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## **Discretionary Trusts in Family Law property proceedings – a crash course**

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## **Introduction**

In the discretionary trust, which is a routine structure found in Family Court proceedings, the trustee will usually be either one of the parties, or controlled by one of the parties and the trustee will have discretion as to which of the beneficiaries will receive any (and if any how much) of the trust income or capital. There will usually be historical information about the activities of the trust.

In such a trust, the primary beneficiaries will be some or all of the members of the immediate family.

There may be other corporate beneficiaries in which family members are directors and shareholders.

The Family Court regularly makes orders treating the assets of a family trust as property of a party to the marriage.

Unless, in property settlement proceedings in the Family Court, there is a concession made by a party that the assets of a trust comprise matrimonial property, the question before the court will be to what degree the property of the trust can be treated as the property or financial resource of a party to the proceedings.

## **The powers of the Family Court**

The powers of the Family Court to make orders under section 79 altering the interests of parties are very broad. Section 79 FLA in conjunction with Part VIII A of FLA provides scope to the court to make orders and injunctions which bind third parties in circumstances where an interest in a discretionary trust is found to be the property of a party to a marriage as a consequence of a party's legal or de facto control.

The power of the family court to make orders under section 79 are broad and in conjunction with Part VIII A the court has the capacity to make orders and injunctions against third parties in circumstances where an interest in a discretionary trust is found to be the property of a party to a marriage as a consequence of a party's legal or de facto control.

## **Definition of "Trust"**

The concept of a trust is defined by Ford and Lee in Principles of the Law of Trusts (1990) in the following terms (at 3);

*"A trust may be defined as an obligation enforceable in equity which rests on a person (the trustee) as owner of some specific property (the trust property) to deal with that property for the benefit of another person (the beneficiary) or for the advancement of certain purposes."*

## **Features of a discretionary trust**

Some of the basic features of trusts are:

- the trustee is the legal owner of the trust property;
- the trustee is bound to use their legal position as owner of the property for the benefit of the beneficiaries;
- as the trust is not a separate entity it cannot be a party to legal proceedings. The trustee is the appropriate person to sue or be sued. In Family Court proceedings, the trustee could be joined as a party; and
- there will not be a trust where the so called trustee is given unlimited enjoyment of the trust property.

The trustee has discretion as to how to distribute the trust income and capital. The trustee selects from a class of objects (the potential beneficiaries) persons who are to receive a particular benefit under the trust and the value of the benefits. The only right a beneficiary of a discretionary trust usually possesses is the equitable right to require the trustee to properly administer the trust.

Beneficiaries have a right to “*due consideration*” for distributions. The beneficiary has “*the right to compel the trustee to consider whether or not to make a distribution to him or her.*”<sup>2</sup> The decision to make a distribution is the responsibility of the Trustee.

The beneficiary of a discretionary trust has three types of interest<sup>3</sup>:

1. An interest, in a loose sense in the totality of the trust fund, providing the beneficiary lives to take a vested interest. This interest may be dependent upon the rights of classes of beneficiaries as defined in a trust deed. It is usual for the general beneficiaries to have rights to income and specified beneficiaries to have rights to capital;
2. An expectation of a benefit in any part of the trust fund, at the discretion of the trustee; and
3. A “*chose in action*” being the right of due administration as against the trustee.

Until such time as the trustee exercises the discretion to distribute to a beneficiary, the beneficiary’s interest in the income and capital of the discretionary trust is a “*mere expectancy.*”<sup>4</sup>

## **The Family Court**

Discretionary trusts are used as part of an overall asset protection strategy by family members and in business.

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<sup>2</sup> *Stephens v Stephens and Anor* (Enforcement) [2009] FamCAFC 240 paragraph 74

<sup>3</sup> “Discretionary Trusts” Hardingham and Bax: 1975 Butterworths page 3

<sup>4</sup> *Garside v IRC* (1968) AC 553; and also *Gummow J in FC of T v Vegners* (1989) 90 ALR 547, 551-2

There is evidence in some cases that they do provide protection in family law disputes. Some of the cases where this has occurred are considered later in this paper.

How the Family Court will treat the assets held in a discretionary trust will depend upon the facts of each case.

Some issues which may arise for the Court to consider are:

1. What the Trust Deed and any Deeds of Variation provide;
2. The identity of the trustees of the trust – are they parties to a Family Law dispute, for example;
3. Have there been changes to the trustee and if so, when?
4. If the trustee is a company, who are the shareholders and directors of the trustee company?
5. Have there been changes to those shareholders and directors and if so, when that occurred may be an important issue: for example did this happen at a time of marital disharmony?
6. Who is the appointor and succeeding appointor of the trust?
7. Who are the beneficiaries?
8. Have there been changes to the definition of beneficiaries and if so when?
9. Who were the beneficiaries of the trust prior to separation?
10. Have there been changes to the trustees of beneficiaries since separation?
11. Are the income beneficiaries different from the capital beneficiaries?
12. How were distributions made during the marriage?
13. What are the assets and liabilities of the trust?

To address the above issues, lawyers and the Court rely upon the process of disclosure pursuant to Rule 13.04 of the Family Law Rules.

In property settlement proceedings, the process of disclosure should result in all documents relevant to the Family Court proceedings being put before the Family Court.

### **Key provisions in the Family Law Act 1975 (Cth) “FLA”<sup>5</sup> in property settlement**

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<sup>5</sup> Noting that the Family Court of Western Australia 1997 (as amended) is our state act. This Act, inter alia, governs property settlement proceedings for de facto couples in Western Australia. In this paper, I will refer only to the FLA

## **proceedings**

**Section 79(1)** the powers of the court to alter property interests between the parties:

*“In property settlement proceedings, the court may make such orders as it considers appropriate....(in the case of proceedings with respect to the property of the parties to the marriage or either or them -altering the interests of the parties to the marriage in the property....including an order for a settlement of property in substitution for any interest in the property: and including an order requiring either or both of the parties to the marriage....to make, for the benefit of either or both of the parties to the marriage or a child of the marriage such settlement or transfer of property as the court determines.*

### **Powers of the Family Court**

If the assets of a discretionary trust are found to be property of the parties, then the Family Court can make orders to deal with the trust assets as if they are the assets of the parties and make orders against third party trustees.

### **What is “property” in Family Court proceedings?**

To understand the powers of the Family Court the starting point is the definition of “property” in the Family Law Act 1975 (Cth) (“FLA”) at Section 4(1),

*“Property in relation to the parties to a marriage or either of them means property to which those parties are, or that party is, as the case may be, entitled whether in possession or reversion”.*

### **No definition of property in the FLA**

The key Australian legislation definition sections do not describe an interest in a trust as property and there is no category or definition of "*matrimonial property*" in the Australian Family Law legislation.

### **Whether to treat an interest in a trust as property, a financial resource or neither**

If an interest is a financial resource, it is a relevant factor taken into account in determining how the property is to be divided, but it is not considered property, and orders will not be made against it.

### **Can a trust be regarded as property for the purposes of Family Court proceedings?**

The question of whether the property of a trust is the property of the parties to a marriage or one of them, or a financial resource of the parties or one of them is dependent upon the facts of each particular case including the terms of the relevant trust deed (*Goodwin and Goodwin Alpe*<sup>6</sup>).

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<sup>6</sup> Goodwin (1991) FLC 92-192

## Definition of property (the Family Court)

In *Jones v Skinner*<sup>7</sup> Lord Langdale MR in the Chancery Division said in 1835 that the term “property”,

*“.....is the most comprehensive of all terms which can be used in as much as it is indicative and descriptive of every possible interest which the party can have.*

In *Duff and Duff* (1997)<sup>8</sup> the Full Court of the Family Court said that, *“Property is the most comprehensive of all terms which can be used in as much as it is indicative and descriptive of every possible interest which the party can have...this is a definition which commends itself to us as being descriptive of the nature of the concept of ‘property’ to which it is intended that the Family Law Act 1975 should relate and as or which the Family Court of Australia should have jurisdiction to intervene.* In *Duff*, the Full Court found that shares held by the husband and the wife in the proprietary company, being the sole shareholders, was property.

In *Kennon v Spry*<sup>9</sup> French CJ as he then was said for the purposes of section 79, *“[t]he word ‘property’ in s79 is to be read as part of the collocation ‘property of the parties to the marriage’. It is to be read widely and conformably with the purposes of the Family Law Act”.*

Family Law cases establish that that an alteration of the interests of a party in property under section 79 is to be made out of their identified property at trial (*Gollings v Scott*)<sup>10</sup>.

There are exceptions to this general principle including a failure by a party to give full and frank disclosure such that the property at the date of trial cannot be precisely ascertained (*Chang v Su*,<sup>11</sup> and *Weir and Weir*<sup>12</sup>). In cases where non-disclosure is not an issue, a section 79 order in favour of a party cannot exceed the totality of the net assets and/or superannuation entitlements of the parties (*Gollings v Scott*).<sup>13</sup>

## Can property be defined as a “Financial resource” in Family Court proceedings

The term “financial resources” appears in section 75(2)(b) FLA. The term “financial resource” is not defined in the FLA.

Under s79 the court identifies whether a party has an interest in a discretionary trust and if so determines whether that interest should be treated as “property” or a “financial resource”.

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<sup>7</sup> (1835) 10 LJ Ch 87 at p90

<sup>8</sup> *Duff & Duff* (1997) FLC 90-257

<sup>9</sup> [2008] HCA 56

<sup>10</sup> (2007) 37 FamLR 428

<sup>11</sup> (2002) FLC 93-117

<sup>12</sup> (1993) FLC 92-338

<sup>13</sup> *Ibid* 35

In *Kelly and Kelly No 2*<sup>14</sup> the Full Court stated:

*“The financial resource which a person has is not necessarily to be equated with the asset or income from which benefit is derived. For example, if the rental of a property were regularly paid to a person under a family arrangement, the receipt of the rent may be regarded as a resource of the person concerned, not necessarily the capital value of the property. It is important therefore to define what benefit a person has received in the past and what is likely to be received in the future.”*

In *Crapp and Crapp*<sup>15</sup> the court considered,

*“that “financial resources” is a term which is clearly intended to be widely embracing and that following the definition of a “resource” in the Shorter Oxford Dictionary it indicates “a source of financial support which a party can reasonably expect will be available to him or her to supply a financial need or deficiency.”*

The High Court in *Hall & Hall*<sup>16</sup> held:

*“Whether a potential source of financial support amounts to a financial resource of a party turns in most cases on a factual inquiry as to whether or not support from that source could reasonably be expected to be forthcoming were the party to call on it.”*

In cases where the entitlement of a party in a discretionary trust is not determined to be property, but is a financial resource, the court is limited to making orders in respect of ‘property’ as defined in section 79 and 4(1) of the FLA.

It is for this reason that the question of what is ‘property’ under section 79 and particularly whether and in what circumstances a party to Family Court proceedings has property in the trust assets is so significant.

### **How will the Family Court deal with interests in trusts?**

A summary of the options available to the Family Court when dealing with interests in a trust are:

1. The assets of the trust are ignored, in a situation where neither party to the marriage has legal or de facto control over the trustee’s discretion;
2. The assets of the trust (or part of them) are treated as property of the parties (or either of them), as the person in control is treating the assets as their own.
3. The assets of the trust are not included in the property pool but treated as a financial resource of the parties (or either of them). In *Kelly and Kelly (No 2)* Fam LR 762 the

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<sup>14</sup> *Kelly and Kelly (No 2)*(1981) FLC 91-108 (@p 76,806)

<sup>15</sup> *Crapp and Crapp* (1979) FLC 90-615

<sup>16</sup> *Hall & Hall* (2016) FLC 93-709 [at 55-56]

Full Court said that “*there are circumstances in which property of a third party can be taken into account as a financial resource of the party to a marriage and the extent to which the party can control the property in question is relevant to this question.*”

It should not be assumed that because a party holds a position in a trust or has received distributions from a trust that the entire value of the trust or any of the trust should form part of the asset pool available for division. A close look at the deed and dealings of the is required.

### **Orders the Family Court could make**

Depending on the circumstances, the Family Court can order the trustee to do any of the following:

1. to distribute either trust capital or income in a particular way;
2. to fix a vesting date;
3. to bring forward the vesting date and vest the trust;
4. push out the vesting date;
5. convert a discretionary trust into a fixed trust;
6. add a beneficiary;
7. make a distribution to a party who, upon a Divorce Order being made, ceased to be a beneficiary.

When making property orders, the Family Court can override the provisions of a trust deed and bind the trustees.

### **Family Court property settlement jurisdiction**

#### **Section 79 FLA “five step” process**

##### **Preliminary step**

The Family Court must be satisfied that it is just and equitable to make any order adjusting existing property interests <sup>17</sup>. This is described as the “first step” in s79 proceedings.

The requirement for a just and equitable determination can be satisfied easily when the parties have separated, have joint property together and no longer have the joint use of the property.

In determining orders which are just and equitable the Court’s power is also said to not be confined by any “steps” or “stages” <sup>18</sup>.

The court will generally satisfy the requirements of section 79 if it follows the four stages

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<sup>17</sup> Section 79(2) FLA Stanford [2012] HCA 52

<sup>18</sup> Bevan v Bevan [2013] FamCAFC 116



process which follows below <sup>19</sup>.

### **Step 1**

#### **Identify the current property of each of the parties, identify ownership rights, and value the property.**

The Court has discretion to adopt values at the date of separation or at the date of hearing. It is more usual for the asset pool to be valued at the date of a Final Hearing, if that is required, or we use the date of any agreement being reached.

In deciding whether the assets of a company and/or a trust are “*property of the parties*” and therefore part of the available property pool for division, the Court will give consideration to the degree of “*control, ownership and management*”<sup>20</sup> exercised by either or both of the parties with respect to the trust.

### **Step 2**

#### **Identify and assess the respective contributions of the parties**

Having identified and valued all the property of the parties, the Court will then consider financial and non-financial contributions made by the parties from the date of commencement of cohabitation during the relationship and post separation.

The legislation obliges the Court to have regard to:

1. the financial contributions made directly, or indirectly by each party towards the acquisition, conservation and improvement of the property;
2. the non-financial contributions made directly, or indirectly by each party to the acquisition, conservation and improvement of the property;
3. any contribution made by each party to the welfare of the family including any contributions as a homemaker or parent;
4. the effect of any proposed order made by the Court on the earning capacity of either party you.

There is no presumption of “*equality of contributions*” as a starting point <sup>21</sup> as was confirmed in *Mallet v Mallet*. The rationale for this is that facts of each case will always be based upon unique circumstances.

Contributions are usually expressed in percentage terms. There is no mathematical formula

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<sup>19</sup> Hickey & Hickey [2003] FamCA 395

<sup>20</sup> VC & GC and Ors [2011] FCWA 89, at paragraph 99

<sup>21</sup> Mallet v Mallet [1984] 156 CLR 605

applied.

Financial contributions can include:

1. property brought into the relationship as an initial contribution;
2. Property acquired by the parties during their relationship;
3. Income earned by the parties during their relationship (noting that it is a financial contribution to accept income through the signing of taxation returns);
4. Inherited property;
5. Gifts.

Non-financial contributions can include:

6. Carrying out unpaid work in a business;
7. Gardening/landscaping;
8. Identifying property such as real estate, for purchase;
9. carrying out renovations to real estate.

Contributions to the welfare of a family can include:

10. Acting in the home as the homemaker/parent/carer

### **Step 3**

#### **Assessment of Future Needs of each party**

Having considered each party's contributions, the Court now needs to determine whether one party should receive a greater share of the asset pool as a result.

With reference to Section 79(4) and Section 75(2) of the Family Law Act the Court is required to consider a whole range of issues including:

1. The age and state of health of the parties;
2. The income property and financial resources of both parties;
3. Whether either party has the primary care of a child of the relationship under the age of 18 years.

Any adjustment at this stage is usually expressed in percentage terms and adjusted in addition to the percentages calculated on contributions.

The approach the Court should take in dealing with these factors is set out in *Ferraro*<sup>22</sup> by the

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<sup>22</sup> *Ferraro v Ferraro* (1993) FLC 92-335 at 617

Full Court saying:

*“A now well established line of authority in this Court indicates that the approach normally to be taken in the exercise of the discretion in Section 79 proceedings. That approach is firstly to ascertain the property of the parties at the time of the hearing then to consider the ‘contributions’ of the parties within paragraphs (a) to (c) of Section 79(4) of the Act and then to consider what matters in paragraph (d) to (g) and especially paragraph (e) which takes up by reference the provisions of Section 75(2) which are generally referred to as the Section 75(2) factors”.*

#### **Step 4**

#### **Consider whether the proposed division is “just and equitable” in accordance with Section 79(2) of the Family Law Act**

After the court has considered the above steps the Court considers whether the proposed final percentage division is fair. This final review could lead to a further adjustment.

The court takes into account s75(2) FLA when deciding a section 79 application to alter property interest pursuant to s79(4)(e), and the court takes into account s72 and s74 when deciding a spousal maintenance claim.

#### **The relevance of the process to identification of a trust as “property” or a “financial resource”**

Section 79 distinguishes between three sources of wealth: income, property and financial resources. The Court is required to have regard to each of these sources of wealth in deciding how to divide the property of the parties.

The Court can only make orders in respect of the property of one or both of the parties to a marriage.<sup>23</sup>

Section 79 provides the Court with a very broad discretion to *“reallocate, property as a result of two factors”*<sup>24</sup>:

- (1) *“the jurisdiction extends to all of the property of the husband and wife, whenever acquired; and*
- (2) *there is an absence of legislative guidance regarding how s 79 should be interpreted and applied...”*

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<sup>23</sup> Stephen Parker, Patrick Parkinson, Juliet Behrens *Australian Family Law in Context (The Law Book Company Limited Australia 1994)* at page 597

<sup>24</sup> Belinda Fehlberg & Juliet Behrens *Australian Family Law: The Contemporary Context 2008* at page 468 and quoting Patrick Parkinson *“Quantifying the Homemaker Contribution in Family Property Law (2003) FedLaw Review 1*

## **Other key sections and parts of the FLA which could be relevant to a Discretionary Family Trust**

**Section 72 and 74** – the power to require the payment of spousal maintenance by one party to the other party;

**Section 75(2)** – requires the court to consider a number of factors relevant to a party's financial needs including pursuant to s75(2)(b) the *“income, property and financial resources of each of the parties”*;

**Section 78** – the power of the court to declare property interests between the parties;

**Section 80** – general powers of the Court;

**Part VIII A FLA** – provisions allowing orders to be made against third parties;

**Section 106B** – the power of the court to set aside any transaction involving the assets and liabilities of the parties if that transaction has the effect, irrespective of intention, of defeating on of the parties' entitlements to property settlement.

### **Identifying the asset pool**

This takes place through the process of disclosure.

### **Disclosure in the Family Court**

Parties in the family law jurisdiction including third parties are subject to the duty of full and frank disclosure of all documents relevant to the proceedings.<sup>25</sup>

The parties are required to provide a written undertaking as to disclosure<sup>26</sup>, file a detailed Form 13 Financial Statement identifying all their property and financial resources<sup>27</sup> and provide continuous disclosure of relevant documents including filing an updated financial statement within 21 days of any significant change in financial circumstances<sup>28</sup> and prior to trial.

A beneficiary is required to disclose the documents they are entitled to have access to in the capacity of a beneficiary. These documents include the trust deed, all deeds of variation, the tax returns and financial statements. The material upon which the Trustee based decisions is not confidential unless this discloses reasons for the decisions<sup>29</sup>.

To be able to advise a client about what should be disclosed, the following documents should all be provided in the event there is a trust:

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<sup>25</sup> Family Law Rules 13.04

<sup>26</sup> Family Law Rules 13.15

<sup>27</sup> Family Law Rules 13.04 and 13.05

<sup>28</sup> Family Law Rules 13.06

<sup>29</sup> Pittman v Pittman (2005) FCWA 34 paragraph 24

1. Trust deed and deeds of variations;
2. Tax Returns and Financial Statements for the last three financial years (as a starting point);
3. Management accounts - Seek Order for provision of monthly management accounts, if not provided;
4. General ledgers;
5. The memorandum and articles of association of the corporate trustee;
6. The banking records of the trust;
7. Division 7A loan agreement/s;
8. The Minutes of the trust;
9. Trustee resolutions;
10. ATO Tax Portal statement;
11. Budgets and forecasts.<sup>30</sup>

In addition, Family Lawyers need to read the financial statements of the trust, and look for Division 7A loans and UPE's, or will need expert assistance to ensure the client is properly advised.

Often, trust and corporate structures are complex. The above checklist is applicable to all the trusts in the structure. A similar check list will apply to corporate entities.

If the structure is complex, an expert is involved.

There can be problems if a party has no funds to pay legal fees. This will require an application for access to funding. Sometimes these applications take many months to come before the Court, causing obvious problems in the litigation.

### **Accessing Trust Documents in Family Law Proceedings if disclosure orders are required**

The obligation to provide disclosure commences at the beginning of negotiations and comes to an end only when the proceedings have been finalised.

### **Who needs to give disclosure?**

The parties to Family Court proceedings including persons joined as third parties (noting this can become a costs issues).

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<sup>30</sup> For checklist and further information see *Untangling Discretionary Trusts* by Robyn Hadley and Adam Somerville-Brown (2017)

## What must be disclosed?

In *Pittman v Pittman*<sup>31</sup> - A beneficiary is required to give disclosure of all the documents which they are entitled to have access to in their capacity as a beneficiary. These documents include the trust deeds, all deeds of variation, the tax returns and financial statements. The material upon which trustees based their decisions is not confidential unless this discloses reasons for decisions made by the trustee.

*Schweitzer & Schweitzer*<sup>32</sup> held that a beneficiary of a discretionary trust “*has no interest in the corpus, but only the right to require due administration of the trust, and...is entitled to access to the financial documents of the trustees only for the purpose of ascertaining that there is due administration.*”

*Masoud & Masoud*<sup>33</sup> - there is a duty to disclose “*each document that is or has been in the possession, or under the control of the party disclosing the document; and is relevant to an issue in the case*”. For a document to be within the power of a party, the party must be in actual possession or have an “*immediate indefeasible right...to demand possession.*”

## The Family Law Rules

Rule 13.04 - parties to a financial case must make full and frank disclosure of the party's financial circumstances including but not limited to any trust:

1. of which the party is the appointor or trustee;
2. of which the party, the party's child, spouse or de facto spouse is an eligible beneficiary as to capital or income;
3. of which a corporation is an eligible beneficiary as to capital or income if the party, or the party's child, spouse or de facto spouse is a shareholder or director of the corporation;
4. over which the party has any direct or indirect power or control;
5. of which the party has the direct or indirect power to remove or appoint a trustee;
6. of which the party has the power (whether subject to the concurrence of another person or not) to amend the terms;
7. of which the party has the power to disapprove a proposed amendment of the terms or the appointment or removal of a trustee; or

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<sup>31</sup> (2005) FCWA 34 at paragraph 24

<sup>32</sup> [2012] FamCA 445

<sup>33</sup> [2016] FamCAFC 24

8. over which a corporation has a power mentioned in any of subparagraphs above, if the party, the party's child, spouse or de facto spouse is a director or shareholder of the corporation;
9. Rule 12.02 sets out the specific documents to be disclosed before the first Court date including:3 most recent taxation returns and assessments;
10. for a corporation:
  - (i) the financial statements for the 3 most recent financial years, including balance sheets, profit and loss accounts, depreciation schedules and taxation returns;
  - (ii) most recent annual return that lists the directors and shareholders; and
  - (iii) the constitution;
11. for a trust:
  - (i) the financial statements for the 3 most recent financial years, including balance sheets, profit and loss accounts, depreciation schedules and taxation returns; and
  - (ii) the trust deed.

Rule 4.15 set out further specific documents to be disclosed before the first Court date for applications which include spousal maintenance including but not limited to bank statements for 3 years.

As noted above, the parties (including third parties) are required to provide a written undertaking as to disclosure (Rule 13.15).

Parties are required to file a Form 13 Financial Statement identifying all their property and financial resources (Rules 13.04 and 13.05). If a party is aware that the completion of a Financial Statement will not fully discharge the duty to make full and frank disclosure, the party must also file an affidavit giving further particulars (Rule 13.05(2)). Consider attachments to Form 13 including the Financial Statements of any Trusts.

Parties are required to provide continuous disclosure of relevant documents throughout proceedings, including filing an updated Financial Statement within 21 days of any significant change in financial circumstances (Rule 13.06).

Rule 13.14 of the Family Law Rules 2004 sets out the consequence of non-disclosure. A non-disclosing party may amongst other things:

1. be guilty of contempt for not disclosing documents; and,
2. be ordered to pay costs.

## Effect of non-disclosure

If the court is satisfied there has been non-disclosure, the adverse findings against the non-disclosing party will follow.

In *Fotia & Welsh*<sup>34</sup> His Honour Walters J discussed parties' obligations to give full and frank disclosure and observed that:

*"Where the Court cannot be satisfied as to the extent of a party's property, it can be less cautious<sup>35</sup> than might otherwise be the case when making relevant orders (see Mezzacappa & Mezzacappa; Black & Kellner<sup>36</sup> and Weir & Weir<sup>37</sup>)".*

The decisions in the above authorities indicates that the Court is entitled to take a "robust view" in relation to findings regarding a party's financial position (including a party's capacity to meet any proposed order) where that party has failed to make full and frank disclosure of his/her financial position:

see *Chang v Su*<sup>38</sup>

In *Chang v Su*, it was said that the Court's role is not to audit the husband's financial records, or those of the partnership or other entities. It was for the husband to present evidence of his financial position in a clear and understandable form. In this case, that was not done. Having regard to the various criticisms and comments raised in relation to a specific exhibit (W2), the court found it could not rely on the accuracy of the financial material presented by the husband. In essence, the Court had to do the best it could with the limited information available to it.

In *K & K*<sup>39</sup> the Full Court said:

*"Whether the non-disclosure is willful or accidental, is a result of misfeasance, or malfeasance or nonfeasance, is beside the point. The duty to disclose is absolute. Where the Court is satisfied that the whole truth has not come out it might readily conclude the asset pool is greater than demonstrated. In those circumstances, it may be appropriate to err on the side of generosity to the party who might otherwise be seen to be disadvantaged by the lack of complete candour".*

## Other relevant legislation in cases of non-disclosure

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<sup>34</sup> [2013] FCWA 112

<sup>35</sup> (1987) FLC 91-853

<sup>36</sup> (1992) FLC 92-287

<sup>37</sup> (1993) FLC 92-338

<sup>38</sup> [2002] HCA 446

<sup>39</sup> (2002) FamCA 1150 (reported as (2003) FLC 93-135)



Section 117 of the Family Law Act enables the Court to make an Order for costs against a non-disclosing party.

The Criminal Code Act Compilation Act (WA) 1913 deals with issues relating to perjury. Sections 124 and 125 deal with the offence and the penalty of imprisonment of up to 14 years.

### **Subpoenas**

Subpoenas are issued in the absence of disclosure to the trustee or corporate trustee to determine whether a party's beneficial interest is property or a financial resource and to value that interest. When drafting a subpoena issues of relevance need to be considered, and costs issues.

### **Joinder**

If there is an issue in dispute regarding legal or de-facto control over a party regarding the trust or the value of the interest held or if there is a loan, there is potential to consider whether the trustee or corporate trustee should be joined pursuant to Rule 6.02 of the Family Law Rules 2004. Compliance with Rule 6.03 is required, and the issue of procedural fairness (*B Pty Ltd v K*). It is also necessary to consider costs considerations. It is impossible to avoid joining the trustee if an order is required against the trust assets.

### **Evidence in the proceedings**

#### **Questions to be asked**

Is the Trust property of the parties to the marriage or either of them? Consider from outset:

1. Has the deed been validly signed?
2. Has the vesting date passed?
3. Has any event changed the nature of the trust?
4. Have all recipients of distributions been beneficiaries?
5. Who is the trustee of the trust? If the trustee ceases to act, do their powers pass to anyone else, and if so, who?
6. Does the trustee need consent/approval of any other person to exercise any of its powers?
7. Does someone (e.g. a principal, guardian, appointor) have the power to unilaterally change the trustee?
8. Is the role of trustee and principal (if any) automatically terminated on certain events (for example death or bankruptcy)?

9. If the principal ceases to act, do their powers automatically pass to anyone else, and if so, who?
10. Is there any risk that the trustee may be seen as simply the 'alter ego' of some other person? What evidence is there of this?
11. Does the trust deed restrict the range of beneficiaries who can receive income or capital distributions?
12. Can beneficiaries be removed or added, and if so by whom?
13. For an existing trust, has there been a pattern of income or capital distributions? There needs to be a careful evaluation of the source of the trust funds – see Justice Watt in *Simmons & Simmons*<sup>40</sup>.
14. What is the date by which income distributions should be made in each financial year? See Income Tax Ruling IT328 and IT329 - "*All trustees who make beneficiaries entitled to trust income by way of a resolution must do so by the end of an income year (30 June). This resolution will determine who is assessed on the trust's taxable income*". The Accounting Period is defined in each Trust Deed. Resolutions by Trustees are to be done before 30 June in each year. If resolutions are made after 30 June see Sections 99A(4) and (4A) ITAA (1936).
15. How is trust income defined and does the trustee have power to alter the meaning of trust income?
16. Is there a broad power to vary the deed?
17. Have variations to the deed been validly made e.g. is there an appropriate exercise of the variation power and have all necessary consents been obtained? See *Mercanti v Mercanti*<sup>41</sup>, in relation to management of trusts and amendment of trust deeds. This is a decision of the WA Supreme Court heard by Le Miere J dated 20 August 2015. The Court of Appeal (Buss P, Newnes and Murphy JJA) dismissed the appeal from that decision. The case involved the scrutiny of two discretionary trust deeds and whether deeds of amendment in relation to each trust were valid. The court found the power to amend existed in one trust deed but not in the other trust deed with serious consequences. The High Court dismissed the application for special leave to appeal.

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<sup>40</sup> [2008] FamCA 1088

<sup>41</sup> [2015] WASC 297

18. Should the trust deed be amended due to changes in the law since it was established?

19. Are there carry-forward tax losses or a family trust election or loan accounts?

(<sup>42</sup>See also checklist from 'Using Testamentary and Family Trusts to Protect against Family Breakdown in the Next Generation' by James Ellwood, Director, View Legal)

If the trust is property or a financial resource of the parties to the marriage or either of them, then the next steps are to:

1. Obtain independent financial/accounting/commercial law advice including advice in relation to tax implications – income tax, CGT, GST, any concessions available, Div 7A loan accounts, deemed dividends and UPE's.
2. Ascribe a property value to the trust.
3. Decide how trust is to be dealt with – remove one party, retain trust, vest or transfer assets from the trust, vest the trust and wind it up.

### ***Ascot Investments Ltd v Harper (1981)***

In *Ascot Investments Pty Ltd v Harper*<sup>43</sup> a finding of the Family Court of the existence of a sham, puppet or alter ego arrangement (where the person with legal control of the trust is the puppet or controlled by the beneficiary) permitted the High court to treat trust property as matrimonial property.

The High Court set out the limitation of the Court's power as follows:<sup>44</sup>

*"Except in the case of shams, and companies that are mere puppets of a party to the marriage, the Family Court must take the property of a party to the marriage as he finds it. The Family Court cannot ignore the interests of third parties in the property, nor the existence of covenants that limit the rights of the party who owns it."*

The early cases indicated limitations on the power of the Court to make orders against property held in discretionary trusts<sup>45</sup>.

More recently, the courts have had to deal with trusts wholly or substantially funded by the parents of a party, and trusts in which neither party to the marriage has actual or effective sole control, or in which a third party had a genuine interest. There are many examples.

### ***Ashton and Ashton (1986)***

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<sup>42</sup> checklist provided by Robyn Hadley and Adam Somerville-Brown in "Untangling Discretionary Trusts" 2017

<sup>43</sup> *Ascot Investments v Harper* [1981] HCA 1

<sup>44</sup> (1981) FLC 91-000

<sup>45</sup> *In the marriage of Kelly (No. 2)* (1981) 7 Fam LR 762 @ 768

Commencing with *Ashton and Ashton*<sup>46</sup> the Family Court has been willing to treat a discretionary trust as the property of a party to a marriage.

In *Ashton* the husband and his cousin were the directors of the corporate trustee. The husband was the appointor. The husband was not a beneficiary. The husband removed the trustee on two occasions. The court found the husband had de facto ownership of the property of the trust. The interest in the trust was found to be property.

Special leave to appeal was sought against the Full Court decision in *Ashton* and this was refused by the High Court in December 1986.

### **Subsequent cases to *Ascot Investments v Harper and Ashton and Ashton***

In subsequent cases in 1991 the Court found interests in a trust to be the property of the parties to a marriage (*Davidson and Davidson*<sup>47</sup>, *Harris & Harris*<sup>48</sup>, *Goodwin*<sup>49</sup>, *JEL & DDF*<sup>50</sup>).

In each of these cases the trusts were settled during the marriage, and the property of the trust was built up during the marriage. In each of the cases, a party to the marriage had a controlling role and the ability to directly or indirectly apply the trust property for the benefit of a party to the marriage.

### **Gould v Gould (1993)**

In *Gould*<sup>51</sup> the Court gave an example where it could interfere in the following passage "*a party may establish a trust over which he or she exercises control. That trust may in turn own or control property. It may be correct to describe that trust as the alter ego or even perhaps the puppet of that party.*"

### **Harris v Harris (1991)**

The principle in *Harris*<sup>52</sup> indicates that if a party has the ability under a trust deed to distribute all the income and assets of the trust to themselves, then that party will be regarded as having the right to all the assets of the trust as if he or she were the legal owner. The test of "*control*" thus emerged in 1991 from the case law, and became the foundation for future decisions.

### **Prior to Kennon v Spry**

It was necessary to establish control/puppet/alter ego and there was some confusion about

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<sup>46</sup> *Ashton and Ashton* (1986) FLC 91-777

<sup>47</sup> *Davidson and Davidson* (1991) FLC 197

<sup>48</sup> *Harris & Harris* (1991) 104 FLR 4548

<sup>49</sup> FN 33

<sup>50</sup> *JEL and DDF* (2001) FLC 93-075

<sup>51</sup> (1993) FLC 92-434 @ p.80433

<sup>52</sup> (1991) FLC 92-254 at pages 78,706-78 to 78,708

the circumstances in which trust assets might be regarded as property.

Following *Kennon v Spry* the issue is whether there are "rights": that is the right of a beneficiary to due administration of a trust. If there are "rights" then the position of the majority in *Kennon v Spry* is that the rights are property and capable of valuation.

### **Stephens & Stephens 2007 (Full Court)<sup>53</sup>**

### **Kennon v Spry<sup>54</sup> 2008 (High Court)**

The Full Court decision *Stephens & Stephens* was appealed to the High Court. The High Court's decision is reported as *Kennon v Spry*.

The majority established that where, on the evidence, a party has legal or de facto control of a discretionary trust, then that party's interest in the discretionary trust is part of the property of the parties.

#### **Key facts:**

1. Dr Spry, the husband, was the sole trustee of the ICF Spry Trust. He created the ICF Spry Trust in 1968 with his siblings, their spouses and their children as beneficiaries.
2. In 1983, Dr Spry excluded himself as a beneficiary for land tax reasons.
3. In 1988, there was Deed of Variation which removed Dr Spry and the wife as capital beneficiaries at a time of marital disharmony. Following the variation, the parties separated.
4. In January 2002 Dr Spry divided the income and capital of the ICF Spry Trust equally between four trusts he had set up for the parties' four daughters. He distributed some shares to which he was beneficially entitled to the four daughter's trusts.
5. Dr Spry was the joint trustee of the four trusts and had de facto control of the trusts.
6. The parties were divorced in February 2003.

The wife sought orders in section 79 proceedings for to set aside the initial variation, the establishment of four trusts, and the transfer of Dr Spry's shares.

At first instance Strickland J set aside the 1998 variation and the 2002 disposition of assets pursuant to Section 106B of the FLA. He ordered Dr Spry to pay the wife a sum exceeding \$2 million.

Dr Spry appealed the decision and he and his co-trustees of the children's trusts cross

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<sup>53</sup> *Stephens v Stephens* (2007) FLC 93-336

<sup>54</sup> (2008) 238 CLR 366

appealed.

The Full Court dismissed the appeals and the cross appeals.

Dr Spry then applied for special leave and the High Court. The majority of the court, French CJ, Gummow, Hayne and Keifell JJ in separate judgments (Heydon J dissenting) dismissed the appeal with costs.

The majority found the husband was not a beneficiary and could not be restored as a beneficiary, but had at all times been the trustee with legal title to the trust assets. As he was not a beneficiary, he could not make distributions to himself. That did not matter. As legal owner of the trust assets he had the power to appoint the whole of the trust fund, capital and income, to the wife.

Without the 1998 variation and 2002 disposition, the wife would have had a right to due administration of the trust and due consideration as a beneficiary. During the marriage the husband could have appointed the whole of the trust fund to the wife, and the potential enjoyment of the whole of that fund was "*property of the parties to the marriage or either of them*" within the meaning of the Family Law Act.<sup>55</sup>

The Chief Justice said, "*Where property is held under such a trust by a party to a marriage and the property has been acquired by or through the efforts of that party of his or her spouse, whether before or during the marriage, it does not, in my opinion, necessarily lose its character as "property of the parties to the marriage" because the party has declared a trust of which he or she is trustee and can, under the terms of that trust, give the property away to other family or extended family members at his or her discretion. For so long as the husband retained a legal right to the trust fund coupled with the power to appoint the whole of the fund to his wife and her equitable right, it remained, in my opinion, property of the parties to the marriage for the purposes of the power conferred on the Family Court by s79. The assets would have been unarguably property of the marriage absent subjection to the Trust.*

*An exercise of the power under s79 requiring the application of the assets of the Trust in whole or in part in favour of Mrs Spry would, prior to the 1998 Instrument, have been consistent with the proper exercise of Dr Spry's powers as trustee and would have involved no breach by him of his duties to the other beneficiaries".*<sup>56</sup>

### **What was the "property" in Kennon v Spry?<sup>57</sup>**

The Chief Justice said that the trust assets combined with the trustees power to distribute

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<sup>55</sup> Above n, 39 at Paragraphs 70 and 137

<sup>56</sup> Above n, 39 at paragraphs 66 and 67

<sup>57</sup> Mr. Grahame Young, Barrister, CPD session 2009 considered "*what was the property in Kennon v Spry*"

assets to Mrs Spry was the property of the parties within the mean of Section 79<sup>58</sup> . The term "*property*" did not have one specific and precise meaning and it was necessary to pay close attention to any statutory context in which the term is used. <sup>59</sup>

Their Honours, Gummow and Hayne JJ said that for the purpose of s 79, Dr Spry's power as trustee to apply the whole of the trust fund to the wife was property<sup>60</sup>.

His Honour Justice Heyden said that although Dr Spry was entitled to the whole of the trust assets, it did not follow that the trust was his property under s 79. His Honour's position was that the trust assets were not the property of the parties<sup>61</sup>.

Her Honour Justice Keifel followed a separate line of reasoning and did not decide this issue and based her decision on Section 85A. She did not consider the question "*what was the property of the parties*".

### **Are "rights" property?**

The Chief Justice said that "*rights*", or the right to due administration of a trust, are property<sup>62</sup>.

Their Honours, Gummow and Hayne JJ looked at the technical elements of a trust. Their Honour's said that beneficiaries do have rights: their rights are to due administration and when this is added to the power Dr Spry had as trustee, this was property. Their Honour's said that "*rights*" are property and they said the value of those rights was the value of the property.<sup>63</sup>

His Honour Heydon J said that "*rights*" in family trusts are not property<sup>64</sup>.

### **Can "rights" be valued?**

His Honour the Chief Justice said "*rights*" are capable of valuation and referred to the possibility of an actuarial calculation. There was nothing in the judgment to provide guidance for the basis of such a valuation. For example, His Honour did not refer to the possibility of valuing an income stream. There was nothing in the judgment to indicate how the income had been distributed or if it had been distributed.<sup>65</sup>

Their Honours Gummow and Hayne JJ said that because the husband had the power to appoint the whole trust fund to the wife during the marriage, the value of right of the wife

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<sup>58</sup> Above n, 39 at Paragraph 58, 59, 62, 68, 70, 71

<sup>59</sup> Above n, 39 at paragraph 89-90

<sup>60</sup> Above n, 39 at paragraph 137

<sup>61</sup> Above n, 39 at paragraph 174, 175

<sup>62</sup> Above n, 39 at paragraph 80

<sup>63</sup> Above n, 39 at Paragraphs 73, 78, 125, 126, 137

<sup>64</sup> Above n, 39 at Paragraphs 160-163, 165

<sup>65</sup> Above n, 39 at Paragraphs 77 and 78

equaled the value of the assets in the trust fund<sup>66</sup>.

His Honour Heydon J said that a power is not property<sup>67</sup> and did not place a value on "rights" or "powers".

### **Summary of Kennon v Spry**

In *Kennon v Spry* the matrimonial property was said by some members of the Court to be the wife's right to due administration of the trust and her right to consideration for distributions of capital and income.

It was the conjunction of several factors, namely Dr Spry's legal title to the trust assets as trustee or his control of the trust, the wife's position as a beneficiary, and the nature of the assets in the trust (including the family home), which was determinative in this matter.

### **What did the High Court say about "control"**

The Chief Justice, and Gummow and Hayne JJ did not use the word "control": what they did was to focus on the rights and duties created by the documents constituting the Spry Trust<sup>68</sup>.

### **The consequences of the High Court decision**

Peter Hannan said in his article referenced in the footnotes: *"the upshot of the majority decision is that the family law courts can deal with trust arrangements in a far more robust way than was possible in the past. The use of the trust structure, particularly one which is in reality a device within which to accumulate family assets is now even less likely to put such property beyond the jurisdiction of the Family Court."*<sup>69</sup>

The right to due consideration for trust distributions by a beneficiary can now be considered property, in the absence of control, but in the presence of rights and duties.

Peter Hannan also said these judgments provide<sup>70</sup>, *"an extension of the reach of s 79"* by expanding the definition of property to include *"rights and duties"*.

One criticism of the decision of the High Court in *Kennon & Spry* is the difficulty in placing a value on rights and powers as property but then in *Pittman & Pittman*<sup>71</sup> the Full Court said, *"uncertainty of ultimate value cannot provide a reason for not categorising an item as property."*

### **Cases after Kennon v Spry**

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<sup>66</sup> Above n, 39 at Paragraph 174

<sup>67</sup> Above n, 39 at Paragraph 164

<sup>68</sup> Above n, 39 at paragraph 164

<sup>69</sup> Peter Hannan, "An extended reach for Section 79" (2010) 1Fam L. Review 18 at page 26

<sup>70</sup> Ibid, at page 30

<sup>71</sup> *Pittman & Pittman* (2010) FLC 93-430 Full Court at 64



### ***Simmons and Onor v Simmons (2008)***

In 2008, the Family Court interim matter of *Simmons v Simmons*<sup>72</sup> concerned an application by the husband and L Pty Ltd for summary dismissal of the wife's application under Part VIII A for final property orders. The application failed.

In this case, control was not relevant to determining whether the trust assets were property or a financial resource. The relevant issue here was the connection between the husband and the trust assets as a result of his significant loans to the trust on very favourable terms. The loans required no interest payable at any time. The initial repayment period being 25 years which was then extended by a further 10 years.

On an interim basis, Watt J found that the facts in the case established a connection between the husband and the trust assets such that he was not satisfied the wife's claim against L Pty Ltd was doomed to failure because it showed no reasonable course of action, nor that the court lacked jurisdiction to exercise the powers conferred on it by Part VIII A.

The husband's rights as a beneficiary were important and his contributions to the trust assets were the relevant factors in His Honour's determination.

#### **Basic facts**

The husband's father established the relevant trust over 50 years earlier and at the time of trial the trust owned several businesses around Melbourne. He had died in 1999. He was survived by his widow and their five adult children including the respondent husband. The family settlement was a discretionary family trust of which all members of the Simmons family were beneficiaries. The husband's mother controlled the trust as Appointor.

*L Pty Ltd* was the trustee of the trust, and three of the six directors of this entity were members of the Simmons family with the directorships rotating through the family as was consistent with a board resolution of *L Pty Ltd*.

The husband was not a shareholder. He had been a director until he resigned in 2003. It is not clear whether his resignation occurred at a time of marital disharmony.

The husband and his siblings and their mother received regular trust distributions. The husband received the same dividends as other family members from *L Pty Ltd* and additional sums when the dividends were distributed.

One of the objects of the trust which was continuing to run businesses established by the husband's father, was "*return on investment to the family*".

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<sup>72</sup> *Simmons & Anor v Simmons (2008) FamCA 1088*

### ***Keach v Keach & Ors (2011)***

In *Keach*<sup>73</sup>, the husband's father established four trusts for each of his four children.

The husband's father was the Appointor of "*Junior*" trust and had made all the decisions for the trust. The structure included a corporate trustee in which the father held five shares and the husband's brothers and his mother had one share each. A new corporate trustee was appointed later and the husband's brothers were shareholders. The beneficiaries were the husband and his three siblings. The husband had no direct control. The assets included the family home occupied by the husband and wife.

The court considered whether or not a trust was sham, and whether the property of the trust was in reality, the property of the husband.

The husband's father in his evidence said that he wanted to provide for his linear descendants. He did not want the Family Court to have any control over his assets. The matter was decided on the basis of control.

"*Sham*" means there is an underlying purpose to the trust at the date of its inception. In *Keach* the husband's father established the trust had been running it. There was no finding of "sham".

The assets of the trust were found not to be the property of the husband. The assets were found to be a financial resource, where Strickland J said at paraps 210 and 211 that: "*...the fact of the matter is the husband has been able to rely on the Junior Trust as a source of benefit to him in many ways....I have no doubt that in the future the husband will continue to benefit from that Trust, including receiving allocations/distributions of income.*"

### ***Harris & Harris*<sup>74</sup> (2011)**

In *Harris & Harris*, a trust was established by the husband's father and on his death the husband's mother became the appointor. At the time of trial, the husband's mother continued to be the appointor. The original beneficiaries were the husband's father, the husband's mother and their children. The corporate trustee of the trust was Harris Nominees Pty Ltd and the directors were initially the husband's parents.

On the husband's father's death, the husband's mother, the husband and the husband's sister were directors of the corporate trustee. The husband's mother remained the majority shareholder with the husband and his sister holding the remaining shares after his father's death.

The most significant asset of the trust was the family business which was run by the husband

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<sup>73</sup> (No 2)[2011]FamCA 192

<sup>74</sup> [2011] FamCAFC 245

and the wife.

During the marriage, the husband had registered a separate company of which he was sole director and shareholder.

The company and the wife received distributions from the trust throughout the marriage although the company and the wife were not named as beneficiaries of the trust.

At separation, the husband's mother established a new corporate trustee of which she was a director and the majority shareholder. The husband's son from a previous marriage and a longstanding friend of the husband were the other directors and minority shareholders. The husband and wife were not directors or shareholders in the second corporate trustee.

Following separation, distributions to the wife from the trust ceased. Distributions to the husband's company continued.

Bell J found that the trust was the "property" of the husband. He was found to have legal and de facto control of the trust evidenced by distributions to his company and the cessation of distributions to the wife. It was inferred that the husband had control of his mother, his son and his friend who were directors of the corporate trustee.

In the Full Court, in their joint reasons for judgment Strickland and Finn JJ said that:

*"We observe in passing that there appears to be no dispute that the husband was the manager of the actual business which was concluded on behalf of the Trust. But the issue raised by the case was whether the husband had sufficient control of the Trust itself such that the assets could be regarded as his assets.....it is not easy to identify with absolute precision the matters which caused the trial judge to conclude that the assets of the trust should be treated as the assets of the husband."*

Finn and Strickland JJ concluded that:

*"In the present case and on the basis of the material before us the husband appears to be no more than a beneficiary of such a trust. He is not the appointor of the Trust nor does he hold any position in the current trustee company. On the assumption that by the use of the word "directly", the Chief Justice was referring to the strict legal position, it therefore cannot be said that the husband "directly" controls the current trustee. Nor could it be said that he "directly" controlled the previous trustee. On the assumption that the reference by the Chief Justice to "indirect" control of a discretionary trust by a beneficiary was a reference to a "puppet" situation, in the sense that the person with legal control of the trust is a puppet of the beneficiary, that could be the situation in the present case.*

*The difficulty, however, for the wife on this appeal is to be able to point to any evidence which*

would support a finding that the husband's mother is his puppet, and that it is through her, or perhaps otherwise, that he exercises de facto control of the trustee company and of the Trust.

...

...we do not consider that his Honour's conclusion that the assets of the Trust should be treated as the assets of the husband can be supported on the basis of his findings, nor indeed on the basis of any of the evidence before him to which we have been referred".

The Full Court identified the difference between legal and de facto control and the evidence that is required to ground a finding of legal control of a discretionary trust as opposed to de facto control.

*Harris* confirms that the main factor continues to be an assessment of the level of control asserted by the relevant party. There must be clear evidence to support a finding of "puppet".

Just because a party is receiving trust distributions does not mean the party getting the distributions has control. The Court found the assets of the trust were not the assets of the marriage.

### **Morton V Morton (2012)**

*In Morton v Morton*<sup>75</sup> the husband, his brother, mother and grandmother, were beneficiaries of a discretionary trust, The Morton Trust. The trustee was J Pty Ltd of which the husband and his brother were directors and equal shareholders. J Pty Ltd owned a bucket company which had a number of unpaid present entitlements in it. There were no special voting rights attached to the shares.

The husband and his brothers were joint Appointors of the Morton Trust.

The Court found there was a bona fide trust arrangement. There was insufficient evidence to suggest either brother had control. The interest in the trust was a financial resource.

The control test failed because the brothers had equal rights as shareholders in the J Pty Ltd. 51% is necessary to make shareholder decisions (and have control). 51% of director's rights is necessary to have overriding voting rights at director level (and have control).

The Court acknowledged there was a financial resource available. If there are multiple individuals in each role, the control test will fail.

### **Third parties (Part VIII A A)**

There was power to bind third parties prior to the FLA<sup>76</sup> by injunctive relief under s 124 of the

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<sup>75</sup> (2012) FamCA 30

<sup>76</sup> *Sanders v Sanders* (1967) 116CLR 366

*Matrimonial Causes Act 1959* (almost identical to S.114 of the Family Law Act).

The Court's power to make orders against third parties was limited by the High Court in *Ascot Investments Pty Ltd v Harper*. The High Court in *Ascot* found that the Family Court did not have the power to deprive a third party of an existing right or impose a duty that that party would not otherwise be liable to perform. This rule applied except in the case of sham or puppet.

Justice Gibb said in *Ascot* there was an exception to that rule, namely "sham" arrangements and transactions:

*"The position is, I think, different if the alleged rights, powers or privileges of the third party are only a sham and have been brought into being, in appearance rather than reality, as a device to assist one party to evade his or her obligations under the Act. Sham transactions may always be disregarded. Similarly, if a company is completely controlled by one party to a marriage, so that in reality an order against the company is an order against the party, the fact that in form the order appears to effect the rights of the company may not necessarily invalidate it except in the case of shams and companies that are mere puppets of a third party to the marriage, the Family Court must take the property of the party to the marriage as it finds it..."<sup>77</sup>*

#### **Part VIIIAA introduced in 2004**

Part VIIIIAA was introduced in 2004 and provides a framework for orders including property settlement orders to be made binding upon third parties in circumstances where the interests of parties to a marriage in, for example a family trust, are found to be the property of the parties to a marriage.

S90A of the Act sets out the objectives of the amendments as being to:

*"...allow the court in relation to the property of a party to a marriage to:*

- a) Make an order under section 79 or 114; or*
- b) Grant an injunction under section 114;*

*that is directed to, or alters the rights, liabilities or property interests of a third party".*

The Court has power to make an order that:

1. directs a third party to do a thing in relation to the property of a party to the marriage; or
2. alters the rights, liabilities or property interests of a third party in relation to a marriage.

<sup>78</sup>

A "third party" is defined to mean a person "who is not a party to the marriage".

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<sup>77</sup> Above n 42 at 91,000

<sup>78</sup> Section 90AE the Act

## **Part VIII AA constitutional validity.**

In 2004 His Honour Justice Brereton commented that *"the constitutional validity of Part VIII AA was questionable, and it should not be assumed that the new provisions would survive a constitutional challenge, though they may."*<sup>79</sup>

In 2008, His Honour commented that Part VIII AA had, thus far, survived constitutional challenge, although he noted that it had not been truly tested in the High Court.<sup>80</sup>

In 2007, Ryan J in *Hunt v Hunt and Others*, having carried out a review of the relevant constitutional law, said that what is not contemplated by Part VIII AA is *"some arbitrary invasion of the rights of a third party but an alteration of those rights where they are sufficiently connected to the division of property between the parties to a marriage,"*<sup>81</sup> and further that the powers of the Court are limited to *"the property of a party to the marriage such as in Ascot Investments v Harper or that alters the rights, liabilities or property interests of a third party "in relation to the marriage.,.,.,"* These comments were cited with approval in *B Pty Ltd and Ors v K and Anor*<sup>82</sup>.

The *"limitation"* approach in *B and K*<sup>83</sup> and *Hunt*<sup>84</sup> (Rand<sup>85</sup> and Bourke<sup>86</sup>) is derived from constitutional principles confining the exercise to the division of only the existing property of the parties to the family law proceedings.

Although judicial interpretation suggests a limited and cautious approach to the use of Part VIII AA the Court has been empowered to make far-reaching orders.

In 2008, His Honour Justice Brereton suggested one of the possible uses of Part VIII AA could include *"(IV) Under s 79, in the context of family trusts, orders which fix a vesting date, or convert a discretionary trust into a fixed trust, or require the trustee to exercise its discretion in a particular manner, or add a beneficiary, or require a distribution to a spouse or upon divorce cease to be a beneficiary."*<sup>87</sup>

## **Powers against third parties**

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<sup>79</sup> 11<sup>th</sup> National Family Law Conference, Gold Coast, October 2004

<sup>80</sup> *"Third parties: Invited Guests or Gate Crashers?"* Hon. Justice Paul Brereton, RFD, 13th National Family Law Conference, Adelaide, April 2008

<sup>81</sup> *Hunt v Hunt and Others* (2007) 36 FamLR 64 (Ryan J)

<sup>82</sup> (2008) FamCAFC 113

<sup>83</sup> (2008) FLC 93-380

<sup>84</sup> (2007) 36 Fam LR 64

<sup>85</sup> (2008) FLC 93-370 per Finn, May and Boland JJ at [138]

<sup>86</sup> (2009) 41 Fam LR 85 per Murphy J at [63]-[120]

<sup>87</sup> Above n 79

Sections 90AE and 90AF FLA give the court a limited power to make orders in relation to third parties confined to making orders granting injunctions that are reasonably necessary, or reasonably appropriate and adapted, to divide property between the parties to a marriage. There are requirements of procedural fairness and consideration of the justice and equity of the order.

Note Section 90AC FLA purports to give the provisions of Part VIII AA primacy over any other law (whether written or unwritten) of the Commonwealth, a State or Territory and anything in a trust deed or other instrument. A third party acting in compliance with Part VIII AA is not to be treated as contravening any such law or instrument.

### **Power to adjourn the proceedings in certain circumstances**

Pursuant to Section 79(5) FLA the court can adjourn Family Court proceedings until the happening of an event, such as the vesting of a trust, if the court is of the opinion that there is likely to be a significant change in the financial circumstances of the parties to the marriage or either of them and that is more likely to do justice as between the parties to the marriage than an order that the court could make immediately.

### **Matters to consider: when running a case in the Family Court involving trusts**

#### **Does the trust need to be joined as a party?**

Does the trustee need to be joined to the proceedings or settlement? Joinder of third parties – Rule 6.02(1) of the *Family Law Rules*. In practice, third parties are usually joined by being named as Respondents on an Application or Amended Application.

#### **Particulars of the relief sought against the trust**

Particularise against third parties early – what is the actual relief sought against the trust – *Patrick & Noschese* [2005] FCWA 12. Bear in mind party may be required to provide undertaking as to damages;

#### **Give notice to the trustee**

What notice needs to be given to the trustee to satisfy the requirements of procedural fairness and consideration of the justice and equity of the order. Ensure proper service and notice of any applications affecting or potentially affecting the rights of third parties, including trustee, appointor and other beneficiaries.

#### **Consider potential costs issues**

Costs of third parties – section 90AJ provides that if an order or injunction is made under Part VII AA and a third party has incurred expense as a result of the order or injunction then “*the court may make such order as it considers just for the payment of the reasonable expenses*”

*of the third party incurred as a necessary result of the order or injunction*". In deciding whether to make an order, subject to what the court considers just, the court must take into account the principle that the parties to the marriage should bear the reasonable expenses of the third party equally.

### **Removal of Trustee**

The Family Court has the power to appoint or remove a trustee:

#### **Section 80 FLA: General Powers of the Court**

Section 80 FLA provides that the court, in exercising its powers under this Part, "*may do any or all of the following...appoint or remove trustees*" – section 80(1)(e)

### **Injunctions**

The Court has the power to make any injunctions deemed appropriate pursuant to s114 and s90AF of FLA.

### **Enforcement**

The Family Court may make an order that any necessary deed or instrument be executed and that such documents of title be produced or such other things be done as are necessary to enable an order to be carried out effectively or to provide security for the due performance of an order (section 80(d)).

### **Other legislation**

s77 Trustees Act 1962 (WA);

The inherent jurisdiction of the Court whereby the welfare of the beneficiaries and of the trust estate requires the removal. *Letterstedt v Broers* (1884).

### **Removal of Appointor/Guardian**

The enforcement of the provisions of the Trust Deed through a Deed of Variation agreed in Family Court Orders or pursuant to the terms of the Trust Deed - see s80(1)(d) FLA.

### **The Court's powers include the power to change the vesting Date of a trust**

*AC and ORS & VC and Anor*, the first trial Judge made orders on 9 December 2011 which had the effect of bringing forward the vesting date of the trust to make property available to satisfy the wife's entitlement and to provide for a payment to the husband's mother in an endeavour to satisfy her prospective entitlements under the trust.

The Full Court upheld the appeal on the grounds that it was not open to the trial judge to find that the order accelerating the vesting date was 'proper' in light of the position of the husband's



mother as controller of the corporate trustee and the distributions received by her as a general beneficiary.

This decision makes it clear that in circumstances in which the court has found trust assets to be property of the parties to the marriage, Part VIIIAA provides important protection to third party beneficiaries, in addition to the fiduciary obligations owed to them by the trustee.

The Family Court can also push the Vesting Date out – section 80(1)(i) FLA “*impose terms and conditions*”.

### **VG & GC and Ors (2011): an example of what the Family Court can do**

In VG & GC and Ors <sup>88</sup>(the second trial) the Trial Judge, in bringing forward the vesting date of a trust by in excess of 50 years, referred to the existing authorities.

Her Honour said that these “*adopt an approach of limitation rather than expansion in the use of Part VII/AA of the Act. Despite this, the Court is of the view that in appropriate circumstances power to make orders for an accelerated vesting of a trust deed could come within scope of s90AF. Unsurprisingly, it very much depends upon the circumstances of each case and the nature of the trust in question.*” The Trial Judge found that “*in appropriate circumstances power to make Orders for an accelerated vesting of a Trust Deed could come within the scope of Section 90AF*”.

Her Honour found that “*the husband and wife have a fixed and irrevocable entitlement to a share of capital upon a vesting of the trust*” which interest is “*property for the purposes of s 79 of the Act*” <sup>89</sup>so and concluded there was power to bring forward the vesting date of the discretionary trust notwithstanding there were general beneficiaries whose rights were truncated by her orders.

The Trial Judge also quantified the entitlements of specified beneficiaries who were not parties to the proceedings in circumstances where orders had not been sought by any of the parties in the terms adopted by Her Honour.

The Trial Judge made orders for the specified beneficiaries to receive the entitlements she had quantified. They were not parties at this stage, and had not sought any orders. The specified beneficiaries included the parties' children who had not contributed in any way to the trust assets.

The husband's mother, who was born in 1931 in Greece had very little formal education and spoke Macedonian. Her evidence was that she had contributed to the creation of the trust assets, including physical work establishing tomato gardens over a period of 6 years in Geraldton. Her

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<sup>88</sup> VC & GC and Ors [2011] FCWA 89, at paragraph 99

<sup>89</sup> Ibid paragraphs 66 and 67

working hours were 5am to 6pm, 6 days per week. After that she worked in the family bakery from 1am to 10am each day.

The tomato gardens and the bakery provided capital for the husband's mother and father to invest in businesses, properties and investments over many years, and then their son became involved in the family businesses which then included a bottle shop and later, a restaurant in Fremantle.

The Trial Judge quantified the value of the husband's mother's entitlement in the trust mainly with reference to life expectancy tables at approximately \$330,000.

In reaching her findings the Trial Judge examined the nexus between the trust assets and the parties, especially the husband. In reaching her decision, she considered the three concepts referred to above in relation to the trust: "*control, management and ownership.*"

Part VIII AA empowers the Family Court to make orders to vary and diminish the rights of third parties<sup>90</sup> in circumstances where the Court considers it just and equitable to do so.

VG & GC & Ors, is still before the Court.

There was a Trial conducted in August & September 2016. A decision was handed down on 12 February 2018<sup>91</sup> and is now the subject of another Appeal.

The 2018 decision summarises the:

1. significant findings in the 2010 Appeal judgment;
2. the findings in the 2011 trial judgment;
3. the 2013 appeal judgment.

The issues for determination in the 2016 trial included whether the property of the trust belonged to the spouses.

In summary, and in a 205-page judgment, his Honour Justice Walter (the second trial Judge) agreed with the 2<sup>nd</sup> Trial decision of Crisford J (the first trial Judge) where she concluded she had, "*little difficulty in categorising the entitlement of the husband and the wife in the Trust is property for the purpose of s 79...*"<sup>92</sup>

His Honour went on to say, "*...The fact that property is held by a company or trust over which a party to a marriage has effective control has long been held to be sufficient for a court exercising jurisdiction under the FLA to conclude that, in reality, the property is that of the relevant party. I refer, for example, to Kennon v Spry (2008) FLC 93-388 at [52] to [80] and [236], and, in particular,*

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<sup>90</sup> Ibid at page 27

<sup>91</sup> [2017] FCWA 183

<sup>92</sup> Ibid at paragraph 221

to [64]...<sup>93</sup>

### **Family Law jurisdiction: criteria for access to trust assets**

In summary, having considered the case law and Part VIII A in the family law jurisdiction trusts will be scrutinised with reference to the following:

1. issues of control, management and ownership in the trust are key factors;
2. the nature of powers and rights under the trust; and
3. whether a party has made any contributions towards the wealth of the trust may be a relevant factor (it wasn't in *Simmons*).

### **How Family Court matters can arise when there is an intact marriage**

#### **Martin & Newton 2011**

*Martin & Newton*<sup>94</sup> is a matter which was before the Full Court in 2011. There was no appeal to the High Court in this matter.

The other matter is the very important 2011 Full Court and High Court 2012 decisions in *Stanford v Stanford*.<sup>95</sup>

Both the above decisions provide examples of the Full Court exercising its discretion in new and perhaps unexpected ways.

A new approach emerged in these cases where the Full Court took account of "*moral obligations*" as a valid consideration when exercising discretion under s 79.

In *Martin & Newton* the moral obligation related to the use of trust funds donated by a charitable foundation to a trust controlled by the husband. *Stanford* did not involve the use of a trust, but is important because of the scope of the High Court decision.

In *Martin & Newton* the husband controlled a trust and corporate structure containing significant funds donated by a charitable foundation for research purposes. There were questions about the husband's obligation as to how the donated funds could be used and whether the funds should be described as the property of the parties. The husband had absolute control over the funds which came into his possession as a result of the donations, and there was evidence he had used some of the funds as for personal purposes. Absent the issue of "*moral obligation*" the funds were the property of the parties.

The majority found that the moral consideration was a valid consideration, and the legislation

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<sup>93</sup> Ibid at paragraph 222

<sup>94</sup> [2011] FamCAFC 233

<sup>95</sup> *Stanford v Stanford* (2012) HCA 52 (5 November 2012)

was cast sufficiently widely to allow the Court "to take account of moral obligations. In saying this we use the word "moral" in its normative rather than descriptive sense. Thus understood the word is no more vague than the word 'just' or the expression 'just and equitable", both of which appear in the Act. Indeed we suggest that an outcome which ignores moral obligations should not be a just outcome"<sup>96</sup>.

### **Stanford (2012) HCA 52**

In Stanford, the husband and wife married in 1971. It was the second marriage for each of them. They both had children of their own marriages. In 2008 the wife suffered a stroke and subsequently developed dementia. She lived in full time residential care and died before the Full Court had given its decision. The husband provided financially for her medical needs and there was no evidence the parties had separated. The wife's daughter applied for a property settlement on her behalf as case guardian. The Magistrate at first instance made a property settlement order in the wife's favour. The husband appealed to the Full Court. In its second judgment, the Full Court, while acknowledging that the parties had "*an intact marriage*" and also found that on the husband's death a sum equivalent to 42.5% of the marital property was to be paid to the wife's legal personal representatives on the basis that "*the many years of marriage...and the wife's contributions demand that those moral obligations be discharged by an order for property settlement*".

The Full Court described the outcome of its orders as "*just and equitable*". The Full Court said that it "*clearly has the power*" to split the assets of elderly couples who are married but are "*physically separate*" with one of them living in a nursing home. The Full Court said it expected to deal with such matters with increasing frequency.

The majority of the High Court in *Stanford* said that "*reference to "moral" claims or obligations is at the very least apt to mislead*" and that the word "*"moral" has no legal foundation in the Act or elsewhere*".

The High Court has put the use of the notion of a "*moral obligation*" outside legal reasoning: decisions must be based upon what is "*just and equitable*" as a "*qualitative description of a conclusion*."

Is *Stanford* an example of the High Court being "*careful to control attempts by the Full Court of the Family Court to expand its jurisdiction by 'reading into' the legislation glosses which are not justified by the statutory provisions and the subordinate legislation?*"<sup>97</sup>

### **Judicial discretion**

Section 79 provides the court with a wide discretion maximised to allow for the "*Family Court to do*

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<sup>96</sup> Above n 95, paragraph 227

<sup>97</sup> Above n 28 page 5

*justice according to the needs of the individual case, whatever its complications may be" reconciled with the guidance provided by the Full Court "acting as a specialist appellate Court with unique experience in the Family Law in this country."*<sup>98</sup> The legislation is drafted in broad terms, and, to quote Dr Richard Ingleby, *"the discretion of trial judges ...is even broader because of the Full Court's inability to create firm rules to control the exercise of that discretion."*<sup>99</sup>

The exercise of discretion is affected by the facts before the court and judicial values as manifested in the exercise of the discretion of the presiding Judge.

There are virtually no legislative guidelines and virtually no rules laid down by the Full Court, as to how judges in the family law jurisdiction are to exercise their discretion.

### **What legitimate steps can be taken to reduce the risk of family wealth being drawn into the expense and uncertainty of family law litigation and what issues should be addressed in cases involving trusts?**

#### **Issues of structure and management**

It is not clear when a trust will become an alter ego of a party, and it is not clear where a finding of de-facto control to be available to a Court in the family law jurisdiction.

The decision of *Morton v Morton*<sup>100</sup> indicates how important it is to consider the structure of a trust, particularly in cases of relationship breakdown.

Ideally, the appointer and trustee including directors and shareholders (of the trustee) should be unrelated in every sense to the beneficiaries. This may not be a practical solution: families are not likely to be prepared to give away total control of a family fortune, or part of a family fortune for decades at a time.

There could (as in *Morton*) be two appointers who act making joint decisions. One of the joint appointers would be a family member and the other would be a non-family member in whom the family has absolute confidence. There should be an appropriate succession plan included in the trust deed.

The Trustee should require the consent of the appointer in the event of any amendment to the trust deed, any distribution of capital and the early vesting of the trust.

The trust deed should be drafted to minimise any vulnerability to family litigation while continuing to maintain flexibility to preserve the features of the discretionary trust which made it so popular in the first place, namely asset protection, tax benefits, and opportunities for succession and estate

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<sup>98</sup> *Norbis v Norbis* (1986) 161 CLR 513

<sup>99</sup> Above n 28

<sup>100</sup> [2012] FamCA 30

planning.

The advantage of drafting a trust deed as suggested may provide protection against the finding of property but there will also be disadvantages and vulnerabilities with control residing in a few individuals and a succession plan which does not include the objects of the trust.

Different forms of discretionary trust may arise over time to protect trust assets against family litigation.

Regardless of how a trust deed is drafted, the Court will always rightly ask the question, "*who exactly is going to benefit from this trust at the end of the day, and how will they benefit?*"

A trust has to have objects, or it is not a valid trust. The question "*who will benefit and how*" needs to be considered carefully at the time the trust is established.

As to whether the suggested structure would be protected in the future against potential claims and a finding that the assets of the trust comprises property under s 79, the advice given by trust lawyers continues to be that there are no guarantees.

### **Variation and amendment of current trusts**

Resettlement occurs where, for income tax purposes tax legislation deems that one trust has ended and another has replaced it.

When a trust is resettled there are immediate capital gains tax implications on the deemed disposal of the old trust and duty on the acquisition of those assets by the new trust. The carried forward tax losses can also be lost.

Parties and their solicitors should always seek advice when varying a trust, particularly in the context of any family law settlement. Variations of trusts should not take place at times of marital disharmony.

*Kennon v Spry* provides an example of what can happen when a trust deed is amended. An amendment excluding a spouse as a beneficiary (even when the amending deed is signed by the excluded spouse) is obviously capable of being set aside, under S106B.

### **Section 85A**

S85A is also a relevant consideration. Keifel J in *Kennon v Spry* relied on S85A of the Family Law Act finding this section was placed in the Act to address issues peculiar to discretionary family trusts with the trust deed being the nuptial settlement.

### **What is the value of the trust?**

In *Spencer v The Commonwealth of Australia (1907) 5 CLR 418* the High Court recognised the principles of:

1. the willing but not anxious vendor and purchaser;
2. a hypothetical market;
3. the parties being fully informed of the advantages and disadvantages associated with the asset being valued (in the specific case, land);
4. both parties being aware of current market conditions.

According to Lonergan, W, (2003) p.6 *The Valuation of Businesses Shares and Other Equity* business valuers in Australia typically define market value as:

*“the price that would be negotiated in an open and unrestricted market between a knowledgeable, willing but not anxious buyer and a knowledgeable, willing but not anxious seller acting at arm's length”.*

### **Valuation methodology**

Valuers of real property usually adopt “*Fair market value*” methodology and base their valuation on “*highest and best use*”.

The valuation of a business operated through a trust is usually based on a number of established valuation methods built around the market-based, income-based and asset-based approaches. These methods include:

1. Capitalisation of earnings
2. Discounted cash flow
3. Calculation of net assets on a 'going concern' basis.

The valuer will determine the valuation method based on their understanding of the business type.

### **Discounts for minority interests**

The discount for minority interests reflects the relationship between the pro rata value of a minority interest and the value of the whole of the equity.

### **Engagement of valuation expert in the Family Court**

There are strict protocols for instructing expert witnesses in the Family Court.

If they are not followed, the expert may not be regarded as independent.

The Rules about instruction of valuation experts are located in Part 15.5 of the Family Law Rules. It is essential to ensure full compliance with Part 15.5 to appropriately qualify the witness.

### **Financial Agreements**

Financial Agreements which are compliant with the FLA provide the same relief for CGT rollover and nominal stamp duty for transfers pursuant to Family Court Orders.

Trust deeds can be drafted to require all beneficiaries aged 18 years and over to execute a Financial Agreement with their partner/spouse before income is distributed or assets vest. This has become a form of succession planning to safeguard for example, interests or inheritances under discretionary trusts.

In the absence of a Financial Agreement the trust deed could note that any beneficiary would not be eligible for consideration by the trustee for distributions.

There will be difficulties for the following reasons:

1. If the formal requirements of the Financial Agreement are not met, then the agreement may not be a financial agreement;
2. Arguments about undue influence and unconscionability; and
3. There are other grounds available in the legislation for setting aside.

The fact that the relevant legislation has been subject to reasonably frequent amendment (with potential legislation pending) is also an issue to be considered.

### **Financial advice – when involving experts**

Lawyers when engaging with accountants, a valuer acting for your client and financial advisors, consider:

1. Potential conflict of interest: Accountants are subject to ethical rules in circumstances where they are acting for parties who are in a position of conflict: for example, a husband and a wife. APES 110 Code of Ethics for Professional Accountants notes, among other things, that a member is required to not allow conflict of interest to override professional or business judgments (sections 100, 220 and 310) while APES 220 Taxation Services also outlines requirements as to objectivity. This is a frequent occurrence where accountant acting for both parties and a trust and then separation takes place.
2. Litigation privilege: Family Lawyers need to consider when this might apply (when communications are brought into existence for the dominant purpose of providing assistance in litigation).
3. Legal professional privilege: this is the privilege which attaches to lawyer/client communications. It is very important to be careful not to waive privilege over advice given to a client.



4. Common interest privilege with all your client's lawyers and accountants: for this to be effective, it must satisfy legal professional privilege or litigation privilege tests. This is applicable if communications are shared confidentially with third party for a common interest in a subject matter;
5. Risk of subpoenas: other solicitors and accountants whose clients are involved in Family Court proceedings need to be aware that their files may become the subject of subpoenas.

### **Capital gains tax - transfers/vesting of assets from a Trust pursuant to a Family Court Order or Financial Agreement:**

The objective of the rollover relief provision for CGT on the transfer of an asset from a Trust or company to a spouse pursuant to a Family Court Order or Financial Agreement is to defer the CGT liability in the circumstances of what is, in effect, a non-voluntary transfer.

CGT event A1 applies upon the disposal of an asset. Section 14-10(2) of the *Income Tax Assessment Act 1997 (ITAA 1997)*, provides that an asset is disposed of "*if a change of ownership occurs from you to another entity whether because of some act or event or by operation of law*".

### **Family Court orders transferring assets**

Family Court orders usually provide for assets to vest or be transferred from the trust to an individual who is a beneficiary of the trust or the other spouse, if they are not the beneficiary of the trust pursuant to a Family Court Order or Financial Agreement.

### ***Sandini Pty Ltd vs Commissioner of Taxation*<sup>101</sup>:**

The Family Court made property orders pursuant to section 79 of the FLA.

The Family Court Orders directed Sandini Pty Ltd (controlled by the husband) to transfer 2,115,000 shares in an entity ("MIN") to the wife personally. The order required Mr Sandini to '*do all acts and things and sign all documents necessary to transfer*' the MIN Shares" to Mrs Sandini. This transaction, had it occurred, would have attracted CGT rollover relief.

After the Family Court Orders were made but before the transfer of shares, the wife asked the husband to arrange for Sandini Pty Ltd to transfer the MIN shares to an entity, as trustee for the wife's family trust, and not to her personally. The husband agreed to do this and Sandini Pty Ltd and the wife's entity signed share transfer forms to this effect.

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<sup>101</sup> (2017) FCA 287

The ATO audited Sandini and the husband and determined that CGT marriage breakdown relief did not apply because Sandini Pty Ltd transferred the shares to the wife's entity as trustee for the wife's trust and not to the wife personally.

The wife's entity was controlled by her. The wife's trust was not a beneficiary of the husband's trust.

The principal issue was whether Sandini Pty Ltd (a corporate trustee controlled by the husband) should be entitled to CGT roll-over relief in circumstances where such relief would normally be available when an asset was transferred from a trust to the wife under a family court order, and would have been available in this case, except the parties had carried out a different transaction.

There were two vesting events. The first was the vesting beneficial ownership by reason of the Family Court Order and then the second event by which the transfer of the legal estate and the beneficial estate was made to the family trust. The first event is sufficient for CGT roll over purposes (at 157).

At first instance, McKerracher J held that CGT event A1 happened when the Family Court orders were made. The Family Court orders under s 79 of the *Family Law Act* had transferred full beneficial ownership to Mrs Sandini on the making of the order (at 160), which in turn satisfied the change of ownership concept in CGT event A1. McKerracher J held that CGT rollover relief could apply to the transaction which had occurred although the shares had been transferred to the wife's trust, because the wife was "sufficiently involved" in the share transfer to the wife's trust.

The trial judge, McKerracher J, found that the only factor which distinguishes this case from every other roll-over case under these provisions is that the transfer was made pursuant to a Family Court order at the direction of the receiving spouse to a trust controlled by the receiving spouse (Mrs Sandini).

On appeal, the Federal Court considered two key questions:

1. What was the CGT event which occurred, and when did it happen;
2. Could CGT marriage breakdown rollover relief apply?

The Full Court found that CGT marriage breakdown roll-over relief cannot apply to a transfer to a trust or company. For CGT marriage breakdown roll-over to apply the CGT assets must go to the spouse personally.

**Lessons to be taken out of *Sandini***

Specialist tax and duty advice should be obtained before entering into any family law settlement. You would have to assume specialists were involved in drafting the orders in Sandini, but apparently, they were not involved in every aspect of implementation.

Special leave to appeal to the High Court was refused in September 2018.

### **Stamp Duty: Western Australia**

*Office of State Revenue on 3 June 2014 - Revenue Ruling 15.0 - "Duties – Transfer of matrimonial or de facto relationship property involving a trust or company"*

The effect of the Ruling is that it is possible to obtain both a CGT rollover and nominal rate of transfer duty when property is transferred from a company or trust to a spouse under court order or a Financial Agreement if the company or trust is taken to be the alter ego of either or both spouses.

Practitioners should take care to properly document the transaction. It is unlikely to be sufficient to merely prepare a transfer. A resolution of the trustee will be required and the terms of the trust deed may impose additional procedures. Full documentation may assist to demonstrate that the transfer by the trustee to the spouse is made because the trust is under the effective control, and is thus the alter ego, of one or both spouses.

If there is doubt as to the power to make the transfer then resort can be had to s 90AC FLA.

### **Division 7A**

Division 7A applies to payments made, loans and debts forgiven by a private company (a trustee) to a shareholder or associate. The payment of funds includes providing an asset to an associate or shareholder for their private use.

An "associate" is defined as a relative, partner, trust controlled by the shareholder or company controlled by the shareholder. The person who receives the benefit is taxed, and that person is not necessarily the shareholder (Definition of Associate: S318 ITAA 1936).

Before Tax Ruling 2010/3 issued, corporate beneficiaries received income distributions which were not paid (Unpaid Present Entitlements or "UPE's") and the UPE's were taxed at the corporate rate rather than at higher rates applicable had the funds actually been paid to the individuals concerned rather than held by the trustee. Historically, the ATO did not regard UPE's as loans. The extent of the loans became a cause for concern, as by 2009, approximately \$1b of UPE's were identified in an untaxed state.

In 2009 the ATO announced UPE's could be considered loans under s109D. Tax Rulings followed using Division 7A so that private companies could not make tax free distributions as loans to their associates or shareholders.

The Division treats a transfer of property from a company to a shareholder or an associate (as defined above) of a shareholder as a dividend which is, to the extent of the distributable surplus of the company, to be included in the assessable income of the transferee. A spouse will almost certainly be an associate if they are not a shareholder.

### **Distributing income of the trust**

The Trust can make distributions to beneficiaries in Family Court Orders (Section 80(1)(a), (b) and (ba) FLA).

The orders may require an indemnity for tax for the recipient beneficiary such that the recipient beneficiary can access their own tax-free threshold for their other taxable income.

The distributions could be made by way of spousal maintenance and/or child support. However, it is essential to be aware of ability of the court to vary spousal maintenance and/or child support orders.

### **Contingent tax liability – Rodgers & Rodgers<sup>102</sup>**

In this case, the parties agreed that the husband would retain the parties' tourism business, companies and trusts and give the wife an indemnity for tax.

The husband sought to include a taxation liability of \$517,000 in the asset pool.

The trial Judge accepted the submissions for the wife that the tax liability was not certain or necessary.

The Full Court agreed with the trial Judge and found that the manner in which a particular liability should be treated is, ultimately, dependent upon the nature of the liability, the circumstances surrounding the liability and the dictates of justice and equity shaped by each.

Where liabilities are vague or uncertain it may be unjust and inequitable to deduct them.

Ultimately, the appeal was upheld because the trial Judge should have quantified the tax through calculations involving future amounts rather than present values as the tax was not immediately payable.

The trial Judge should also have considered how the relevant entities had met previous Division 7A obligations.

Where neither party suggests that the relevant loans should be forgiven immediately, a consequential fact of great significance emerges: the calculated taxation (whatever be the correct quantum) is not, and will not be, payable *in that sum* either immediately or in the future. None of the sums represents that which fixes, and renders due, a taxation liability, namely an

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<sup>102</sup> [2016] FamCAFC 68

assessment. If a contingent liability is not to be included in the asset pool and is otherwise considered under section 75(2)(o) FLA, then some attempt in the settlement should be made to detail and quantify the amount with consideration given to its relevance and effect on the adjustment of the overall settlement.

### **Non-compliance with Corporations Act and/or tax laws**

The Commissioner is capable of intervening in Family Court proceedings. In *Atkinson v FC of T* [2000] ATC 4332 and also in *Commissioner of Taxation and Darling and Anor* [2014] FLC 93-583 the rights of the Commissioner were dealt with, including the option of carrying out an inspection of the Family Court file and any documents produced to the Court.

The Family Court has the power to refer matters that come before it in relation to tax evasion or tax fraud, to the relevant powers including the Commonwealth or State Attorney General and or the tax office.

In *Katic & Katic (No. 3)*<sup>103</sup> – see paragraphs 11 to 18 and 184 and 206. In that case the Court embargoed the implementation of orders for property settlement to give the ATO the opportunity to decide if it wished to intervene in the proceedings.

### **Other relevant legislation in Family Court property settlement proceedings**

#### **Corporations Act 2001 (Cth)**

Under section 1337C jurisdiction is conferred on the Family Court and the state Family Courts with respect to civil matters arising under the Corporations Legislation. There are other relevant sections in the Corporations Act 2001 (Cth):

1. Section 198F, Section 290;
2. s248A, s251A, s1311, Schedule 3, s1375
3. Section 1337C; Section 1337J;
4. Section 1337U ; s459E and s459G.

#### **The Australian and Securities Investments Commission Act 2001 (Cth)**

The Commission acts as Australia's corporate regulator. The legislation allows for the transfer of certain proceedings to the Family Court.

See Section 12GL and Section 12BA.

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<sup>103</sup> [2014] FamCA 750