The facts matter when using trusts to protect assets from family law attack (a $2.3 million lesson)

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A previous article in this Bulletin (reported at 2021 WTB 17 [340]) explored recent developments in the approach of the family court in relation to discretionary trusts.

The ability of the Family Court to attack assets held via a discretionary trust has been in little doubt, at least since the decision in *Kennon & Spry* [2008] HCA 56 (*Spry*).

In *Spry*, a trust that, according to the husband, did not at the relevant times feature him as a trustee, appointor or beneficiary, still saw its assets considered property of the marriage, and allocated to the wife. An intervening "trust split" that saw 4 sub-trusts created and 25% of the assets of the original trust held for the primary benefit of each of the 4 children of the marriage was effectively unwound by the decision.

Numerous cases since *Spry* have however confirmed that appropriately structured and administered trusts can provide significant protection in the event of a spousal relationship breakdown.

The recent decision in *Rigby & Kingston (No 4)* [2021] FamCA 501 provides a compelling example in this regard.

Factual matrix

In summary, the key aspects of the factual matrix were as follows.

- A group of trusts and companies was largely created by a father who under his estate plan arranged for control to pass to his 3 adult children.
- A testamentary trust was created under the father's will, controlled by the 3 adult children, with a somewhat unique obligation that the trust should vest and the assets transferred to the 3 adult children on the youngest attaining 60 (an approach that many specialist advisers would question in the context of issues such as tax planning, stamp duty management and asset protection).
- The trustee of the testamentary trust did however have discretion to make interim capital distributions to any beneficiary prior to the vesting date, meaning that there was no guarantee that the 3 adult children would in fact receive anything on vesting of the trust.
- The terms of the will set out that decisions of the trustees (being the 3 adult children) were to be made by majority, in the context that the will also specifically stated that it was the father's "desire that the benefit of my estate should pass to my children and/or grandchildren and that it is my express desire that no entitlement should accrue to any present or future spouse of my children or grandchildren particularly if such entitlement were to disadvantage my children or grandchildren or the continuity of any of the businesses which are conducted by the group of companies controlled by me".
- One of the adult children, after over 15 years of marriage, suffered a relationship breakdown and while there was a form of 'prenup' in place, it predated the legislation that would have allowed it to be binding on the parties automatically.
- It was accepted that the adult child had contributed over $10 million to the relationship, while her former husband had contributed less than $1.2 million.

- The wife returned to work after each child of the relationship with the husband was born, while for long periods the husband was unemployed or unemployable – yet still did not contribute as much as the wife to assisting with raising their children.
- The husband was wanting assets in the various trusts the wife was in joint control of added to the matrimonial pool and allocated to him.
- The husband argued the value of assets in the trusts was perhaps worth up to $100 million, while the wife claimed the assets were up to $50 million.
- The combined legal fees at the date of the trial (including those of the wife's 2 brothers who were co-trustees of many trusts with the wife) were $2,301,196 and the wife had to sell her main personal asset (a home) to fund the legal costs.

Decision

In dismissing the husband's claims and determining that the wife's interests in the assets of the various trusts were not property of the marriage, the Court confirmed the following.

The starting point in relation to the question of whether the property of the trust is, in reality, the property of the parties or one of them is a matter dependent upon the facts and circumstances of each particular case, including the terms of the relevant trust deed, and the fact there has been a long marriage is not of itself determinative (see *In the Marriage of Goodwin and Goodwin Alpe* [1990] FamCA 147).

The beneficiary of a non-exhaustive discretionary trust who does not control the trustee directly or indirectly has a right to due consideration and to due administration of the trust but it is difficult to value those rights when the beneficiary has no present entitlement and may never have any entitlement to any part of the income or capital of the trust (see *Spry*).

The only property that a trustee has in the assets of a discretionary trust is the bare legal title, which is of no practical value; and the only property that a potential beneficiary has is the right of due administration which – although it is property, in the sense that it is a chose in action – is also of no practical value (see *Gartside v Inland Revenue Commissioners* [1967] UKHL 6). This means that, without more, the interest of a trustee or potential beneficiary in a discretionary trust, although they might be within the wide definition of 'property", are of little practical worth when it comes to matrimonial property adjustment. In particular, they do not equate to an interest in trust assets (see *Karllson & Karllson* [2014] FamCA 571).

In *Spry*, the treatment of the assets of the trust as property of the parties or either of them arose as a result of a combination of factors including control, legal title, powers of distribution and the source of the trust fund. In the case here, none of those factors existed, for example:

- the wife did not control any of the trust, rather legal title was held either jointly with her 2 brothers or by a corporate trustee in which the wife was one of 3 directors;
- the wife alone could not make decisions to distribute trust funds to herself;
- the source of the funds in the testamentary trust (and essentially all other inter vivos trusts in the group) was from a stranger to the marriage, being the wife's father, and not through the efforts of the wife or the husband.

Where there is a unit or fixed trust, or a discretionary trust that has been converted into a fixed trust creating irrevocable entitlements to either income or capital, then the trust assets may be considered property of a marriage (even if sourced from a stranger to the marriage). However, that was not the case here given the trustees of the testamentary trust retained the discretion as to whom distributions would be made and in what sum, including to the total exclusion of the wife (see *Pittman & Pittman* [2010] FamCAFC 30).

Ultimately, the rights that the wife had were of little practical worth and, in the absence of control, did not equate to a proprietary interest in the assets of the trusts.

Furthermore, the Court noted that the entirety of the testamentary trust assets could be distributed at the election of the wife's brothers to beneficiaries other than the wife prior to the vesting date and that any such decision would be entirely consistent with the clearly articulated purpose of the trust (created by the father under his will, as a stranger to the marriage) that none of his property should benefit a spouse of his children.

The power of the Family Court to unwind transactions designed to prevent a spouse accessing assets (see s 106B of the Family Law Act) are of no relevance when assets of a trust are not and were not property of the spouse and the spouse has no irrevocable rights to income or capital - the powers of the court in this regard cannot be utilised to create rights that did not otherwise exist.

An "Umbrella Deed" that set out the intentions and expectations of the wife and her 2 brothers and stated an intention to ensure equality of division of assets as between the 3 parties upon cessation of the family businesses (defined as being on 30 June 2040), did not override the fiduciary obligations of the trustees of the testamentary trust to administer the trust in accordance with its terms (and indeed the Umbrella Deed specifically stated this). Thus, the Umbrella Deed did not change the conclusion that the wife had no interest of value in the various trusts.

Finally, while control of a company by a party to a marriage as well as majority shareholding may lead to the treatment of the assets of the company being treated as assets of a party to the marriage, this was not relevant here as the wife had neither the control of, nor the majority of shares in, any company (see *Ascot Investments Pty Ltd v Harper* (1981) 148 CLR 337).

Discretionary powers

In light of the above conclusions, the husband also asked the Court to instead exercise its powers to nevertheless access assets of the trusts on the basis of the powers under s 79 of the Family Law Act to "make such order as it considers appropriate" as long as the court "'is satisfied in all the circumstances, it is just and equitable to" do so.

After a careful analysis of the issues, the Court also rejected this aspect of the husband's claim. The Court confirmed that if the husband was unable to maintain himself adequately, then he had the right to claim spousal maintenance from the wife.

Conclusion

While properly crafted trusts (including testamentary trusts) can withstand attack in family law proceedings, revenue related issues must still be considered.

In this case, the tax (and presumably stamp duty) consequences of a mandated early vesting date do not appear to have been considered.