

ASSET PROTECTION AFTER *RICHSTAR*



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THE ABILITY OF A DISCRETIONARY TRUST TO PROTECT BUSINESS ASSETS IS CALLED INTO QUESTION BY A RECENT FEDERAL COURT DECISION.

The recent case of *Australian Securities and Investments Commission In the Matter of Richstar Enterprises Pty Ltd v Carey (No. 6)* [2006] FCA 814 ('*Richstar*') has set alarm bells ringing because of its apparent redefinition of established discretionary trust principles, with some commentators even suggesting it signals the end of trusts as we know them. What is the position?

BACKGROUND

The case stems from the litigation surrounding the failed Westpoint group. The Federal Court had already appointed receivers to the property of several directors and companies of the failed group. The Australian Securities and Investments Commission (ASIC) sought to have the definition of the 'property' to which receivers had been appointed extended to include property held by a third party on trust for a defendant, including where the defendant was a general beneficiary of a discretionary trust.

The key issue was the correct definition of 'property' in s 9 of the *Corporations Act 2001* ('the Act'). Section 9 provides that property means "any legal, equitable estate or interest (whether present or future and whether vested or contingent) in real or personal property of any description and includes a thing in action".

WHAT HAPPENED?

The Court held that some of the defendants had "at least a contingent interest" in the trust property, so that this was amenable to control by the receivers. A contingent

interest was found to arise where "the trustee is effectively the alter ego of the relevant beneficiary or otherwise subject to his or its effective control".

Although this was not the full order sought by ASIC, it still challenges the traditional view that any beneficiary of a discretionary trust has a mere 'expectancy' not sufficient to constitute 'property'.

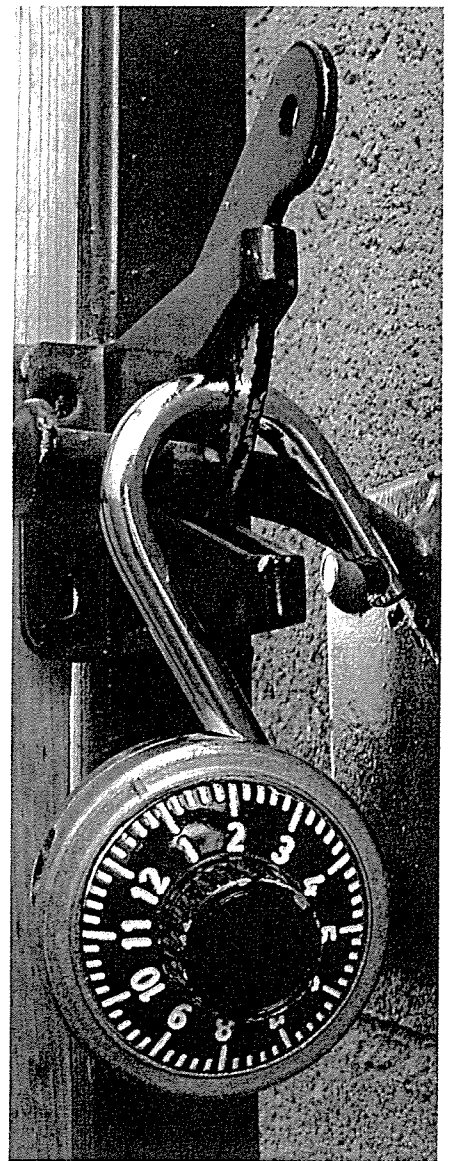
EXHAUSTIVE VS NON-EXHAUSTIVE TRUSTS

The Court held that the difference between 'exhaustive' and 'non-exhaustive' discretionary trusts was important. Differences include:

- **Exhaustive** – the trust deed requires the trustee to distribute the whole income after each defined period. If this is combined with a closed class of beneficiaries, the beneficiaries as a group can direct the trustee how to deal with the property, and can require that the legal interest in the property be transferred to them.
- **Non-exhaustive** – the trustee can distribute some, none or all of the trust income, however the trustee sees fit.

In this case, even a closed class of beneficiaries acting together cannot direct the trustee how to deal with the trust property.

It was held that "in the ordinary case the beneficiary of a discretionary trust, other than perhaps the sole beneficiary of an exhaustive trust, does not have an equitable interest in the trust income or property which would fall within even the most generous definition of 'property' in s 9 of the Act".



However, the Court went on to distinguish the 'ordinary case' from the case in which the beneficiary effectively controls the trustee's power of selection, in which case "there is something which is akin to a proprietary interest in the beneficiary".

ISSUES NOT CONSIDERED

Somewhat surprisingly, the reasons for judgment do not address whether any of the trusts in question had default beneficiaries, even though default beneficiaries have long been regarded as perhaps having a legal interest in the trust property. Also, although some significance is given to the identity of the appointor in each case, no mention is made of previous cases which have held that an appointor's power of appointment is not 'property' for the purposes of the Bankruptcy Act 1966.

WHAT HAS CHANGED?

The effect of the Richstar decision seems to be that discretionary trust assets still cannot be regarded the 'property' of a person only because that person is a beneficiary, or a trustee, or a director or shareholder of a trustee company, or an appointor. However, certain combinations of these roles may be sufficient to trigger a finding of effective control and hence an interest in 'property'. The distinction between the effect of each role individually and the effect of a combination of roles is not discussed in any detail in the case.

For many years, the Family Court has been able to 'look through' formal trust structures to decide who has de facto ownership of trust property. The decision in Richstar is significant because it is the first time that a beneficiary's interest in a discretionary trust has been held to amount to a form of property in a commercial situation. The decision in Richstar considered a number of Family Court cases in concluding that it is appropriate to

look beyond the structure of the different legal entities involved (including lifting the corporate veil) to determine whether the relevant person can be said to have effective control of the assets in question, and thus some form of contingent interest.

The Court considered the likelihood that a beneficiary who controlled the trustee's power of selection would exercise that power in their own favour. In this regard it was held that "where a discretionary trust is controlled by a trustee who is in truth the alter ego of a beneficiary, then at the very least a contingent interest may be identified because ... 'it is as good as certain' that the beneficiary will receive the benefits of distributions either of income or capital or both".

IF THIS APPROACH IS ACCEPTED AND ADOPTED GENERALLY WITHIN THE CONTEXT OF APPOINTING RECEIVERS, IT COULD PAVE THE WAY FOR TRUST ASSETS TO BE AVAILABLE TO, FOR EXAMPLE, TRUSTEES IN BANKRUPTCY OR COMPANY LIQUIDATORS.

WHAT DOES IT ALL MEAN?

This decision is a significant departure from the traditional view of trusts, but it is far from conclusive. As the case involved an interlocutory application in relation to a specific provision of the Act, its application is arguably limited to similar fact scenarios. It is also worth remembering that this is an interim decision to preserve the trust assets held. Whether the assets can in fact be distributed to creditors remains to be seen.

In addition, it was only a single judge decision, has not as yet been followed by any other judges and could still be challenged in the future.

The main concern is that, if this approach is accepted and adopted generally within the context of appointing receivers, it could pave the way for trust assets to be available to, for example, trustees in bankruptcy or company liquidators. If this were to happen, maintaining 'control' over a trustee would come at the price of reduced asset protection.

DO DISCRETIONARY TRUSTS STILL HAVE A FUTURE?

At this stage, the benefits of discretionary trusts are still sufficient to make this a valuable structure for asset protection purposes. Any decision to move away from a discretionary trust structure based solely on the judgment in Richstar would be premature. That said, the issues and questions that Richstar raises are significant and should be carefully considered in any decision-making process concerning asset protection strategies.

Richstar highlights the longstanding need to carefully review all aspects of a client's circumstances including tax planning, estate planning and succession planning, before establishing new (or changing existing) structures. **NA**

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