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Variation of power should not be too narrow: legal expert

By Keeli Cambourne, Deputy Editor, SMSF Adviser and Matthew Burgess, Director, View Legal

A trust instrument with a variation power that is considered too narrow to achieve wider objectives can be difficult to vary, warns a legal specialist.

Matthew Burgess, director of View Legal, said making sure a variation power allows you to vary a trust deed as intended is key, as the consequences of getting it wrong can be critical.

“As with many issues this too can be explained by the mantra ‘read the deed’, and will often depend on the exact terms of the trust instrument,” he said.

A deed of variation is a legal document used to change the details of an existing trust.

In most circumstances, to properly execute a deed of variation, it is important that the appointor – sometimes referred to as a principal or guardian – consents to the proposed change along with the trustee.

The terms of the trust deed and, in particular, the wording of the variation power will set out what it does and does not permit.

Burgess said in broad terms that if there is a restriction on how the variation power may be exercised, it is generally not possible to vary the power to remove that restriction.

“In other words, a trustee cannot implement steps indirectly to achieve something that is prohibited via direct action,” he said.

“The reason for this conclusion is largely based on the rule that a trustee has an overriding duty to comply with the terms of the trust instrument as articulated on the settlement of the trust.”

However, he said it also then follows that if the power of variation expressly “contemplates itself being varied”, then the trustee should be able to do so.

“As is almost always the case with trust deeds, there are several related potential issues that should be considered depending on the facts,” he said.

“For example, if a particular trust instrument prohibits distributions to a certain person, but not to a trust of which that person is a potential beneficiary, would a ‘back-to-back’ distribution from the initial trust to the second trust and then to the relevant person constitute a breach of trustee duties?”

There is case law to support an argument that where a trustee takes steps to achieve an ulterior purpose, this can constitute a “fraud on the power”, which means the arrangements may be held to be void by a court.

The decision in Budumu Pty Ltd [2021] NSWSC 522 illustrates this point. In this case, a power to vary was granted under the trust instrument, however, it could only be relied on during the lifetime of two named (primary) beneficiaries, both of whom had died by the time the variation was required.

Court approval was needed, and granted, to ensure the trust avoided the land tax surcharge concerning foreign beneficiaries.

Burgess said another example is provided in the decision of Casibond Pty Ltd: In the matter of George Tsivis Family Trust [2021] NSWSC 320.

In this case, a trust deed had no formal power of variation, however, it did have the following provision:

"(The Trustee may) generally, determine all matters as to which any doubt, difficulty or question arises in relation to the Trust Fund and every such determination shall bind all parties interested in the Trust, but nothing in this sub-clause shall prevent the Trustee or any person interested in the Trust Fund from applying to the Court."

"This provision was held to be insufficient to allow the trustee to avoid the application of the foreign beneficiary surcharge, however again the court approved steps allowing the desired outcome," Burgess said.