

Trusts, beneficiary loans, unpaid entitlements and getting the accounts right

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The High Court's decision in *Fischer v Nemeske Pty Ltd* [2016] HCA 11 is one of the most important trust-related cases in recent years, given the fundamentally critical role that loan accounts can play in a range of situations, not least of which, tax and estate planning.

Fischer

By way of recap, broadly, the factual matrix in *Fischer* was as follows.

- A family trust owned shares in a company.
- The trustee of the trust resolved to revalue the shares to market value, crediting the relevant amount to an asset revaluation reserve.
- Following the revaluation, the trustee distributed the reserve to 2 of the beneficiaries of the trust.
- As no amount was physically paid, the relevant amount remained outstanding as a debt and a charge (to secure repayment) was granted to the beneficiaries over the shares in the company.
- Following the death of one of the beneficiaries, the other beneficiary under his estate plan transferred the control of the trust to certain parties, with other beneficiaries entitled to personal assets under his will.
- The repayment of the loan by the trustee to the estate following the beneficiary's death was challenged by the controllers of the trustee who sought to avoid the obligation to make the payment.

Briefly, the High Court by majority held as follows.

- The resolutions creating the revaluation reserve and subsequent distributions were effective.
- This meant that the trustee of the trust was obligated to repay the debt outstanding to the estate.
- In saying this, it will not always necessarily be the case that interim distributions of capital from an asset revaluation reserve will be effective. Much will turn on the terms of the trust instrument and the relevant resolutions.
- In particular, resolutions must be consistent with the provisions of the trust instrument. Furthermore, the way in which the accounts are prepared should align both with the trust instrument and the relevant resolutions.

Overview of Australian Karting

Many of the key principles from *Fischer* are also explored in the recent case of *Australian Karting Association Ltd v Karting (NSW) Incorporated* [2021] NSWSC 1075.

The factual matrix centred on the way in which trust distributions had been documented and the financials for the trust had been prepared.

Some of the difficulties in this regard were that at different times, amounts outstanding between the trust and beneficiaries were described in the notes to the accounts as either:

- the capital and income of the (trust) fund is held on trust for the beneficiaries in the proportions contributed by the beneficiaries, by way of payment of levy or other charge; or
- the beneficiary loans are the result of the income distributed to the beneficiaries but not yet paid.

Summary of decision

Mentioning *Fischer* regularly, the NSW Supreme Court confirmed the following.

- A distribution of trust property has the effect of removing the amount distributed from the corpus of trust property.
- If the distribution is paid to the beneficiary, the distribution is complete.
- If the distribution is made but not yet paid to the beneficiary, the amount of the unpaid distribution becomes the subject of a "bare" or "absolute" trust in favour of the beneficiary to which the distribution was made.
- As the beneficiary's entitlement in such a case is absolute (by reason of the distribution), the beneficiary can call for the distribution (under the principles of *Saunders v Vautier* (1841) 49 ER 282) or obtain judgment for the amount of the distribution in an action for money had and received.
- The effect of crediting amounts to a loan account of a beneficiary is to distribute those amounts. That is, the funds are no longer held by the trustee on trust pursuant to the terms of the discretionary trust; they are held by the trustee on a bare or absolute trust in favour of the beneficiary in the amounts set out in the loan accounts and are repayable on demand by each beneficiary.
- This interpretation is consistent with the net assets of a trust generally being equal, at the end of each financial year, to the settlement sum (after deducting the total liabilities of the trust, which include the amounts in the loan accounts).
- Where a trustee admits a debt to a beneficiary, an action for money had and received lies at the suit of the beneficiary (see *Edwards v Lowndes* (1852) 1 El & Bl 81 and *Fischer*).
- The fact that there may have been no board meeting or resolution concerning a decision does not mean that a trustee company's intention has not been sufficiently established - the outcome in *Fischer* did not depend on the trust having made formal resolutions (although, as it happened in that case, the trustee had made such a resolution) to make distributions.
- Rather, for trust law purposes, latitude is given to companies in being found to have made resolutions notwithstanding that no formal meeting has taken place and no resolution has been documented (see *MYT Engineering Pty Ltd v Mulcon Pty Ltd* (1997) 140 FLR 247. This means that the intention of the directors of a company may be determined by reference to what they say or do (see *H L Bolton (Engineering) Co Ltd v T J Graham & Sons Ltd* [1957] 1 QB 159).

Conclusion

The creation and accurate documenting of loan accounts, particularly as a result of trust distributions, is crucial in a range of areas.

It is important to note however that the above comments in the Australian Karting decision in relation to the flexible requirements for making valid distributions are unlikely to be agreed by the ATO.

Rather, for tax purposes, clear and valid income distributions will normally need to be made by 30 June in the relevant income year, or such earlier date as mandated by the relevant trust deed.