

Structuring

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Trusts and asset protection after Richstar

In 2006, the decision of *Australian Securities and Investments Commission In the Matter of Richstar Enterprises Pty Ltd v Carey* (No .6) [2006] FCA 814 (**Richstar**) set alarm bells ringing because of its redefinition of established discretionary trust principles, with some commentators even suggesting it signalled the end of trusts as we knew them.

This article examines the Richstar case, its effect at the time and the current position of the law in this specific area. Separate articles by specialists at McCullough Robertson consider related issues, including family law cases concerning trusts.

Background

The Richstar case stemmed 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. ASIC sought to have the meaning of 'property' (for the purposes of it being available for distribution amongst creditors) 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 considered by the decision was the definition of 'property' in section 9 *Corporations Act 2001 (Act)*. Section 9 provides that property 'means any legal or 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, which was sufficient for the property to be available to 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, the decision challenged the traditional view that a beneficiary of a discretionary trust has a mere 'expectancy', which is not sufficient to constitute 'property' which is available to creditors.

Exhaustive vs non-exhaustive trusts

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

Exhaustive trusts

Under an 'exhaustive' trust, the trust deed requires the trustee to distribute all of the income after each defined period.

Where an exhaustive trust has 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 trusts

Under a 'non-exhaustive' trust deed, the trustee can distribute the trust income however they see fit, whether that is a distribution of some, none or all of the trust income.

Under a non-exhaustive trust deed, even a closed class of beneficiaries acting together cannot direct the trustee how to deal with the trust property.

Richstar 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 section 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 judgment did 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. Further, although some significance was given to the identity of the appointor, no mention was made of previous cases which have held that an appointor's power of appointment is not 'property' for the purposes of *Bankruptcy Act 1966*.

Effect of Richstar

On its face, the Richstar decision appears to support the position that discretionary trust assets cannot be regarded as the 'property' of a person merely because that person is a beneficiary, trustee, 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 was not discussed in any detail in the case.

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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* was significant because it was the first time that a beneficiary's interest in a discretionary trust had been held to potentially 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 was appropriate to look beyond the structure of the different legal entities involved (including lifting the corporate veil) to determine whether the relevant person could have been 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 have exercised 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.'

What does this mean for discretionary trusts?

The decision in *Richstar* represents a significant departure from the traditional view of discretionary trusts, but it was far from conclusive. As the case involved an interlocutory application in relation to a specific provision of the Act, its application was, and arguably still is, limited to similar fact scenarios. It is also worth remembering that this was an interim decision to preserve the trust assets held. Whether the assets could in fact be distributed to creditors was not considered.

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 significant price of reduced asset protection.

Cases since *Richstar*

It is also important to remember the '*Richstar* decision' was only a single judge interim decision. While the judge is now the Chief Justice of the High Court, the decision itself has not as yet been followed or applied by any other judges and could still be challenged in the future.

Furthermore in *Public Trustee v Smith* [2008] NSWCA 397 (**Smith**) there is some indication of the likely scope of the *Richstar* decision. The key issue in *Smith* was whether property that was owned by a discretionary trust could be considered as being owned by a person, who was the sole shareholder and director of the corporate trustee, to enable the assets to be gifted via that person's will.

The Court made a clear distinction between actual ownership and effective ownership and concluded that the willmaker was not the actual (beneficial) owner of the trust assets. In relation to *Richstar* it was noted the Court in that case:

'Did not say that it followed from the defendant's position as beneficiaries of discretionary trusts and their control of the trustees that this amounted to actual ownership as distinct from effective control.'

In *Smith* the Judge also confirmed:

'I do not understand ASIC v Carey (No. 6) (i.e. Richstar) to establish that because a beneficiary of a discretionary trust controls the appointment or removal of the trustee, or controls the exercise of the trustee's power and can appoint trust property to himself or herself, that the holder of such a power is the beneficial owner of the trust property irrespective of the terms of the trust deed.'

The above reasoning in *Smith* was applied by the same judge in a subsequent 2008 case.

Do discretionary trusts have a future?

For the time being, the benefits of discretionary trusts are generally still sufficient to make them the preferred structure for asset protection purposes.

That said, the issues and questions raised in *Richstar* are significant and should still be carefully considered in any decision-making process concerning structure establishment or review.

Ultimately, *Richstar* and the continuing uncertainty in its current application, 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.

There is a separate focus article which provides an example 'checklist' of 20 issues to consider when determining whether a discretionary trust is the appropriate structure for the circumstances. Please click on [Trust 'checklist' - 20 issues to consider](#) to view the article.

Further information

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