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LET'S TALK ABOUT TRUSTS

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Let’s talk about Trusts

The use of trusts in all their variants has been a regular feature of asset protection, tax minimization and legal risk minimization for as long as trusts have existed.

Trusts, but particularly *inter vivos* (*inter vivos* means ‘in life’) family trusts and testamentary trusts are important aspects of estate planning and should be considered at the time more general estate planning such as Wills, Enduring Powers of Attorney and other estate planning documents and structures are being discussed.

Beyond tax minimization (which is not within the scope of this presentation and is generally well understood by accountants and financial planners anyway), trusts have generally been seen to offer the beneficiaries of the trust good protection against two main risk exposures: Creditors and Predators.

The trusts which are the focus of this paper are testamentary trusts. The key distinction between a testamentary trust and an *inter vivos* discretionary trust (or family trust) for the purposes of this paper is taken to be that a testamentary trust is established within a Will (not in life); that the trust will not come into existence until the testator (necessarily also the settlor) dies; that the assets settled into the trust will not be and never will have been the primary beneficiary’s nor those of any other class of beneficiary. There are other differences within the taxation treatment and often different CGT and Stamp Duty consequences but those are all outside the scope of this paper and not relevant to our primary purpose.

Let’s talk about all the good things (and the scope of this paper)

Creditors are an obvious group that pose risk to an individual. Creditors represent any financial and or commercial risk to which a beneficiary of a trust might be exposed personally. Key examples of creditor risk for a beneficiary that is actively involved in the commercial world – perhaps conducting a business, might be a trustee in Bankruptcy, a liquidator, trade creditors, ASIC or the ATO. Generally, the risks to which any business proprietor might be exposed should the business fail or struggle financially. Another class of creditor might be judgement creditors or any person who has sued the beneficiary successfully for whatever reason, howsoever arising and who are entitled to enforce judgement against the beneficiary of the trust personally. A situation where this risk is foreseeable is the class of beneficiary who is a working professional or otherwise exposed to being sued for professional negligence or other loss that may or may not all be able to be covered by insurance.

Trusts, when properly structured, and whether testamentary or *inter vivos* remain suitable and safe protection for beneficiaries against the risk of creditors. The fundamental separation of legal and beneficial ownership of the assets within the Trust ensure that assets owned by the trustee of the trust to which the beneficiary of the trust has a beneficial interest in the form of a discretionary expectancy will only be treated as assets of the trustee and not the beneficiary. This holds true with regard to creditor claims even when the trustee of the trust is within the eligible class of beneficiaries of the trust. Trusts will continue to be the most risk effective structure for the foreseeable future in terms of protecting beneficiaries against creditor risk.

Predators are a different risk to which beneficiaries of trusts might be exposed. “Predators” is by no means a term of art. I use it mainly because it rhymes with creditors and enables all risks to be limited to two categories only. The predator class includes those who would seek to attack the beneficiary

personally in order to take assets from the beneficiary. The most obvious class of predator is domestic partners (including same sex partners) and spouses.

Trusts still afford significant asset protection for beneficiaries against predators. For the foreseeable future trusts will remain the best and most effective asset protection mechanism available to estate planning lawyers to assist clients to protect their assets and those assets they choose to pass to their beneficiaries in the form of testamentary trusts.

There has, however, been much dispute in recent years as to how strong the asset protection is within trusts, but particularly testamentary trusts in terms of asset protection for the beneficiaries of testamentary trusts in the context of predator claims such as those of domestic partners or spouses in the Family Law context. The scope of this paper is to provide a careful examination of the future use of testamentary trusts and the risks to which such trusts might be exposed in terms of Family Law property settlement proceedings between a beneficiary of the testamentary trust and their domestic partner or spouse after the testator has died.

Let's talk about all the bad things that may be (and our hypothetical scenario)

Limited cases have come before the Family Law Courts regarding testamentary trusts. There is no settled position on the risk or safety that a testamentary trust affords the beneficiary in terms of the protection of assets within the trust.

How the Court will deal with testamentary trusts can arguably be inferred from the way it deals with family trusts. This is a relatively safe analogy because the main difference between an *inter vivos* discretionary trust and a testamentary discretionary trust is that the *inter vivos* trust was made by a settlor who was alive and the testamentary trust was made by a testator/settlor in their Will and came into effect following the death of the testator/settlor. Essentially an *inter vivos* trust is made in life and a testamentary trust is made in death.

The hypothetical scenario for this paper is that of a testator with children (maybe adult maybe minor. It doesn't matter how many) who prepares a Will which incorporates testamentary trusts for the benefit of each of her children. The testator makes her Will at a time when all of her children are either unpartnered or happily married. The testator then dies some years after making her Will, again at a time when all of her children are either unpartnered or happily married. All of the testator's children take up their testamentary trusts and each child becomes the trustee of their own testamentary trust. Some years after the death of the testator and after the settling of the various testamentary trusts one of the testator's children separates from their spouse partner and proceedings for division of property under the *Family Law Act 1975* ("the Act") are brought by the spouse of the testator's child. The spouse claims that the assets within the testamentary trust are part of the property of the marriage and asks the Court to treat the assets within the testamentary trust as divisible property for the purposes of the Act.

What are the questions for the Court?

The key issues and the key questions for the Family Law Courts have not changed since the inception of the Act. The only real question for the Court will be: Is the interest of the party to the marriage or relationship before the Court in the trust in the nature of "Property" for the purposes of Part VIII of the Act?

If the interest is not "property" no order can be made pursuant to s79 of the Act. Section 79 is the provision of the Act that deals with altering the *property* interests of the parties to the marriage.

Section 79 (reduced for our purposes) provides:

(4) In considering what order (if any) should be made under this section in property settlement proceedings, the court shall take into account:

(a) the financial contribution made directly or indirectly by or on behalf of a party to the marriage or a child of the marriage to the acquisition, conservation or improvement of any of the property of the parties to the marriage or either of them, or otherwise in relation to any of that last-mentioned property, whether or not that last-mentioned property has, since the making of the contribution, ceased to be the property of the parties to the marriage or either of them; and

(b) the contribution (other than a financial contribution) made directly or indirectly by or on behalf of a party to the marriage or a child of the marriage to the acquisition, conservation or improvement of any of the property of the parties to the marriage or either of them, or otherwise in relation to any of that last-mentioned property, whether or not that last-mentioned property has, since the making of the contribution, ceased to be the property of the parties to the marriage or either of them; and

(c) the contribution made by a party to the marriage to the welfare of the family constituted by the parties to the marriage and any children of the marriage, including any contribution made in the capacity of homemaker or parent; and

(d) the effect of any proposed order upon the earning capacity of either party to the marriage; and

(e) the matters referred to in subsection 75(2) so far as they are relevant; and

(f) any other order made under this Act affecting a party to the marriage or a child of the marriage; and

(g) any child support under the Child Support (Assessment) Act 1989 that a party to the marriage has provided, is to provide, or might be liable to provide in the future, for a child of the marriage.

(5) Without limiting the power of any court to grant an adjournment in proceedings under this Act, where, in property settlement proceedings, a court is of the opinion:

(a) 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, having regard to the time when that change is likely to take place, it is reasonable to adjourn the proceedings; and

(b) that an order that the court could make with respect to:

(i) the property of the parties to the marriage or either of them; or

(ii) the vested bankruptcy property in relation to a bankrupt party to the marriage;

if that significant change in financial circumstances occurs is more likely to do justice as between the parties to the marriage than an order that the court could make immediately with respect to:

(iii) the property of the parties to the marriage or either of them; or

(iv) the vested bankruptcy property in relation to a bankrupt party to the marriage;

the court may, if so requested by either party to the marriage or the relevant bankruptcy trustee (if any), adjourn the proceedings until such time, before the expiration of a period specified by the court, as that party to the marriage or the relevant bankruptcy trustee, as the case may be, applies for the proceedings to be determined, but nothing in this subsection requires the court to adjourn any proceedings in any particular circumstances.

Key from the wording of s79 of the Act is the requirement that the asset first be property in the ordinary sense of the word and second be property of a party to the relationship or marriage. A similar provision applies to domestic partnerships (parties of the same or opposite sex who are not married). Of importance to our purposes is the fact that the property needs to be property of a party to the marriage. What is or is not ones property is in most instances readily discernible. If, for instance, one has legal as well as beneficial ownership, there is no question as to whether the property is truly property of the party. In the context of trusts, however, the line is blurred by the separation of legal and beneficial ownership. The point of a trust, of course, is to do just that. The separation of legal and beneficial ownership creates a certain outcome with respect to claims of creditors, but with respect to the claims of predators in the Family Court, the outcome is less certain.

If the Court determines that the interest of the spouse in the trust assets is not "property" then the next question is whether the interest is a "financial resource".

If the interest is a "financial resource" the Court can't make orders affecting the interest directly, but can take the interest into account in performing its overall assessment as to what is a just and equitable settlement. Section 75 of the Act deals with financial resources to be taken into account in a property settlement.

Section 75 (reduced for our purposes) provides:

(2) The matters to be so taken into account are:
- *(a) the age and state of health of each of the parties; and*
- *(b) the income, property and financial resources of each of the parties and the physical and mental capacity of each of them for appropriate gainful employment; and*
- *(c) whether either party has the care or control of a child of the marriage who has not attained the age of 18 years; and*
- *(d) commitments of each of the parties that are necessary to enable the party to support:*
  - *(i) himself or herself; and*
  - *(ii) a child or another person that the party has a duty to maintain; and*
- *(e) the responsibilities of either party to support any other person; and*
- *(f) subject to subsection (3), the eligibility of either party for a pension, allowance or benefit under:*
  - *(i) any law of the Commonwealth, of a State or Territory or of another country; or*
  - *(ii) any superannuation fund or scheme, whether the fund or scheme was established, or operates, within or outside Australia; and the rate of any such pension, allowance or benefit being paid to either party; and*

(g) *where the parties have separated or divorced, a standard of living that in all the circumstances is reasonable; and*

(h) *the extent to which the payment of maintenance to the party whose maintenance is under consideration would increase the earning capacity of that party by enabling that party to undertake a course of education or training or to establish himself or herself in a business or otherwise to obtain an adequate income; and*

(ha) *the effect of any proposed order on the ability of a creditor of a party to recover the creditor's debt, so far as that effect is relevant; and*

(j) *the extent to which the party whose maintenance is under consideration has contributed to the income, earning capacity, property and financial resources of the other party; and*

(k) *the duration of the marriage and the extent to which it has affected the earning capacity of the party whose maintenance is under consideration; and*

(l) *the need to protect a party who wishes to continue that party's role as a parent; and*

(m) *if either party is cohabiting with another person--the financial circumstances relating to the cohabitation; and*

(n) *the terms of any order made or proposed to be made under section 79 in relation to:*

  (i) *the property of the parties; or*

  (ii) *vested bankruptcy property in relation to a bankrupt party; and*

(naa) *the terms of any order or declaration made, or proposed to be made, under Part VIIIAB in relation to:*

  (i) *a party to the marriage; or*

  (ii) *a person who is a party to a de facto relationship with a party to the marriage; or*

  (iii) *the property of a person covered by subparagraph (i) and of a person covered by subparagraph (ii), or of either of them; or*

  (iv) *vested bankruptcy property in relation to a person covered by subparagraph (i) or (ii); and*

(na) *any child support under the Child Support (Assessment) Act 1989 that a party to the marriage has provided, is to provide, or might be liable to provide in the future, for a child of the marriage; and*

(o) *any fact or circumstance which, in the opinion of the court, the justice of the case requires to be taken into account; and*

(p) *the terms of any financial agreement that is binding on the parties to the marriage; and*

(q) *the terms of any Part VIIIAB financial agreement that is binding on a party to the marriage.*

Section 106B gives the Family Court the power to set aside a disposition of assets which would otherwise have formed part of the pool of assets of the parties to a marriage or been considered a financial resource of one of the parties.

Section 106B (reduced for our purposes) provides:

(1) *In proceedings under this Act, the court may set aside or restrain the making of an instrument or disposition by or on behalf of, or by direction or in the interest of, a party, which is made or proposed to be made to defeat an existing or anticipated order in those proceedings or which, irrespective of intention, is likely to defeat any such order.*

(2) *The court may order that any money or real or personal property dealt with by any instrument or disposition referred to in subsection (1), (1A) or (1B) may be taken in execution or charged with the payment of such sums for costs or maintenance as the court directs, or that the proceeds of a sale must be paid into court to abide its order.*

Let's re-cap the 'vibe' of the inter vivos authorities:

Since there is no instance of our exact hypothetical testamentary trust scenario coming before the Court it is necessary to examine the way the inter vivos trust cases have been dealt with before considering what the difference would be if the trust were a testamentary trust, rather than an inter vivos trust and more particularly, if the testamentary trust came about in the circumstances set out in our hypothetical scenario.

The line of authorities from *Kennon v Spry* regarding *inter vivos* trusts show a tendency on the part of the Court to make orders against trustees of *inter vivos* trusts where the trustee or appointor is simply an alter ego of one of the parties to the marriage or domestic partnership. Generally, these cases arise where the party transferring property into the trust does so primarily for purposes of asset protection in the event of future matrimonial separation from their current spouse at the time the primary beneficiary transfers the primary beneficiary's property into the trust. Another class of cases in which the Court shows a tendency to treat the interest of beneficiaries in trusts of which the primary beneficiary is the trustee; the primary beneficiary has power of appointment for the trust and the primary beneficiary has effective control on a day to day basis of the trust as 'property' capable of being the subject of an order for division of property under s79 of the Act. This is especially the case where the assets settled into the trust have come from the primary beneficiary. In such cases it is fair, reasonable and proper (at least in the writer's view) for the Court to make orders detrimental to the interest of the beneficiary of the trust. We will examine some of the authorities in these circumstances. See *Kennon v Spry, Russo v Dorsey* and *Beeson v Spence.*

Kennon v Spry [2008] HCA 56

In *Kennon v Spry* a discretionary trust was created by the husband, Dr Spry, in 1968, 10 years prior to the marriage, with himself as settlor and trustee. The Trust Deed was executed in 1981. Dr Spry and his wife married in 1978 and had four children.

In 1983 Dr Spry varied the trust by Deed to exclude himself as a beneficiary and appoint his wife as trustee on his death. A second Deed was executed in 1998 (as the marriage deteriorated) excluding the wife as a capital beneficiary of the trust. In 2001 Dr Spry and his wife separated. In 2002 Dr Spry created separate trusts for each of his children and distributed the capital and income of the trust equally between them. In 2002 the wife sought orders for property settlement and maintenance. She sought to have the variations to the trust made in 1998 and 2002 set aside.

The Court held that Dr Spry was the sole trustee and appointor of the trust with absolute discretion to vary the trust deed and distribute income and capital. At all relevant times Dr Spry had sole control of the trust.

The 1998 and 2002 variations to the trust deed were set aside on the basis that the amendments were undertaken for the purpose of limiting the wife's access to the assets of the trust in any subsequent property settlement. The assets of the trust were found to be "*property of the parties to the marriage"* within the meaning of s79 of the Act for the purposes of the family law proceedings. The trust was in effect an alter ego of Dr Spry and not a separate entity.

Beeson v Spence [2007] FamCA 200

In *Beeson v Spence* the parties were married in 1997. The husband had a child from a previous relationship and together the husband and wife had two children. In 2000 the husband's business began to experience financial difficulties as his business began to fail. The majority of jointly owned assets (including the marital home) had to be sold and in 2001 the wife used her share from the sale (approximately $3 million) to establish a trust. The wife was the appointor of the trust, and the wife's father and solicitor were the trustees. The two children of the marriage were the specified beneficiaries with the husband and wife in the class of potential beneficiaries.

While the husband and his funds were tied up in costly and unsuccessful litigation the trust purchased the family's next dwelling and made some distributions to the children.

The husband and wife separated in 2003. Also in 2003 the trust deed was varied to exclude both husband and wife as potential beneficiaries and the wife resigned as the appointor and was replaced by her sister. In practical terms the deed still allowed the husband and the wife to receive distributions from the trust as the parents of the specified beneficiaries. The husband and wife were divorced in 2004. In 2005, with an outstanding judgment against him of $64 million, the husband was declared bankrupt.

The husband argued that the trust was established for the benefit of the family as a whole and as such should be treated as property of the parties to the marriage. The wife claimed that the trust had been established for the benefit of the two children of the relationship and so should not be treated as part of the asset pool of the marriage.

The Court held that although the wife had relinquished direct control of the trust she still maintained sufficient control to warrant a finding that the trust assets were property of the marriage. The Court had the power to look beyond the formal legal ownership by the trustee when determining the pool of assets on the basis that "it would be contrary to public policy to allow a spouse with full control of assets to quarantine them via a trust from property settlement proceedings where the controlling spouse has the power to determine at any point to whom income and/or capital will be distributed, including to themselves." (at [31]).

Russo v Dorsey [2012] FamCA 914

Ms Russo and Mr Dorsey began living together in a de facto relationship in 2007. Both parties to *Russo v Dorsey* had adult children from previous relationships. Mr Dorsey was wealthy and had approximately $31 million in assets (including super). Ms Russo had minimal assets and liabilities.

The relationship was very short lived and lasted either three years and two months (by Ms Russo's account) or two years and eleven months (by Mr Dorsey's account).

Six months after the commencement of the relationship Mr Dorsey created the B & C Dorsey Trust ("the trust") with himself named as the settlor, director of the Trustee Company and principal beneficiary. The primary beneficiaries of the trust are included in a class as direct descendants and immediate family of Mr Dorsey. Mr Dorsey gifted $29.2 million dollars to the trust upon its creation and immediately took out a secured loan from the trust of the same amount.

Mr Dorsey resigned as director of the Trustee Company (being replaced by one of his sons) and principal of the trust (replaced by all three of his sons).

Ms Russo sought to have the trust included as property of Mr Dorsey for the purposes of the property settlement.

The Court found that the trust was effectively an alter ego of Mr Dorsey who had control of the trust. Even with Mr Dorsey's son as sole director of the trustee there was no indication that he would act in any way other than in accordance with his father's wishes.

The bloodline trust failed as a form of asset protection and the trust property was found to be property of Mr Dorsey for the purposes of the property settlement.

What is common amongst these *inter vivos* authorities is that:

1. In the absence of the trust the property of the trust would undoubtedly have been "property" within the meaning of s79 of the Act 1975.
2. The property within the trusts was originally that of a party to the marriage or relationship.
3. The intention or motivation of the party placing their property into the trust was mainly to reduce the risk of the partner later claiming any interest in it in the event of marriage break up or separation.

None of those circumstances apply to our hypothetical scenario.

There are also a number of authorities regarding *inter vivos* trusts in which the Court makes findings that the assets of the trust are not property of a party to the marriage in circumstances were the spouse party does not have control of the trust. The party to the marriage, in most such cases, did not establish the trust and never had ownership of the trust assets. The party is generally not the trustee or appointor of the trust, or if they are they are not the sole trustee or appointor. In such cases the trust is not considered a part of the asset pool and may or may not be considered a financial resource of the relevant party. Some of the authorities in these circumstances include *Edgehill v Edgehill, Essex v Essex* and *Morton v Morton*.

Edgehill v Edgehill [2007] FamCA 1102

The facts of *Edgehill v Edgehill* are that the husband and the wife commenced cohabitation in 1978 and married in 1980. They had two children. In 1994 the wife's mother established a Discretionary Bloodline Trust ("the trust") with the family home in New Zealand as the main asset. The wife was the trustee of the trust and there were three classes of beneficiaries: Class A) the wife's brother; Class B) the wife and her children and any of their lineal descendants; and Class C) the wife's sister, her children and any of their lineal descendants. Upon the death of the wife's mother each class of beneficiaries would be entitled to one third of the trust property.

The husband and wife separated in 2004. The husband was made redundant and was unemployed at the date of the hearing. The wife, having also been made redundant, had been undertaking some consulting work and acknowledged a greater earning capacity than the husband going forward.

In 2005 the wife was removed as trustee of the trust and in 2006 her mother prepared a Memorandum of Wishes which stated that the trustees may resettle the trust after her death into three separate Discretionary Trusts for the primary benefit of each of her three children, their children and their lineal descendants. The mother retained control of the trust during her lifetime, with the power to change the terms of the trust and add or remove beneficiaries

The Court held that the wife's interest in the trust was not property of the marriage as her mother was the one with control of the trust. In accordance with the Memorandum of Wishes dealings with the trust

after the death of the mother would require the consensus of a large number of people. The wife did not have control of the trust.

The wife's interest in the trust was held to be a financial resource, although as one of a class of beneficiaries her entitlement was the subject of much debate. The Court made an adjustment in the property settlement in favour of the husband in the sum of $87,435.00.

Essex v Essex [2009] FamCAFC 236

In *Essex v Essex* the husband and wife married in 1981 and had two children. They separated in 2000.

Two trusts were established in 2004 by the husband's mother (the S Trust and the N Trust) for the benefit of the 'bloodline' of the husband's parents. The assets of both trusts were gifted by the husband's mother and were assets of the husband's parents. The husband's mother placed her assets in the trusts for three reasons: firstly in order to be eligible to receive an aged pension; secondly, to prevent her from dissipating her assets through 'unwise or ill-considered investments'; and thirdly, to protect any provision she may make for the husband in her Will from the wife in a property settlement.

The children of the marriage were the capital beneficiaries and the husband was a default beneficiary of the S Trust. The husband's brother was the primary beneficiary and the husband was a general beneficiary of the N Trust. The husband's brother was the appointor of both trusts.

The wife claimed that the husband had significant interest in the two family trusts and that these trusts had been settled with the primary purpose of excluding the Court from dealing with assets as property of the marriage.

The Court found that the husband's brother had control of both trusts. The husband had not contributed to any of the assets of the trust and had no control over either trust. He had also not received any distributions from either trust during the course of the marriage. As neither party to the marriage had control of the trust the property of the trust could not be considered property of the marriage.

The likelihood that in the future distributions would be made to the husband from the trusts was taken into consideration and the trusts were determined to be a financial resource of the husband. An adjustment was made in favour of the wife in the property settlement.

Morton v Morton [2012] FamCA 30

The husband and wife in *Morton v Morton* were married for 10 years. There were no children of the relationship but the wife had three children (including one severely disabled child) from a previous marriage.

6 months into cohabitation the husband sold his real property and paid the proceeds to W Pty Ltd a trustee company for the Morton Discretionary Trust. The husband and brother were equal shareholders and directors of the Trustee Company "J Pty Ltd". The husband and brother were joint appointors.

The trustee company owned "T Pty Ltd" (a bucket company) which was registered in 2005 some three years before separation of the husband and wife. The sole director and secretary of T Pty Ltd was the husband's brother. The sole shareholder of T Pty Ltd was J Pty Ltd which held its shares as trustee for the Morton Trust.

T Pty Ltd was an eligible beneficiary of The Morton Trust. J Pty Ltd was indebted to T Pty Ltd on account of beneficiary entitlements.

The wife alleged the husband had an interest in the Morton Trust of half of the market value of all assets less liabilities and half of the interest of T Pty Ltd.

The husband argued that he did not, in fact, control the trust as neither he nor his brother had control of the trustee company. The 50/50 shareholder split and the equal standing as directors of the company and appointors of the trust meant that neither brother had effective control of the trust.

The Court Held: "I concede that on the face of it, circumstances such as these could give credence to the Wife's submissions. However I am equally satisfied that such a set of circumstances can, as I have found to be the case here, represent a bona fide trust arrangement."

The Court held that the husband had insufficient control of the assets of the trust. "unless I am satisfied that a person has control of a trust, in other words that it is his alter ego, I do not believe that it can be…property"

The husband conceded that the interest he may have in the Morton Trust was, however, a financial resource and it was treated as such.

The effect of this approach was that the Property Pool available for division was reduced by the value of the Morton Trust and T Pty Ltd and J Pty Ltd (close to $2.1M).

The s75(2) adjustment after taking all things including financial resources into consideration was 10% in favor of the wife. That is 10% of a property pool of $3.6M rather than $5.6M and a lot less than 45% of the value of the Morton Trust and bucket company which would have been about $1M.

Let's look at the testamentary trust authorities so far for their 'vibe':

There are limited testamentary trust authorities at this point but the authorities so far give us an indication of the direction in which the law is going.

Ward v Ward [2004] FMCAfam 193

In *Ward v Ward* Mr Ward separated from his wife, Mrs Ward. Mr Ward's mother did not want Mrs Ward to receive anything from her estate if she were to die. Mr Ward's mother went to her solicitor and explained the situation and the fact of Mr Ward's separation from Mrs Ward. Mr Ward's mother had a testamentary trust Will prepared whereby upon her death, Mr Ward would be the beneficiary of a testamentary trust.

The terms of the testamentary trust provided that Mr Ward would not be the trustee of the testamentary trust nor would he have the power of appointment.

Mr Ward's mother died before Mr and Mrs Ward resolved their separation by way of Family Court Orders. The testamentary trust was active and on foot at the time the Family Court was considering the position of the parties and the orders to be made under s79 of the Act. The question for the Court was whether Mr Ward's interest in the trust was "property" within the meaning of the Act and therefore available for division between the parties.

The value of the interest transferred to the testamentary trust from Mr Ward's mother's estate upon her death was approximately $290,000.00.

During the hearing before the Court Mr Ward said that his mother had made the testamentary trust for his share of her estate in order to keep the inheritance away from the wife.

The Court held that the interest of Mr Ward was not "property" for the purposes of the Act. The Court held, however, that the interest of Mr Ward in the testamentary trust was a "financial resource" and could not be overlooked altogether.

The Court made an adjustment in the property settlement order in favor of Mrs Ward in the sum of $67,000.00. No orders were made against the trustee of the testamentary trust and the trust remained intact and undisturbed. Whilst Mr Ward's mother's intention might not have been achieved completely, the outcome must be considered a win for Mr Ward and his mother and the testamentary trust generally. The outcome was undoubtedly far better (in the writer's view) than the outcome that would have arisen in the exact same scenario if Mr Ward's mother had simply gifted the $290,000.00 to Mr Ward in her Will. If that were to have occurred then there would be no question that the $290,000.00 was 'property' within the meaning of s79 of the Act. All of the $290,000.00 would have been available for division between Mr and Mrs Ward in that case. In such a circumstance Mrs Ward would likely have received a share far greater than the $67,000.00 she received.

Daniels v Bell [2007] FamCA 152

Daniels v Bell involved a testamentary trust made by the father of the husband to the marriage shortly before the father died. At the time the father made his Will, his son was separated from his wife and was engaged in a custody and child support dispute with his wife. The father made a testamentary trust of which the husband was not the trustee, but the sole director of the corporate trustee. The husband was a beneficiary of the trust.

The husband's father died before the parties finalised their separation and property settlement and the trust was in operation at the time the parties were before the Court, with the husband having received distributions from the trust.

During the hearing the husband said that his father had made his Will in the way he did to protect the husband's inheritance from the wife.

The Court held that the trust was simply an 'alter ego' of the husband and made an order upon the trustee of the trust requiring the sale of trust assets in order to advance monies to the wife.

Daniels is probably best viewed as a loss for the testator and the husband and a loss for testamentary trusts generally.

That means there is 1 win and 1 loss.

What are the common themes in Ward and Daniels?

In both cases:

1. The party to the marriage before the Court was aware of the testamentary trust Will made by their parent at the time it was made.

2. The predominant if not sole purpose of the trust was matrimonial protection for the child already undergoing separation.
3. The separation or Family Law ‘risk’ was present when the testamentary trust Will was prepared.
4. The husbands in each case stated that the purpose of the trust was to reduce the wife’s chance of getting any of the husband’s inheritance.

These themes are similar to the *inter vivos* authorities. In general, if the purpose for which the trust is established is to defeat a claim of the spouse party and the transfer occurs where that risk is already present, there is a high risk of the trust being interfered with by the Court.

Ward is a more tolerable outcome from the perspective of estate planners and testamentary trusts generally and on balance generated a far greater outcome for the husband beneficiary than would have occurred had the inheritance been paid direct to the husband by the deceased. If the inheritance in both *Ward* and *Daniels* had been paid direct to the husband (rather than into a testamentary trust) it would certainly have amounted to “property” and been available for division between the husband and the wife.

The main difference between *Ward* and *Daniels* is that in *Ward*, the beneficiary was not the trustee of the testamentary trust or an alter ego of the trustee (by being the sole director shareholder of the corporate trustee of the testamentary trust.

Bernard v Bernard [2019] FamCA 421

Bernard v Bernard is the most recent testamentary trust matter to go before the Family Court. Mr Bernard senior, the father of the husband to the marriage, made a testamentary trust Will in 2012 and died later the same year. The Will created a testamentary trust for each of his two children and the residue of his estate was split equally between the two trusts. At the time Mr Bernard senior executed his Will, and at the time of his death shortly thereafter, the husband and the wife were still married with no suggestion that their marriage was in trouble (although this was not discussed in any detail).

The trustee of the husband’s trust was his sister, Ms Bernard, and the trustee of Ms Bernard’s trust was the husband. At no time was the husband the trustee of his own trust.

The husband and wife, who were married in 1988 and had two children, separated in 2015 and divorced in 2017. The wife claimed that the husband’s testamentary trust was “property” within the meaning of s79 of the Act.

It was argued that the mirror nature of the husband’s trust and Ms Bernard’s trust gave the husband effective control of his trust. The husband, on the other hand, argued that the trust was no more than a financial resource and should be treated as such.

The Court held that the trust was not simply an alter ego of the husband. While he was a beneficiary of the trust he was not the settlor, appointor or trustee of the trust and he had no control over the assets of the trust. The application of the wife in this matter was therefore dismissed.

Can testamentary trusts be used in the future? Are they safe? How should they be drafted?

The authorities clearly show that the less control over the trust the beneficiary has the less likely the Court is to be satisfied that the interest of the beneficiary in the trust is "property" available for division between the parties to the marriage.

Ward shows that if a beneficiary is not the trustee of their trust when the matter is considered by the Court then the interest of the beneficiary will more likely be a "financial resource" rather than "property". This is a favorable outcome albeit not a complete defeat of the spousal claim.

Bernard provided the long awaited opportunity to observe how the Court would treat a testamentary trust that was drafted **before** any matrimonial risk existed for the beneficiary and which trust became operational before any separation of the beneficiary from their spouse party took place. In this case, however, there is only the determination that the testamentary trust was not "property" of a party to the marriage for the purposes of s 79 of the Act. Both the husband and the trustee (his sister) had already conceded that the trust was a financial resource of the husband.

Consider our hypothetical scenario of the testator who makes a testamentary trust Will establishing a testamentary trust for each of her children. At the time she makes the Will, her husband has died and her three children are school aged. The same Will is in place 30 years later when the mother dies. At the time of the mother's death the 3 children were happily married. Five years after the death of the mother, the eldest son separates from his wife. The eldest son is the trustee of the trust and the beneficiary of the trust. How will this trust be treated?

Arguably, the case would be distinguishable from most of the *inter vivos* authorities and also *Ward* and *Daniels* in the sense that the trust was not made to defeat a risk that existed at the time the Will was made although possibly defeating a future claim.

The fact that the husband has control of the trust distinguishes this scenario from *Bernard* and does place it at some risk. A solution is to not have the beneficiary be their own trustee. But how?

One option is to begin the trust with a third party trustee. This involves careful consideration at the time the Will is drafted. On a practical level, beneficiaries don't tend to like not having control of their trusts and the option is likely not particularly appealing to the beneficiary.

The next option is to allow the beneficiary to be the trustee of their own trust but permit them to appoint other trustees. This option is fine in the sense that it will create a situation analogous to *Ward* PROVIDED the beneficiary trustee has appointed a different trustee of the trust besfore the matrimonial risk arises. The difficulty with this option is that the beneficiary/trustee may not know when that risk arises and may leave it too late. For instance, if the trust permits the beneficiary to be trustee and gives the beneficiary the power to appoint new trustees and the beneficiary's partner leaves the beneficiary whilst the beneficiary is still trustee of the trust, any change of trustee made by the beneficiary after that separation will almost certainly be deemed by the Court to be a transaction to defeat a claim and in breach of s106B of the Act. If, however, the beneficiary appointed a new trustee in the fourth year of the trust whilst the marriage was still solid and intact, the position would likely be more in favor of the beneficiary.

The third option is a variation of the second and is the best option. It involves an automatic change to the trustee of the trust being triggered as a result of certain events including the separation of the beneficiary from their partner. It is arguable that because the disqualification of the beneficiary as trustee and the replacement of the new trustee is automatic without any 'instrument or disposition' being prepared (these are the words that trigger s106B of the Act) the change in trustee will not amount to a

transaction to defeat a claim in breach of s106B. In this situation the beneficiary will be before the Court in circumstances where:

1. The property in the trust was never the beneficiary's, it having been settled into the trust by the testator.
2. The reasons the testamentary trust was prepared were varied and included matrimonial property protection as only one of many benefits including asset protection from creditors and tax minimization.
3. No risk of matrimonial separation was current at the time the Will was made.
4. No risk of matrimonial separation was current at the time the testator died and the trust came into being.
5. The beneficiary is not the trustee of the trust.

What is the solution?

Clearly appointing a person other than the beneficiary as the trustee of the trust from the outset will increase the safety of the trust from matrimonial property proceedings on the part of the beneficiary in the future, but such a situation will generally be unpalatable to the beneficiary.

For now, it is likely a safe compromise to have a self-executing automatic disqualification of trustee provision incorporated within the provisions of the testamentary trust within the Will that does not offend s106B of the Act which ensures that on separation from their partner the beneficiary is no longer the trustee of their trust. The Will must be carefully drafted to provide for who and how the automatic replacement trustee is to be selected. If the Will does not then the trust will fail for lack of a trustee.

In adopting this course, it is likely that the worst case scenario is that the interest of the beneficiary within the trust is treated as a financial resource rather than property. That is a fairly palatable outcome and still markedly better for the beneficiary than if the interest were deemed to be property.

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