[809] The Family Court attacking trusts: 2 key cases to remember

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The ability for the Family Court to "look through" trust structures and attack the underlying assets is an ongoing issue for all trust advisers.

Two key cases in this area are explored further below.

Testamentary Trusts

Testamentary trusts are one form of trust there have been a limited number of reported decisions on.

At least anecdotally some believe that this is because the Family Court is less inclined to consider assets held via testamentary trusts to be exposed to division on a property settlement.

The decision in *Bernard v Bernard* [2019] FamCA 421 seems to add weight to this line of reasoning, assuming the testamentary trust is properly structured and administered appropriately.

In this case, a testamentary trust was set up under the will of the husband's father, who died 3 years before the husband and wife separated.

Facts of the case

Broadly, the testamentary trust (which was named after the husband) was structured as follows:

- the husband was the primary beneficiary;
- the appointor was a third party, and although not disclosed in the case, may have been a trusted adviser;
- the husband's sister was the sole trustee; and
- the range of beneficiaries was relatively "standard" - although not limited to the bloodline of the willmaker in that the husband's wife was a potential beneficiary;

There was also a second testamentary trust for the husband's sister, structured on mirror terms.

While the (notorious) family law decision in *Kennon v Spry* (2008) 238 CLR 366 ("Spry") was mentioned by the court, it was largely only to observe that the *Spry* situation was entirely different to the facts of this case; other than for the fact that there was a trust in existence.

In holding that the assets of the husband's testamentary trust did not form part of the matrimonial pool, the court mentioned the following key aspects of the trust:

- the husband was not the settlor (rather his father was);
- the husband was not the trustee;
- the trustee retained complete and unfettered discretion to administer the trust;
- the husband was not the appointor;
- while the husband was a primary beneficiary, this of itself created no legal title to the property of the trust; and
- there was nothing to support a suggestion that the testamentary trust may be a sham.

The court also confirmed that the trustees of each of the 2 testamentary trusts had been scrupulous in their dealings and in their promulgation of resolutions, to ensure accumulation of funds to carry out the activities of the trustee, holding of meetings and in the filing of tax returns and their distinct roles as trustee and beneficiary. Indeed, the court stated that "rarely (does it) see a family law matter where tax returns and disclosure is so up-to-date and thorough, as has been in this matter". Undoubtably meaning some credit must go to the advisers for the trust.

While the testamentary trust assets were still considered a financial resource, this meant that they could only be factored in to the final property settlement in an indirect manner.

Family Trusts

The case *Morton v Morton* [2012] FamCA 30 is another important decision in relation to the way in which trusts are dealt with on a relationship breakdown.

Essentially, ***the case also confirms that, where appropriately structured, the assets of a family trust will not be considered matrimonial property on a relationship breakdown.***

The decision highlights the importance of carefully considering ***the most appropriate structure*** for trust arrangements to achieve the objectives of the parties, particularly in the context of a relationship breakdown.

This particular decision here again largely rejected arguments based on the *Spry* decision, which, at the time, caused many advisers to believe that family trusts provided little (and perhaps no) protection on a relationship breakdown.

Facts of the case

The case involved a property settlement in the divorce between Mr and Mrs Morton (pseudonym), a couple from Sydney who had been married for approximately 10 years. There were no children of the marriage.

At the time of the divorce, the husband was a beneficiary of a discretionary trust, the Morton Trust ("Trust").

The beneficiaries of the trust included the Husband ("H") and his brother ("HB"), their mother, any grandchildren or remoter relatives and any companies or trusts in which H or HB had an interest.

The trustee company, J Pty Ltd ("Trustee") had 2 ordinary shares, one owned by each of the brothers. The brothers were both the directors of the Trustee.

The brothers jointly were the appointors of the Trust.

The Trust had a "bucket company", T Pty Ltd ("Bucket Co"), which was owned 100% by Trustee on behalf of the Trust. There were unpaid present entitlements ("UPEs") owing to Bucket Co. HB was the sole director of Bucket Co.

The wife claimed that, between them, H and HB each effectively had a 50% share in the assets of the Trust and Bucket Co. As such, she argued that H's interest in the Trust and Bucket Co (half of its assets) should be treated as his property, and therefore added to his pool of assets for division under the property settlement.

Issues

The wife argued that H, as a director of Trustee, had "control" of the Trust and in turn Bucket Co. However, H argued that, as HB was appointed and acted in the same capacity as a director, neither H nor HB had control of the Trustee, and their rights were equal (ie neither brother had effective control).

The fact that the brothers were joint appointors and had the power to remove and appoint a trustee was also considered.

The court held that there was a bona fide trust arrangement. While (as most families would hope) there was a "warm and loving relationship" between the brothers and there had been inter-mixing of funds - not only their own personal funds, but funds from various entities from which the Trust received distributions – there was insufficient evidence to convince the judge that H had sufficient control over the Trust and Bucket Co to simply treat those assets as his.

It was held that the interest in the Trust and the UPEs in Bucket Co should be excluded from the husband's asset pool. The interest in the Trust was treated as a "financial resource". However, this was not a contentious issue, H had previously conceded that the interest in the Trust should be treated as such.

Implications of the decision

In considering the relevance of *Spry*, the court was satisfied on the evidence that the Trust did not hold the assets as an "alter ego" of H. As such, the judge found that the assets of the Trust were not to be treated as H's assets – ultimately, he was merely a potential beneficiary and did not in fact control the Trust.

Had it not been for the husband's brother, who was appointed as co-director of Trustee and co-appointor for the Trust, the outcome of this case may have been different.

Conclusion

The structuring of any form of trust can have significant consequences for tax, estate planning and asset protection arrangements.

The decisions in the 2 leading cases outlined in this article demonstrate that when establishing trusts and related entities, advisers should give thought to:

- relinquishing some control at a shareholder level;
- appointing multiple directors of any trustee company; and
- appointing more than one appointor (including utilising an independent person, such as a trusted adviser) and requiring that they act jointly.