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Implications for SMSF appointors in discretionary trust case

by Miranda Brownlee, Deputy editor, SMSF Adviser

A recent decision involving a discretionary trust appears to confirm that appointors may not owe any fiduciary duties, according to a law firm.

In a recent article, View Legal director Matthew Burgess said the concept of an SMSF trust deed using a principal, guardian, nominator or appointor role to empower a party to unilaterally remove a trustee had been explored by a number of lawyers previously.

Mr Burgess noted that the utility of this style of power is questionable, given the SMSF rules require a member to consent to any removal from a fund under SIS Regulation 6.28.

"Furthermore, this style of role may be a fiduciary one, meaning someone cannot exercise the power for their own benefit," he stated.

However, a recent decision by the Supreme Court of NSW appears to confirm that appointors, including those for SMSFs, may not owe any fiduciary duties, he explained.

The recent discretionary trust-related case of *Cihan v Cihan [2022] NSWSC 538* involved a discretionary trust established by a father as a sole individual trustee, with immediate family members including two sons as potential beneficiaries and one of the sons as the sole nominator. This son had the ability to unilaterally change the trustee.

Mr Burgess explained that following numerous falling outs between the father and the sons, a series of five deeds of variation seeking to secure control of the trust were entered into by various parties.

The court determined that the only deed of variation that was effective was the one that saw the father retain his role as sole trustee and have himself and his two sons acting as nominators, with the ability to make decisions by a majority.

It confirmed that where there is a wide power of variation, it is rare that a court will seek to curtail the power, explained Mr Burgess.

The court found that decisions such as *Jenkins v Ellett [2007] QSC 154* may be questionable to the extent they rely on an argument that a nominator's role can not be subverted by the trustee it was designed to supervise by amending a trust deed.

"That is, if the power to vary under a deed is wide, this can allow a trustee to change a nominator, without the consent of the nominator and without destroying the substratum of the deed," Mr Burgess explained.

"While this conclusion arguably runs counter to the decision in Jenkins, critically the variation power in Jenkins was materially narrower than in the deed in the case here and similar decisions that have permitted trustees to unilaterally change an incumbent appointor such as *Mercanti v Mercanti* (2016) 50 WAR 495."

Even where a deed sets out the circumstances in which a nominator would cease to hold office and what the line of succession would be if that occurred, the court said that this does not implicitly curtail the trustee's power of amendment, explained Mr Burgess.

“Indeed, a power of amendment is perfectly consistent with the existence of specified terms in a trust deed. Any argument to the contrary, taken to its logical conclusion, would in fact prevent any amendments being made at all,” he noted.

“The court also rejected an argument that a nominator could have their actions in changing a trustee unwound on the basis of the doctrine of fraud on a power (being an exercise of a power with an intention contrary to, or not justified by, the instrument creating it).”

Mr Burgess said the court held that in the context of a modern discretionary trust and arguably SMSFs, the use by an appointor of a power to replace the trustee so as to maintain or exercise control over the trust would not necessarily be inconsistent with the purpose for which the power was conferred.

This is on the basis that there is no intention on the appointor’s part that the appointee is to act otherwise than properly in the interests of the trust and in accordance with its terms.

While the trustee in this case stated that his purpose for establishing the trust was to avoid tax on his assets, this of itself did not mean that the trust was a sham.

Mr Burgess said this conclusion by the court is also relevant for SMSFs.

“The court confirmed that if it were possible to achieve the flexibility and tax advantages associated with a discretionary trust structure while retaining legal ownership and control of the founder’s assets, then ‘everyone would probably do it’. However, the reality is that in order to achieve those results it is necessary for ownership and control of the trust property to be given up, as a matter of law, to the trustee — and this is what had occurred here,” he stated.

You can read further analysis on this case here.