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Stark reminder: original trust deeds matter

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As is generally well understood by specialist advisers, one of the key - if not the key - trustee duties of any form of trust is to know the terms of the trust deed.

The starting point in discharging this duty is to at all times retain the original wet, as opposed to electronically, signed trust instrument safe and securely.

In other words, the duty is likely be breached where the trust deed is lost - potentially even if there is a full electronic copy.

Where a deed is lost, often the only remedy that will satisfy third parties is court approval of a replacement deed. The convergence of holistic tax and estate planning being embraced by more advisers and financier requirements under the 'know your client' regime has seen an explosion in recent times of reported decisions concerning lost trust deeds.

While many of the decisions are 'good news stories' (if the financial and loss of privacy costs of court applications are ignored), there are also an increasing number of cases that provide a stark lesson for advisers and clients alike of the material downsides of fails in administrative hygiene tasks; such as maintaining an original document register.

Recent decision

The decision in *Application by Gainer Associates Pty Ltd* [2024] NSWSC 1437 reinforces many of the key rules in this area.

The court accepted that a lost discretionary trust deed had 2 primary beneficiaries, being a husband and a wife – both of whom had passed away.

The trustee company brought the court application because while the relevant trusts act (and the general law) can supply some terms of a trust (and thereby potentially avoid the need for court intervention), here there was no evidence about who all the potential beneficiaries of the trust were.

Where, as was the case here, the court is satisfied the trust deed must have specified other beneficiaries, the trust will be held to fail for uncertainty. In these situations, the court is required to confirm how the assets of the trust should be administered by the trustee.

This is in the context that where a trust fails, at law the assets of the trust revert to the settlor, through the mechanism of a resulting trust – and if the deed has been lost the avatar of the settlor is unknown.

The available evidence before the court was limited (despite the trust owning assets of circa $3M in the financials, with the market value potentially being materially more) – and centred largely on an affidavit of an administrative secretary of the deceased husband.

The court concluded that the husband may have been the settlor of the trust (which is what the secretary recalled) however it was more likely that the secretary was the settlor. If the secretary was the settlor, the court held this was 'in name only', with any initial settled property in fact provided to her by the husband (including the generally nominal amount paid to the trustee as the initial corpus of the trust).

The court concluded this finding was based on the court's 'experience with family trust deeds and common knowledge' that it is 'not unusual' for the named settlor to be someone such as the family solicitor or accountant, or a secretary or clerk in the employ of such a person. Despite this, the court concluded that there could be no doubt that such a named settlor was never in fact intended to have any beneficial interest in the relevant trust.

This analysis meant that on failure of the trust, there was a resulting trust in favour of the 'true' settlor, being the husband. As the husband was deceased, the assets therefore passed to the sole beneficiary of his will, being his wife. As she was also deceased, the court held the assets of trust would be dealt with under the wife's estate.

Second order consequences

The court observed that the high profile lost trust deed case of *Vanta Pty Ltd v Mantovani* (2023) 72 VR 19 (and later cases such as *Application of DEK Technologies Pty Ltd as trustee for DEK Technologies Unit Trust & Others* [2023] NSWSC 544) which held that the historical requirement of 'clear and convincing proof' of the terms of a lost trust deed was no longer the standard and instead there need only be 'sufficient' proof were irrelevant where there was no substantive evidence at all (as was the case here).

However the court did not consider a range of second order consequences that would seem to have a material impact on the approach approved. For example:

1. There appears to be a material risk that the revocable trust rules under section 102 of the Tax Act would be held to apply if the true settlor of the trust was (as held in this case) one of the main beneficiaries. Indeed, most specialist advisers would likely conclude (with respect) the exact opposite of the court's suggestion of what is 'common knowledge' about named settlors - that is if the named settlor is a mere puppet of the 'true' settlor of the trust, this allows the Commissioner to assess the trustee on the income from the settled property in each relevant year, and at a rate referable to the marginal rate at which the settlor would have paid tax on that income.

2. the capital gains tax (**CGT**) consequences of the assets passing from the trust to the husband's estate and then from the husband's estate to the wife's estate and then finally under the wife's estate are clearly relevant - it is assumed that CGT would have been triggered at least on the initial vesting of the trust - although in theory (assuming the rollover under division 128 of the Tax Act was available), not on the subsequent transfers;

3. similarly, there would likely be stamp duty on at least the initial transfer to the husband's estate - and possibly on each subsequent transfer

4. in relation to purported, but likely invalid, yearly income distributions made it is also likely that the trustee would be taxed on all such income and capital gains, at the top marginal rate under sections 99 or 99A of the Tax Act; with no access to the CGT discount regime;

5. any losses the trust had accumulated would have been forfeited at the date of the resulting trust;

6. the trustee company of the trust in this case also acted as trustee of a self managed superannuation fund - meaning there were likely issues around the integrity of what assets were owned by that fund; a record keeping and compliance issue often agitated by both specialist auditors and, ultimately, the Tax Office.

A further reminder for SMSF advisers

As explained in previous articles, in the context of lost SMSF trust deeds (and indeed other forms of fixed trusts with a narrow range of known beneficiaries, who can be proved via other evidence), a court application for adopting a new trust deed is generally seen as being unlikely to be necessary from a trust law perspective.

That is, the trustee and all interested beneficiaries can potentially simply resolve and agree to adopt a replacement deed.

However, the well known federal court decision in *Kafataris v DCT* [2008] FCA 1454 highlights that even for trusts with an ostensibly narrow range of potential 'beneficiaries' extreme care must be taken.

In this case, a husband and wife established separate SMSFs appointing themselves as sole members. They later declared a property owned by them as property of their respective SMSFs.

In considering who the 'beneficiaries' of each SMSF were, it was held that upon construction of the SMSF deeds, the class of beneficiaries was broader than each single member. This was because the trust deed allowed the trustee to pay

benefits to the member's dependants and even relatives (if there were no dependants, as defined under the superannuation legislation) of the member.

As such, in this case, the potential class of beneficiaries included 21 different people - for what were effectively sole member funds. If the funds had 4 - or even 6 members - the range of potential beneficiaries would probably be materially larger, and where any beneficiary was an infant or under a legal disability it is likely that court approval would be required; even if all other potential beneficiaries were in agreement.

Best practice therefore dictates that each person who can enforce the due administration of the trust should be a party to and sign a deed of variation that seeks to implement a replacement for a lost SMSF trust deed. This conclusion is supported by other decisions, for example the case of *Re Bowmil Nominees Pty Ltd* [2004] NSWSC 161, where it was held that if all potential beneficiaries agree to a variation, there is no need for the court approval.

Again however, the case of *Application by Gainer Associates Pty Ltd* [2024] NSWSC 1437 is relevant - that is if there is not even a copy of the trust deed then the ability to identify all potential beneficiaries will often be impossible, and in turn a court application unavoidable.