

## SMSFs and unit trusts: why the legal niceties matter

- by *Matthew Burgess, Director, View Legal*

**From an asset protection perspective, most specialist advisers recommend that an SMSF intending to invest in real property (ignoring any borrowing arrangements) should do so via a unit trust.**

Conservatively, if there are multiple properties acquired, each should be owned via a separate unit trust to minimise the risk of 'domino theory' applying. This concept is one of the key asset protection principles, centred on ensuring that there is a deliberate limit placed on the number of assets owned by any one entity, and where real property is involved, that the 'site risk' of each property is quarantined in a separate trust.

The approach of leveraging a unit trust as the wholly owned investment vehicle of an SMSF is however predicated, perhaps tritely, on there being effective legal documentation.

Indeed, without appropriately drafted, legally enforceable documentation, often the only remedy will be court proceedings; with the inevitable costs and (often) unwanted attention that then result.

Furthermore, if the legal documentation is not prepared and reviewed by a law firm (as opposed to the underlying template simply being drafted by a lawyer or barrister and then sold via online document resellers), there is a likelihood that the accountant or financial planner who sourced the documentation will be liable, and potentially uninsured.

### Failed trust deed establishment

Another reminder of the issues in this regard is provided in the decision of *El-Cheikh v Miraki* [2020] NSWSC 1781, as largely confirmed (in relation to the requirements to validly establishing a trust) in the appeal decision of *El-Cheikh v Miraki* [2021] NSWCA 271.

Relevantly, in relation to an ultimately failed attempt to establish a unit trust, the key aspects were as follows:

- 1 Two business associates agreed to purchase of a property, with the intention that the acquisition would be structured through a trust (described as a 'Fixed Unit Trust (NSW Land Tax) Deed') with an individual initially appointed as trustee, who would later be replaced by a corporate trustee.
- 2 The deed for the unit trust however ultimately was created with a company listed as trustee.
- 3 While all parties accepted the trust deed was validly signed (and in this regard, the case seemed to implicitly assume the deed was wet signed; noting that an electronically signed deed would have been at risk of being automatically held to be invalid) and dated, one party subsequently, successfully, argued that the trust never came into existence.
- 4 This was because while the deed was validly executed and dated, the subscription payments for units (which were intended to be the initial trust property) were never paid. Therefore there was never any trust property to be the subject of the trust and the intended unitholders never became so. The key recitals in this regard are set out at the end of this article and reflect a relatively standard approach to establishing a unit trust.

- 5 In other words, the court confirmed that 'a trust does not exist at the time of the execution of the trust deed. It only comes into existence at the moment when the first unitholder subscribes (their) units and pays (the) subscription money'.
- 6 The purchase of the property was made by an individual, who one of the parties argued was acting as trustee of the unit trust. There was however nothing in the purchase contract of the property to suggest that the individual was purchasing the property in any capacity other than personally.

## Template unitholders agreement

- 7 A separate, undated, unitholders agreement was also signed by all parties, listing the unitholders as in fact being 'subscribers' and the individual as trustee. However because this document was executed as an agreement, no question of estoppel by deed (ie in relation to the statement that the unitholders were subscribers to the unit trust) was held to arise.
- 8 Furthermore, the court confirmed its view that the unitholders agreement was an 'ill-fitting adaption of a precedent intended to do something else, probably a shareholders' agreement'. For example the document:
- a had a heading for certain clauses of 'management of the company' when there was no definition of 'company';
  - b set out a definition of the individual as the trustee, despite the balance of the document contemplating a corporate trustee;
  - c was lodged for stamping at the Office of State Revenue, despite it not being liable for duty (unlike the trust deed).

## Failed change of trusteeship

- 9 Finally, with reference to the way in which the trust related documents were crafted, the court confirmed that the unitholders agreement did not effect an (alleged) change of trustee from the trustee company to the individual who signed the purchase contract for the property.
- 10 There were a range of reasons for the unitholders agreement being held not to evidence a change of trustee, including the inability in this case to rely on the principle of trust construction that words should not be construed as meaningless or ineffectual if a meaning can reasonably be given to them, because:
- a a trustee does much more than 'manage' the trust, thus the argument that the unitholders agreement caused a change in the 'management' of the trust was not sufficiently wide to sustain an implication of an actual appointment to the office of trusteeship, with all that entails;
  - b the court should avoid a construction that brings about a doubt in the administration of a trust. In the absence of an express removal and an express appointment of a new trustee, the court would have needed to imply whether there had been a removal of the existing trustee or imply that the appointment was of an 'additional' trustee;
  - c this doubt became real in this case, because implying a joint trusteeship between the individual and the company would have meant the property contract should have been in those joint names; which it was not.
- 11 Ultimately, while it took court intervention to resolve, it was held that despite the ineffectiveness of the legal documentation, there was in fact a common intention that the property purchased was to

be beneficially owned by the two companies (listed as the unit holders of the invalid trust deed) in equal shares.

## **Unit trust deed recitals**

- A The Subscribers will pay to the Trustee the Subscription Amount in return for Units to be issued by the Trustee.
- B The Trustee will deposit the Subscription Amount in the Bank Account with the intention that such deposit and any further amounts received and deposited will be held upon the trusts and subject to the terms contained in this Deed.
- C This Deed is made with the intention that:-
  - (i) it will bind the Trustee and each of the persons who have or may become Unitholders in the manner set out in this Deed;
  - (ii) the trusts declared in this Deed will have effect to the extent provided for in this Deed for the benefit of each Unitholder...