Trusts and the rule in Murphy's Law

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Many previous articles in WTB have featured explorations of how trust law can often be an example of the adage of Murphy's Law, ie "anything that can go wrong will go wrong".

The case *Re McGowan & Valentini Trusts* [2021] VSC 154 is arguably a quintessential example of a trust structure going horribly wrong.

The decision focuses on 5 key problems in relation to 2 trusts, as summarised below.

Issue 1 – corporate trustee's existence

The non-existence of the (purported) corporate trustee on the date the trust deeds were "signed" (the relevant company was in fact not registered until 19 months after each trust was settled). On this issue, the Court held the following.

- Equity will not allow a trust to fail for want of a trustee because, generally, that would be contrary to the settlor's intention.
- The individual directors effectively constituted themselves as trustees of the trusts.
- On its incorporation, the company stepped into the role of the pre-incorporation trustees and, itself, became the trustee of the trusts.
- A party executing a trust deed on behalf of the intended trustee prior to its incorporation becomes a trustee of the settled sum upon receipt, and holds the sum on trust. The corporate trustee would ordinarily step into the place of the pre-incorporation trustee upon registration with ASIC and the ratification in some manner of the trust relationship (see *Rubino Investments Pty Ltd as trustee for the Rubino Family Trust v Chief Comr of State Revenue* [2018] NSWCATAD 133).
- A person can become trustee of an express trust by their conduct in administering the trust and thereby taking on the liabilities of trusteeship.

Issue 2 – ownership of property

A property which had been treated as part of the trusts' assets was purchased by and registered in the names of the later-to-be directors of the trustee company and there was no express declaration of trust in favour of the trustee company. In relation to this aspect, the Court held:

- the ownership of real property on trust must be evidenced in writing; and
- there was sufficient evidence here due to, eg statements made by the trustee directors, the financial statements of the trusts, the typed (although unsigned) declarations of trust, a lease that indicated trust ownership and the Stamps Office having the asset noted as being owned on trust.

Issue 3 – declaration of trust

Other properties registered in the name of the corporate trustee had no express, signed declarations of trust made, although had been treated as if they were assets of the trusts. With this aspect, the Court held that the following evidence was sufficient to demonstrate a written declaration of trust.

- The original deeds.
- The subsequent deeds of variation.

- Income tax returns and distribution records of the trusts from 1999 onwards.
- An affidavit of 1 of the trustee company directors.

Issue 4 – continuation of trusts

The property of the trusts vested "absolutely" in each beneficiary in 1988 and 1991 respectively, however, for another 30 years, the trustee continued to deal with the trust property as if the trusts continued. With respect to this issue, the Court held the following.

- There was nothing in the terms of the original deeds that prevented the continuation of the trusts beyond the date of vesting pending the winding up of the trusts.
- While it may be a breach of an obligation imposed by the trust deeds not to wind up the trusts upon vesting of the trust property, nobody had sought to argue that the trustee failed, in breach of trust, to wind up the trusts.
- Rather, the absolutely entitled beneficiaries of the trusts, who were each of full age and capacity, actively consented to the continuation of the trusts and, indeed, to their subsequent amendment.
- Applying the principles in *Clay v James* [2001] WASC 18, the vesting of trust property upon the absolutely entitled beneficiaries, neither brought their respective trusts to an end nor brought into existence any new trusts upon which the property was held.

Issue 5 – power of amendment of deeds

After vesting, the settlor, trustee and each absolutely entitled beneficiary purported to significantly amend the trust deeds, "relying" on the power of amendment in those deeds. The amendments introduced a wider class of beneficiaries into each trust, extended the vesting date and varied the trustee's powers. With these issues, the Court confirmed the following.

- The power of amendment in the original deeds had no express limitation on duration and, whereas it could have been drafted in a manner so as to prevent its exercise from affecting interests that had already vested, it was not so drafted. The amendment power also included the power to declare trusts in addition to or in substitution for the original beneficiary of each trust.
- Any concern about defeating established interests of the absolutely entitled beneficiaries was overcome because the settlor, trustee and each original beneficiary had all consented to any potential breach of trust.
- A power of amendment to enlarge the class of beneficiaries and vary the vesting date may also be exercised after vesting so long as it is for the benefit and with the consent of the then entitled beneficiaries.
- When determining the ambit of a variation clause, it is legitimate to consider its scope and evident purpose, however this "consideration is not much use when the evident purpose of the power is to ensure maximum flexibility".
- Furthermore, with reference to the suggestion that a variation power would not extend to permit the destruction of the substratum of the trust, often it may be impossible to locate any substratum or it may be that any such substratum may be no more than a very wide objective such as to benefit the descendants of a named person (see *Kearns v Hill* (1990) 21 NSWLR 107).
- The purpose of the trusts here was held, inferentially, to be a tax-effective mechanism for spreading the income of the entire family enterprise in an advantageous way to the family as a whole.

- Thus, the deeds of variation could be reasonably considered to be within the contemplation of the parties to the original deeds at the time they were made.
- Where a trust deed contains a power of amendment and that power is validly exercised then, so long as there is a sufficient degree of continuity, the amended trust will not result in a new trust (that is there will be no resettlement).

Issues to be aware of

While the outcome in relation to the 5 key questions was clearly positive and provides a potential pathway in similar situations from a trust law perspective, there are a number of other aspects that would generally need to be considered, including the following.

- It is likely that a number of the steps taken would have adverse revenue consequences. In particular, from a tax perspective, any amendment to a trust after the vesting date would probably trigger a CGT event (see Taxation Ruling TR 2018/6).
- Similarly, in most discretionary trusts, the default beneficiaries on vesting are likely to be different to those who will have been distributed income after the date of vesting; leading to potential disputes between beneficiary classes as well as giving the ATO cause to likely issue amended assessments.
- In most jurisdictions, a number of the transactions would have triggered duty events.
- A number of aspects of the trustee's conduct would likely be held to be breaches of trustee duties, if a disgruntled beneficiary chose to pursue the issue (an aspect that in the case here, the Court noted was raised, at least with reference to the absolutely entitled beneficiaries).
- To be legally enforceable, a number of the aspects would require court intervention; an inherently costly exercise, even in "simple" situations.
- The ability to satisfy a court that, even an ostensibly narrow range of potential "beneficiaries" have all consented to a variation may be problematic. For example, in *Kafataris v DCT* [2008] FCA 1454, a husband and wife established separate self-managed superannuation funds appointing themselves as sole members. The Court held there was in fact a potential class of beneficiaries of 21 different people. If a variation of the trust was to be requested, it would be likely that all of these people would need to consent to the proposed course of conduct.

Achieving the relevant consents will likely be even more problematic where some of the potential beneficiaries are infants, as generally the courts will require they have separate independent legal advice. That is, a Guardian ad Litem will need to be appointed (being a lawyer who is appointed by the court to be responsible for the conduct of legal proceedings for a child on the basis that the child is incapable of choosing someone to represent them).