Manolis (No 2)*** [2011] FamCAFA 105 [65] – [66].
[20] ***Milankov and Milankov*** (2002) 28 Fam LR 513; ***Townsend*** [1994] FamCA 144; (1995) FLC 92-569; ***AJO v GRO*** [2005] FamCA 195; (2005) FLC 93-218.

[21] (2008) 238 CLR 366
[22] MacDonald A, "Protecting the family assets (trusts and divorce): Part 1" in *The Tax Specialist* Vol.14 No. 2 October 2010 at page 106; and Hannan P, "Kennon v Spry: An extended reach for s 79?"; (2010) 1 Fam L Rev 18 page 18.

a. the husband was the only person entitled in possession to the assets of the Trust.
b. No object of the Trust had any fixed or vested entitlement.
c. the husband was, after execution of an Instrument in 1983, left in possession of the assets of the Trust, with the legal title to them, and to the income which they generated, unless and until the husband should decide to apply any of the capital or income to any of the continuing beneficiaries.
d. the husband was not obliged to distribute to anyone.
e. The default distribution gave male beneficiaries other than the husband no more than a contingent remainder. None had a vested interest subject to divestiture.
f. the husband was the sole trustee of a discretionary family trust and the person with the only interest in its assets as well as the holder of a power, inter alia, to appoint them entirely to the wife.

After considering the above factual scenario French CJ held that the "*true character*" of the Spry Trust was a vehicle for the husband and wife and their children to enjoy assets.

Majority judgment

In summary French CJ held that the Trust assets were "*property of a party to the marriage*" because:

a. the assets of the Trust were acquired during the period of the marriage;
b. the husband had legal ownership of the Trust assets;
c. the husband had power as a trustee to appoint the assets to his spouse; and
d. The wife had a right to be considered.

In summary Gummow and Hayne JJ held that for the purposes of section 79 FLA, the trust property was the wife's property because:

a. The wife had a right to due administration of the Trust;
b. The husband had a duty as trustee to consider how to exercise the power of distribution;
c. The power could have been exercised entirely in favour of the wife.

Not insignificantly French CJ held in both ***Kennon v Spry*** and ***Richstar*** (as per orthodox trust law) that an object of an ordinary discretionary trust has no equitable interest in the trust assets. [23] The Chief Justice held the assets of the Spry Trust could be made the subject of orders under section 79 FLA because those assets constituted "*property of the parties to the marriage*" within the meaning of that section. [24]

According to French J trust property, when viewed from a family law perspective (at least in the context of the Spry trust and arguably more generally), may be "property of the parties to the marriage where:

[23] ***Kennon v Spry*** at [49] –[50]; see also French J in ***Australian Securities and Investments Commission: In the matter of Richstar Enterprises Pty Ltd (ACN 099 071 968) v. Carey*** **(No 6)** [2006] FCA 814 at [29].
[24] ***Kennon v Spry*** at [59] – [62].

a. The property is held by a party to a marriage under a non-exhaustive discretionary trust with an open class of beneficiaries and there is no obligation to apply the assets or income of the trust to anyone;
b. One of the spouses is the trustee (or presumably controls the trust)
c. The property has been acquired by or through the efforts of that party or his or her spouse, and
d. The property was acquired before or during the marriage. [25]

The property does not necessarily lose its character as "*property of the parties to the marriage*" just because the party has declared a trust of which he or she is trustee and can, under the terms of that trust, give the property away to other family or extended family members at his or her discretion. [26]

Aside from the fact that by the execution of the 1983 Instrument the husband excluded himself from the class of beneficial objects of the Trust, the circumstances remarked upon by His Honour were entirely commonplace in the context of discretionary trusts. [27]

Minority Judgment

Heydon J was in the minority but wrote a separate judgment. In summary Heydon J held as follows:

a. The objects of a discretionary trust do not have "*property*" in the assets of the trust in the sense in which "*property*" is understood in the general law or in the way in which that word is used in a number of important statutes.
b. The word "*property*" as used in section 79 FLA should not be given an extended meaning.
c. Even if, contrary to the foregoing, Mrs Spry did have "*property*" rights (eg by virtue of her position as an eligible object of benefaction under the Spry Trust having a right to compel the trustee to duly administer the Spry Trust) within the meaning of s 79, the orders sought by Mrs Spry were directed to gaining access to the assets of the Spry Trust (as opposed to access to the "property right" just described) and Mrs Spry had no property in those assets. As such, the "*asset orders*" sought by Mrs Spry did not meet the description "*proceedings with respect to the property of the parties to the marriage or either of them*".
d. The definition of "*property*" in s 4(1) does not contemplate entitlements to property as trustee.
e. The Family Court, in making orders under s 79, cannot ignore the existence of trust obligations which limit the rights of a party who owns the property and holds the office of trustee.

[25] per French CJ in ***Kennon v Spry*** at [65]
[26] per French CJ in ***Kennon v Spry*** at [62] – [80].
[27] See ***Thurlstone (Aust) Pty Ltd v Andco Nominees Pty Ltd*** [1997] NSWSC 517.

TRUST ORTHODOXY MEETS FAMILY LAW

As set out above courts with inherent jurisdiction (such as the Supreme Court of New South Wales) and the Family Court (who's power is based in statue) deal with trusts and trust assets in fundamentally different ways. [28]

There is a series of related cases ranging across the Family Court to the equity division of the Supreme Court of New South Wales over nearly a decade that encapsulate the tensions between the two jurisdictions and (fortunately) show that they can work effectively together. In this paper I summarise just three of the multiple of related cases to make the relevant point. The first is the ***Marriage of Davidson (No. 2)*** [29] in which the Family Court ordered the husband to pay the wife a certain sum of money and failing that exercise his power over a family trust to so that the wife may be paid out of trust assets. The husband defaulted in compliance with the Family Court's Orders and a registrar of the Family Court executed a deed as appointor of the trust (that is exercising the husband's power) to appoint a new appointor. The new appointor removed the existing trustee and appointed a new trustee, a nominee company associated with the firm of accountants. An order was made vesting the trust assets in the new trustee.

The appointment of the new trustee was challenged in the Supreme Court of New South Wales on the basis that it was a fraud on the power of appointment as being made for the purpose of making a distribution from the trust to the wife of the amount payable by the husband under the Family Court's judgment: ***Andco Nominees Pty Ltd v Lestato Pty Ltd***. [30] Santow J on hearing the matter in the Supreme Court rejected the argument and held that it was not established that the appointment of the new trustee was a fraud on the power. His Honour noted that the new trustee was required to consider the interests of all of the potential discretionary objects. He considered that it was not pre-ordained that assets would be appointed in favour of the wife and observed that the new trustee intended to act in accordance with its obligations.

The decision of Santow J in ***Andco Nominees Pty Ltd v Lestato*** was appealed to the Court of Appeal (coincidentally as was a related first instance decision of Young J). The tension between the two jurisdictions is brought into focus when Meagher JA (with whom Powell and Cole JJA agreed) in the Court of Appeal said it was "a little difficult" to know what to make of the Family Court's findings that the trust assets were "de facto" assets of the husband given that it was common ground that the trust was a discretionary trust of the normal kind and was not a sham. Significantly for present purposes neither Santow J (at first instance) nor their Honours in the Court of Appeal considered

[28] The suite of cases leading up to and including the High Court case of ***Kennon v Spry*** (2008) 238 CLR 366 are an illustration of how difficult it has been to manage the tension between orthodox trust law and family law. ***Kennon v Spry*** and related cases leading no fewer than nine judges attempted to expound and clarify the law across these jurisdictions, including five judges in the High Court who provided three (somewhat) different judgments (as further discussed below). Including the enforcement judgment of ***Stephens v Stephens*** [2009] FamCAFC 240

[29] (1990) 101 FLR 373

[30] (1995) 126 FLR 404; 17 ASCR 239.

that the effect of the Family Court's findings was that the husband was the beneficial owner of the assets of the trust. [31]

White J in ***Public Trustee v Smith*** [32] after considering the Family Law cases identified by French J in ***Richstar*** [33] and the line of Family Court and Supreme Court cases that flowed from ***In the Marriage of Davidson (No. 2)*** maintained the orthodox line with regard to beneficial entitlement in discretionary trusts and at [105] wrote:

> *"to say that a person who controls a trustee which holds property on trust for others, rather than the beneficiary of the trust, is beneficially entitled to the trust property, is inconsistent with the very notion of a trust."*

White J's reasons in ***Public Trustee v Smith*** are particularly illuminating in an area that has caused quite a few judicial minds to work overtime. White J has, at least to my mind, managed the tensions between the two areas of law where he sets out that in the context of section 79 of the FLA the expression "*property of the parties to the marriage or either of them*" should be read as extending not only to property owned by a party to the marriage but also property controlled by a party to the marriage where the control is such as to put the party in the same position ***as if*** he or she were the owner of the property. [34] No doubt his Honour has intentionally appropriated the language of Bryant CJ in ***Stephens v Stephens***.

Based on ***Public Trustee v Smith*** orthodox trust law with regard to beneficial ownership of trust property is maintained and varied only in particular circumstances where statute permits (orrequires?) it to be treated differently. In the circumstances of family law proceedings beneficial ownership of trust property may be viewed ***as if*** a party were the owner.

THE LIMITS OF STATUTORY POWER

As indicated above the Family Court, as a court of statutory creation does not have inherent jurisdiction. That is its powers are limited by statute and accrued jurisdiction. A relevant example of the Family Court's limitation is that it does not have powers in respect of the law partnership. While the Family Court has power under section 79 FLA to alter the interests of the parties to the marriage with regard to their interests in a partnership the Court would firstly need to be satisfied that there was a partnership and up to what date the partnership subsisted or whether it still subsists. [35] The Family Court can order accounts of the property of the parties to a marriage with particular reference to an account of their property as partners but at this point the Family Court reaches the limit of its powers as it cannot order partnership accounts as such if it does not find the property of the partnership is property of the marriage for it has not power over partnership assets otherwise. [36]

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[31] **Thurlstane (Aust) Pty Ltd v Andco Nominees Pty Ltd** [1997] NSWCA 517.
[32] [2008] NSWSC 397; (2008) 1 ASTLR 48
[33] **In the matter of Richstar Enterprises Pty Ltd (ACN 099 071 968) v. Carey (No 6)** [2006] FCA 814.
[34] ***Public Trustee v Smith*** [2008] NSWSC 397; (2008) 1 ASTLR 48, at [125].
[35] ***R v Ross-Jones; Ex parte Beaumont*** [1979] HCA 5; (1979) 141 CLR 504 per Gibbs J at 602.
[36] ***Summitt & Summitt and Ors*** [2009] FamCA 371 at 603.

The Family Court manages this limit to its power by notionally considering the value of assets (which may have been dispersed by a party and no longer exist) so as to determine what is a just and equitable split of the existing pool of assets under s79(3). [37]

The limits of the Family Court's power to deal with trusts and trust assets was explored in ***BP v KS***. [38] In ***BP v KS*** the parties to the marriage made a maintenance agreement which was approved by the Court. The agreement provided that the maintenance would be provided from a trust that neither party were beneficiaries of but other family members were. In effect the parties wrongly treated the assets of the relevant corporations and trusts as their own.

After suffering a stroke the husband defaulted in meeting his obligations under the maintenance agreement and the wife sought to enforce the agreement by obtaining orders that the husband exercise his powers as shareholder or director of the trustee to cause the trustee to vary the trust deed to add the wife as a beneficiary and to vest so much of the trust property in the wife as was due to her by the husband, or alternatively, to appoint the wife's nominee as trustee of the trust in order for the proposed substituted trustee to make such payment out of the trust assets.

Warnick J wrote that it was necessary to distinguish the basis of the Family Court's power and noted its limitations. Warnick J concluded:

> "*[78] There are a number of Family Court cases in which findings were made that the capital of discretionary trusts was either 'property' of a person who could control the trust or the 'defacto property' of such a person. While such findings might impliedly leave the court at liberty to deal with that property as the court sees fit, this is not necessarily so.*
>
> ....
>
> *[82] While the distinction between orders* designed to facilitate *satisfaction of other orders for property settlement by distribution from a trust and orders that* direct *that result may seem fine, it is nonetheless real.*
>
> ....
>
> *[85] In my view, this goes a step beyond the position under consideration in* Davidson*, and the orders sought, on the evidence, cross the line between facilitation and even expectation, to pre-determination. Therefore, they should not be made.*"

CONTROL

Orthodox trust law

Under orthodox trust law when assets are settled on a trust the settlor loses proprietary interest to the trustee who has a fiduciary duty to administer the trust assets for the benefit of the objects of the trust. Control of the assets is severed from the settlor as the proprietary interest is severed.

[37] see ***Milankov and Milankov*** (2002) FLC 93-095, 88,864.
[38] (2002) 177 FLR 354; 31 Fam LR 436, [2003] FLC 93-157

Family Law

In family law control over the assets of a trust is a fundamental issue for the Court when considering whether to classify assets of the trust as property of the marriage under section 70 FLA. This issue is perhaps best amplified in ***Kennon v Spry***.

The concept of '*control*' has been addressed in a number of cases in the Full Family Court [39] and is well summarised by Coleman J in ***Choate & Choate & Ors*** [40] where his Honour wrote:

> *"Unlike the position which applied in Kennon v Spry [2008] HCA 56; (2008) 251 ALR 257, whilst the husband is a discretionary beneficiary of the trusts, he does not have the legal or other capacity to control the exercise of the trustee's discretion. As such, whilst the husband is entitled to proper administration of the trusts and due consideration by the trustee, he has no "property" in the trusts as such."*

Using control as a touchstone for assessing whether assets in a trust are property of a marriage under the FLA has been effective and significantly endorsed by the High Court in ***Kennon v Spry***.

In ***Harris v Harris*** [41] the husband's father had caused the trust to be established. The husband, his mother and his sister were directors of the corporate trustee. The husband's mother held 50%, and the husband and his sister both held 25%, of the corporate trustsee's shares. The wife argued the husband controlled the trust and anything else was a sham. The Full Court applied the principles referred to in ***Kennon v Spry*** and found that, while the husband was a '*beneficiary of the trust, he did not control the trustee directly or indirectly*' and there was no basis to notionally include the assets of the trust as part of the pool of assets. In ***Coventry v Coventry & Smith*** [42] the mother of the husband was also the trustee but by contrast in that case the full court found on the facts that the husband (who was also the principal beneficiary and appointor of the trust) controlled the trust despite his mother being the trustee.

Similarly in ***Morton v Morton*** [43] the court decided that, as the husband was merely a potential beneficiary and did not in fact control the trust. The Court found that the trust was not his "alter ego" on the basis that there was insufficient control by him. The relevant facts in ***Morton v Morton*** was that the husband, his mother and brother were the primary beneficiaries of a discretionary trust and the brothers were directors of the corporate trustee and were appointors of the trust. A different result was reached in ***Beeson v Spence*** [44] although the same control analysis was used. In this case it was held the court could "look through" a trust but only because the spouse had control of the assets and could determine where the income or capital was distributed.

In keeping with the notion that control is the touchstone in family court disputes to determine whether assets of a trust are property of a marriage under section 79 FLA it remains that if neither

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[39] see ***Stephens v Stephens*** [2009] FamCAFC 240 at [37] per May, Boland and O'Ryan JJ; ***In the Marriage of Kelly (No 2)*** (1981) 7 Fam LR 762; ***Ashton and Ashton*** [1986] FamCA 20; (1986) FLC 91-777.
[40] [2009] FamCA 525 at [173]
[41] [2011] FamCAFC 245
[42] [2004] FamCA 249
[43] [2012] FamCA 30
[44] [2007] FamCA 200

party was the settlor, the appointor, or beneficiary and neither had control [through influencing the trustee, settlor or appointor] then the trust property will not be the property of the parties. [45]

In ***Richstar*** [46] French J has 'flirted' with using control as a tool to assess whether assets of a trust are property of a party in non-family disputes and considered that if a party has 'effective control' of assets of a trust the party may have 'something approaching ... the ownership of the trust property'. This approach has been met with "doubt" [47], and outright rejection. For instance Logan J in ***Minister for Immigration and Citizenship v Hart*** [48] when referring to ***Richstar*** wrote that "Notions of the effective control of a discretionary trust such as described by French J ... are foreign to the definition of 'ownership interest' as it stands."

MORE EFFECTIVE USE OF TRUSTS IN FAMILY LAW DISPUTES

If the goal is to protect family wealth from future ex-spouses then family trusts may be of some (but possibly limited) utility for while it may be possible with appropriate planning to ensure the trust assets are not part of the assets of the marriage a court may well find that the assets of the trust are a financial resource of one party and make an adjustment of ownership of the assets of the marriage on the basis that it would be 'just and equitable' to do so.

Plan early

As in all asset protection strategies it is always better to plan well before a difficulty or concern arises. In an attempt to preserve family assets it is not uncommon for spouses (most often men) to change trustee, vest the trust and distribute the assets elsewhere or remove beneficiaries when they 'discover' the marriage is in trouble.[49] A party belatedly divesting himself of control of the assets of a trust after the marriage is in difficulty will be scrutinised by the Family Court to see if the actions were for improper purposes and may look to setting aside the disposition under section 106B FLA an added the trust property back into the marital pool to be divided under section 79 and 75(2) of the FLA [50]; which is essentially what happened in ***Kennon v Spry***. [51]

Control

A trustee cannot be the 'alter ego' of a party if the party does not control the trust. [52] Not uncommonly in family discretionary trusts one party to the marriage is the sole trustee or sole director of the corporate trustee vehicle. It may be sufficient to overcome the control analysis if there are a number of trustees, or number of directors of the corporate trustee. If this were the factual matrix the party to the marriage who as a trustee (or a director) would need to obtain

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[45] ***In the Marriage of Kelly (No 2)*** (1981) 7 Fam LR 762.
[46] ***In the matter of Richstar Enterprises Pty*** Ltd (ACN 099 071 968) v. Carey (No 6) [2006] FCA 814
[47] ***Public Trustee v Smith*** [2008] NSWSC 397; (2008) 1 ASTLR 48, at [135].
[48] (2009) 179 FCR 212; [2009] FCAFC 112 at [118].

[49] Eg: ***Ashton and Ashton*** [1986] FamCA 20; (1986) FLC 91-777; ***Marriage of Davidson (No. 2)*** (1990) 101 FLR 373; ***In Marriage of Goodwin*** (1990) 101 FLR 386.
[50] see ***Coventry v Coventry & Smith*** [2004] FamCA 249.
[51] [2005] FamCA 1181 at [268] – [269].
[52] ***Morton & Morton*** op cit.

consensus from the other trustees/ directors before the party to the marriage could receive distributions of income or capital from the trust. [53]

As part of early planning to minimise section 106B from being employed to set aside the disposition it may be effective if the trust deed contains terms to the effect that a party to the marriage is automatically removed from any control of the trust (eg removal as trustee, or director of corporate trustee or appointor) if the marriage becomes troubled or the parties separate.

Beneficiaries

If a party to the marriage is one of a number of objects to a discretionary trust and the history of distributions is that the other objects of the trust have been made presently entitled then a Court may find that a party to the marriage has a mere expectancy. In this circumstance an argument that the assets of the trust were a financial resource for one of the parties will be weakened and a Court may then disregard a mere expectancy when considering the property division of the martial pool under section 79 FLA. [54]

Source of the assets

If the assets held in the trust were acquired by the efforts of at least one of the parties during the marriage then a Court is most likely to find that the assets are marital property. However if the capital in the trust was settled on the trust before the marriage or the settlor of the capital was not one of the parties then the court is unlikely to find that that the relevant asset in the trust is martial property. Depending on the factual matrix a Court might find that the trust asset is either a resource of one of the parties or a mere expectancy.

[53] ***Kelly and Kelly (No 2)*** (1981) FLC 91-108; ***Edgehill & Edgehill*** [2007] FamCA 1102 at [22].
[54] ***Goodwin and Goodwin Alpe*** (1991) FLC 92-192

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