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Using court applications to remedy tax risks with trust deeds

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The extent to which a trustee has power to amend a trust deed is predicated on the terms of the deed.

In this regard, it is important to note that if a trust deed does not have any, or any adequate, power of variation a trustee may apply to the court to implement changes.

State based regimes

While in some states, for example Queensland, it is generally accepted there is a relatively wide power available to the courts to assist with amending trust deeds that do not have robust provisions, the rules in New South Wales have historically been far more restrictive.

An example in this regard is the decision in *Application of Country Road Services Pty Ltd (In the matter of the Browne Family Trust)* [2019] NSWSC 779.

In this case a desired amendment to a trust deed to appoint a related trust (that had losses) to allow distributions to it was rejected as not being 'expedient' (as required by the legislation in New South Wales).

The court confirmed that:

1. The variation of the terms of a trust (including by way of conferral of some new power on the trustee) is not something within the ordinary and natural province of a trustee's powers (unless the trust deed otherwise grants the relevant power).

2. It is neither something that is 'expedient' that a trustee should do nor, fundamentally, something that is done 'in management or administration of' trust property.

3. Rather, a trustee's function is to take the trusts as it finds them and to administer them as they stand.

4. A trustee should not be concerned to question the terms of the trust or seek to improve them.

5. Thus, even where the trust instrument itself gives the trustee a power of variation, exercise of that power is not something that occurs "in the management or administration of" trust property. It occurs in order that the scheme of fiduciary administration of the property may somehow be reshaped.

6. Ultimately, the Court's power to amend a trust deed in New South Wales cannot be used to subvert the beneficial disposition in the trust instrument.

Similarly therefore, a request to amend a trust deed to extend the perpetuity period was held to be another example of the kind of order not authorised by legislation in New South Wales (see *Cisera* v *Cisera Holdings Pty Ltd* [2018] NSWCA 286), even though the trust was due to vest in around 7 years and would likely trigger significant capital gains tax costs at that point.

Interestingly, in this decision the court highlighted the fact that in NSW the variation of trust legislation was arguably inadequate, at least compared to other jurisdictions (as described below).

Subsequently the NSW regime was amended to significantly expand the powers of the court to approve any arrangement to:

(a) vary or revoke all or any of the trust, or

(b) enlarge the powers of the trustees for the purpose of managing or administering any of the property subject to the purpose of the trust.

Latest decision

The extension of the powers however does not guarantee a favourable outcome from the court, as highlighted in the subsequent decision in relation to the same trust, namely *Cisera v Cisera* [2023] NSWSC 1507. This follow up decision related to a further court application shortly before the original vesting date of the trust of 1 January 2024.

Although unclear, it appears the key driver for the application was the perceived prospective liability for capital gains tax (**CGT**) on the properties held via the trust on vesting.

In again rejecting an application (subject to any further arguments that may be made) to extend the vesting date of the trust, the court confirmed:

1. if the changes in question amount to more than a 'variation' of the trust then the court lacks power to approve the arrangement, no matter what its merits might be;

2. a key question is whether the requested changes are so extensive that the trust in its changed form no longer answers the description of a 'variation' of the existing trust;

3. the issues in this regard are ones of substance, not form;

4. to say that the changes amount to a 'resettlement' may be a useful aid to analysis, but it is not itself the test;

5. similarly, considering whether the 'substratum' (being a shorthand way to reference the distinction between changes which fall within and outside the boundaries of 'variation') of the trust has changed may

be helpful, however the focus must be on changes to the persons benefited and the nature of the benefits provided to them via the trust.

In the application here the proposal involved a rededication of the trust property away from the beneficiaries who would become absolutely entitled on vesting, in the hope of avoiding the (assumed) adverse taxation consequences of such a vesting.

The court was not satisfied that the changes could be properly described as a 'variation' of the existing trust.

CGT consequences

The court also confirmed its view that the real motivation, in other words the 'central and dominant purpose', for the application was to avoid the CGT which was believed would otherwise accrue on vesting. Managing CGT exposure was acknowledged by the court (confirming the position seen in other leading cases, such as *Re Arthur Brady Family Trust; Re Trekmore Trading Trust* [2014] QSC 244 (see 2014 WTB 44 [1445]) as being a potential reason for allowing the proposed variation.

However the court observed that there would be no utility in approving the proposed deed of arrangement if entry into it generated an equivalent tax liability to that triggered by allowing the trust to vest.

In this regard the court concluded that it was 'unlikely that a set of changes which in substance effected a complete resettlement of the trust property would escape the adverse taxation consequences of such a resettlement merely by being dressed up as a family arrangement between the parties', either due to a specific CGT event or the general anti-avoidance provisions. The court noted that the parties seemed to assume that the proposed variations were minor, with no effect on the substratum of the trust - conclusions the court did not agree with, in the absence of specialist advice to the contrary.

While the court accepted the specialist stamp duty advice presented (which confirmed there should be no duty consequences of the proposed changes), the court observed that the advice was predicated on the assumption that the changes were not substantive, a hypothesis the court again called into question.

Specialist tax advice critical

Despite the arguments of the parties and the comments of the court in relation to the CGT consequences, it appears the CGT conclusions in the case contradict the position of the Tax Office, and most specialist advisers, in this area.

In particular, unlike the argument of the applicant in this case, as confirmed in Taxation Ruling 2018/6 (see 2018 WTB 37 [1193]), the vesting of a trust, of itself, does not ordinarily cause a trust to come to an end and its property to settle on the terms of a new trust - that is, the mere vesting of a trust (with no other steps taken to distribute the trust property) will not normally trigger any CGT event.

Furthermore, the mere extension of the perpetuity period of a trust to defer its vesting is unlikely to cause a CGT event, as confirmed by the Tax Office publication in relation to resettlements, being Tax Determination TD 2012/21 (released following the landmark case of *Commissioner of Taxation v Clark* [2011] FCAFC 5). Indeed TD 2012/21 specifically confirms that the valid amendment to the vesting date of a trust pursuant to an existing power will not result in CGT - similarly, the consequence of a valid court extension clearly should be seen to be free of CGT.