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DISCRETIONARY TRUSTS – CHALLENGING THE TRUSTEE'S DISCRETION

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1 Scale of the issue

1. Australian Taxation Office figures as at 2019-2020 showed that there were about 930,000 trusts in Australia. This is recent information posted by the ATO:[1]

Trust size	2017–18		2018–19		2019–20	
	Trusts (no.)	TBI ($m)	Trusts (no.)	TBI ($m)	Trusts (no.)	TBI ($m)
Loss	500	−58	526	−60	537	−156
Nil	535,943	0	544,893	0	557,333	0
Micro	333,852	115,100	331,051	113,678	337,585	116,230
Small	27,103	107,287	26,647	105,403	27,585	108,730
Medium	4,638	109,617	4,551	105,947	4,673	108,023
Large	195	29,623	186	27,196	200	30,076
Very	55	33,163	60	38,486	58	35,966
Total	**902,286**	**394,732**	**907,914**	**390,650**	**927,971**	**398,869**

2. This means that hundreds of thousands of year-end decisions are made, about who (if anyone) should benefit from trust income.

3. And this is just the beginning.

4. Operating a trust involves decisions involving value judgments. When a decision is made, someone is benefitted, and others are disappointed.

5. What then is the scope to review the exercise of a discretion by a trustee?

6. How can professional advisers avoid being caught up in the dangers?

[1] Refer to this website, viewed 9 August 2022: https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Taxation-statistics/Taxation-statistics-2019-20/?anchor=Truststatistics#Truststatistics

7. What is involved in challenging a trustee's exercise of discretion? What are the practicalities?

2 Essential Rule

8. In the exercise of a power, a trustee must act in good faith, responsibly and reasonably.

9. The trustee must inform itself, before deciding, of matters relevant to the decision. This is not limited to matters of fact. Quite often, this will involve taking advice from experts. But it is a matter for the advisers to advise, and for the trustee to decide. There are real limits on the ability of a trustee to delegate.[2]

10. But we immediately run into complications.

2.1 Excessive and fraudulent execution of a power

11. There is a difference between excessive execution of a power (purported execution of a power in a way the law renders partially ineffective)[3] and fraud on a power.

12. Fraud on a power is defined classically, both positively and negatively, in *Duke of Portland v Topham*.[4]

    (a) The trustee must act in good faith and sincerity, and with an entire and single view to the real purpose and object of the power.

    (b) A power is not to be exercised for the purpose of accomplishing any bye or sinister object, going beyond the purpose and intent of the power.

13. The difference between excessive and fraudulent execution of a power can go to whether the trustee is ultimately liable. Where there has been excessive execution of a power, the trustee is not automatically liable, but may escape liability where it has acted

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2 Paraphrasing *Pitt v Holt* [2013] 2 AC 108, [10].

3 *Ibid*, [80].

4 (1864) 11 HLCas 32; 11 ER 1242 ; [1864] EngR 339.

conscientously in obtaining and following advice that is apparently competent, even if the advice turns out to be wrong.[5]

2.2 Relevance of failure to consider information

14. Finally, for present purposes, it may not be sufficient to prove that a trustee has failed to consider relevant information. The information must be such as would have changed the decision, not simply such as might have changed it.[6]

15. The best way to understand these concepts is to apply them in practice.[7]

3 Unhappiness with the Wolfram Trust

3.1 Family which set up the trust

16. Mr and Mrs Wolfram set up the Wolfram Trust to provide for one of their two sons, Cain.

17. The other son was Abel.

18. Cain had been badly injured in an accident when young. His parents were concerned that he should have access to substantial capital when he was older, since he would not have the same opportunities as Abel.

19. Although Cain's injuries were principally physical, there was always concern about:

    (a) how he might cope in stressful situations, and

    (b) whether there was a cognitive impairment or educational disadvantage that would require more assistance in business matters.

3.2 Trustees

20. Mr and Mrs Wolfram are the trustees of the Wolfram Trust. They are now elderly.

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5 *Pitt v Holt*, above, [80].

6 *Pitt v Holt*, at [92].

7 The examples in this case study are fictitious. Any similarity in names or fact patterns with real life is coincidental.

3.3 Investments

21. The deed provided that the trust fund might be invested in land and in securities, in addition to the usual cash assets.

22. One half of the original trust capital, $10 million, was invested in shares in Dud Properties Pty Ltd (the ***Dud Investment***), a speculative property vehicle controlled by Mr and Mrs Wolfram's brother-in-law, Mr Dud.

23. The other half, $10 million, has been profitably invested directly in land on the outskirts of Adelaide (the ***Direct Property***). It has benefited from successive town planning decisions enabling the land to be subdivided with enormous success.

3.4 Named beneficiaries

24. Mr and Mrs Wolfram never referred to this trust when speaking to Abel.

25. It was kept secret from Cain until he achieved his majority.

26. The primary income & capital beneficiaries of the Wolfram Trust were named as Cain & Abel.

27. There are then tiers of other relatives also named as beneficiaries.

28. Primary beneficiaries take unless income is appointed away by year end: likewise capital, unless otherwise appointed before the vesting date.

29. Lower tiers of beneficiaries, such as any children of Cain or Abel (as the second tier), only become default income and capital beneficiaries if all beneficiaries in all higher tiers have died. All tiers of beneficiaries are objects of discretion (whilst alive).

3.5 Developments with investments

3.5.1 Dud Investment

30. The Dud Investment soured, losing half the capital so invested.

31. Mr and Mrs Wolfram had invested $10 million of the trust's capital in shares in Dud Properties Pty Ltd.

32. They regret that they did not insist on having a seat on the board of that company.

33. They have not insisted on seeing financial reports.

34. They simply trusted their brother-in-law. But he made some elementary errors in the approach he took to property investment through Dud Properties Pty Ltd, leading to the substantial losses.

3.5.2 Direct Property

35. On the other hand, the Direct Property investments have been supervised closely by Mr and Mrs Wolfram, albeit with the usual consultants helping. These have enjoyed enormous success.

3.6 Appointments of income

36. Income of the Wolfram Trust was never appointed in favour of Abel.

37. Further, a view was taken that the trust fell within the excepted income provisions, as the seed capital came from the personal injury compensation paid in favour of Cain. Thus, substantial distributions were made each year to Cain to provide ongoing medical expenses and assistance with his educational and social needs.

3.7 Abel finds out

38. Twenty years on, Cain and Abel live in different countries. They rarely speak.

39. Cain never married, in part owing to his childhood injuries, but Cain retained a vital interest in the property development activities which continued to occur through the Wolfram Family Trust. Cain has gathered around him a group of trusted professional

advisers, in relation to his legal and accounting requirements, but also his property development activities.

40. Abel married and has children who are potential objects of discretion under the Wolfram Family Trust. But he has only just learned of the existence of this trust.

41. Abel wonders why he has never been told about this trust. He learned about it only through a careless line in a newspaper report concerning the fabulous wealth generated over the past decades through Cain and his parents' efforts concerning the Direct Property.

42. Abel has his solicitor write to Cain enquiring whether Abel and his family are beneficiaries or objects of discretion under the Wolfram Trust. On the assumption that they are, the solicitors ask for the trust deed and full accounts of the trust back to the time when the trust was settled.

4 Immediate Areas of Dispute

43. From the above facts, we can see that the trustee may fall into dispute with Abel about:

    (a) whether Abel has been properly considered for distributions, and how he and his children might be considered for distributions in future; and

    (b) the monumental losses incurred by the trust through the Dud Investment.

44. Cain may also attempt to join the fray, in his capacity as a beneficiary. There are limits to his ability to do so. But he will likely be joined in any proceedings, and he will have to decide whether he takes an active part in such proceedings. There are significant costs consequences of a decision to take an active part in such proceedings. The decision is not taken lightly.

45. But the first point which may divide the parties is access to information. It is fundamental that the actions of a trustee or fiduciary should be capable of review.[8]

46. Without basic information, such as whether Abel is a beneficiary or object of discretion, Abel is hamstrung in questioning the of the affairs of the trust.

5 Access to Information

47. Accessing information is a vital step toward articulating complaints about trustee exercises of discretion or misfeasance. Without information, a beneficiary cannot hold a trustee to account. This was fundamental to the reasoning in *Armitage v Nurse*.[9]

5.1 Duty to inform beneficiaries of their rights

5.1.1 Principles

48. The position differs between an object of discretion, and a beneficiary of a strict trust. These might be regarded as extremes, on a range.

49. A beneficiary of a strict trust must be informed by the trustee of his rights under the trust when of full age and capacity.[10]

50. The position for objects of discretion, on the other hand, is not as clear. The obligation to tell a mere object, of the possibility that he might be considered for a distribution, was again left unexplained in *Segelov v Ernst & Young Services Pty Ltd*.[11] Gleeson JA said:

> *It is, however, a much larger step to suggest that in all trusts a beneficiary's right to inspect the trust documents, including the trust deed, gives rise to a corresponding duty of disclosure owed by the trustee to the beneficiary to have his or her rights explained to them, including in the case of potential objects of a discretionary trust their entitlement to an interest in the trust fund once determined by the trustee. ... This contention should be rejected. To accept such*

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8 *Armitage v Nurse* [1998] Ch 241, 253, speaking of an irreducible core of obligations. There, the context was a broad exemption clause in a trust deed. As to provision of information in England, see *Schmidt v Rosewood Trust Ltd* [2003] 2 AC 709.

9 [1998] Ch 241, 253.

10 *Re Emmet's Estate* (1881) 17 ChD 142, 149. See also Ford & Lee, *Law of Trusts*, [9.4610].

11 (2015) 89 NSWLR 431 (NSWCA).

> *a proposition would be to impose a duty on trustees without regard to the nature and the terms of the relevant trust and social or business environment in which the trust operates …*

51. In South Australia, section 84B(2)(c) of the *Trustee Act 1936 (SA)* requires the trustee, at the request of a beneficiary under the trust, to produce records kept under section 84B. Failure to do so is a criminal offence. The beneficiary may examine or make copies of those records.

52. Regulation 5 of the *Trustee Regulations 2011 (SA)* states the records that a trustee must keep relating to administration of the trust property for the purposes of section 84B.

53. Although the wording of this provision is somewhat peculiar, it would appear that the trust deed must be produced upon request by a beneficiary under section 84B(2), as well as a record of all reviews of investments (which must be annual, at least, as we shall see); any instrument varying distribution of the trust property; and "trust statements" which appears to be a blend of a cashbook, balance sheet, cashflow statement, and record of other property received or transferred.

54. Nevertheless, a beneficiary must know to enquire under section 84B. There will always be a question as to whether a beneficiary or object must be informed of its entitlement.[12]

5.1.2 Right to be told here?

55. In the present case, if Cain was a default beneficiary as to capital, with his brother Abel, then arguably both were entitled to be told of their respective beneficial, vested interests upon attaining majority.

56. Cain was told.

[12] Cf section 51 of the *Trusts Act 2019 (NZ)*.

57. Abel was not. Abel was thus never able to make representations to the trustees as to his needs, if any, which could have been met using discretionary powers to appoint income or capital.

58. What of the children of Abel?

59. Abel's children might (during Cain and Abel's lives) effectively only be objects of discretion as to income, or as to capital, and might yet not have attained majority.

60. Real problems arise where such persons are also second or lower tier default beneficiaries, ranking behind, say, their parents. They have only a contingent interest (dependent upon surviving other lives in being). And such a contingent interest is also liable to be defeated by appointment in favour of a discretionary object.

61. Therefore, it is difficult to find, let alone formulate, hard and fast rules admitting of no exceptions in this field.

62. Some of the case law about the rights of those who take only in the event of the happening of a contingency does look decidedly dated in the face of the modern discretionary trust deed.[13]

63. Indeed, some of the distinctions drawn in the cases not only look dated, but are also decidedly difficult to apply in practice.

64. Thus, in *Schmidt v Rosewood*, the person seeking disclosure of trust documents was not yet named as a beneficiary under one of the true settlements concerned. (There was power to name that person as beneficiary, but it had not yet been exercised.) The applicant was nevertheless successful.[14]

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13 *Re Tillott* [1892] 1 Ch 86; *Re Dartnall* [1895] 1 Ch 474. See also Heydon & Leeming, *Jacobs' Law of Trusts in Australia* (8th Edition), page 350, paragraph 17-15, footnote 135; Dal Pont, *Equity and Trusts in Australia* (7th Edition), paragraphs [20]-[30].

14 [2003] 2 AC 709.

65. Again, this is subject to section 84B of the *Trustee Act 1936 (SA)*, and Regulation 5. Those provisions overlay discussion under the succeeding subheadings as well.

5.2 "Trust documents"

66. I now turn to rights to see documents.

67. The first issue is whether a document is a "trust document", or something private to the trustees.

68. The New South Wales Court of Appeal decision of *Hartigan Nominees Pty Ltd v Rydge*[15] gives examples of documents that may be property of the trustees, and may have come into existence in relation to the administration of the trust, but which nevertheless will not be a "trust document". These include:

    (a) a letter from a possible beneficiary conveying information about the beneficiary's circumstances;

    (b) a note for or by a trustee of discussions with other beneficiaries to assist the trustee to decide how to exercise a discretionary power; and

    (c) a memorandum of wishes.[16]

5.3 "Confidential" trust documents

69. Next, there are questions of confidentiality, which may justify withholding a document from a beneficiary.[17]

70. In *Hartigan Nominees*, much of the debate was about a memorandum of wishes. As seen above, this was not a "trust document".

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15 (1992) 29 NSWLR 405, 433.

16 *Ibid*, page 437.

17 *Ibid*, at 433F.

71. But you could also imagine a case where disclosure of information, or a document, such as a secret recipe or other confidential information, could cause jeopardy to the other beneficiaries and objects.

72. Yet, the document recording the secret recipe would be a "trust document".

73. A good example was the South Australian Full Court decision, *Rouse v IOOF Australia Trustees Limited*.[18] The trustee acted for investors in a forestry project. The trustee was suing people. There was a question about whether the trustee ought to provide information to beneficiaries about that litigation, including the brief to counsel.

74. Critically, the beneficiaries had not claimed that they had been prevented from exercising rights under the trust deed. Nor did they claim that their attempts to exercise such rights had been frustrated.

75. They had not shown that reasonable requests for information, about the course of the litigation, had been rejected. Such reasonable requests were distinguished by the Full Federal Court from requests for access to particular primary documents.[19]

76. Giving the principal judgment of the Full Court, the Doyle CJ said that the trustee was entitled to refuse access to trust documents (in cases going beyond a necessity to maintain confidentiality in the reasons for exercise of a discretion).[20]

77. Doyle CJ said (underlining added):[21]

> *There must be various situations in which a trustee, particularly a trustee conducting a business, would be put in an impossible position if the beneficiary of the trust could, as a matter of right, claim to inspect documents in the possession of the trustee and relevant to the conduct of the business. It is readily conceivable that there will be situations in which an undertaking of confidentiality is not sufficient protection. The fact that the trust is one in which numerous beneficiaries have an interest, and the further fact that those beneficiaries may have differing views about the wisdom of the course of action being pursued by*

18 (1999) 73 SASR 484.

19 *Ibid*, [74].

20 Ibid, [98].

21 Ibid, [100].

> *the trustee, only served to emphasise, in my opinion, the need for the law to recognise some scope for a trustee to refuse to disclose information on the grounds that it is confidential and on the further ground that the disclosure is not in the interests of the beneficiaries as a whole.*

5.4 Theoretical basis for beneficiary access to documents

78. We have now dealt with the issues of whether something is a "trust document" and whether something should otherwise not be disclosed because it is "confidential".

79. We now get to the difficult question: the basis upon which a beneficiary may assert an entitlement to see a trust document, absent any threat to litigation.

80. *Rouse* adverts to, but does not decide, whether the claimed entitlement must be decided by reference to whether a beneficiary has a proprietary interest in a trust document, or on the basis that a fiduciary must be ready with his accounts.[22]

81. The seachange in favour of a flexible approach, requiring disclosure to the extent necessary to enable a beneficiary or object to hold a trustee to account, came in the Privy Council decision, *Schmidt v Rosewood Trust Ltd*, an appeal from the Isle of Man.[23]

> *Their Lordships have already indicated their view that a beneficiary's right to seek disclosure of trust documents, although sometimes not inappropriately described as a proprietary right, is best approached as one aspect of the court's inherent jurisdiction to supervise, and where appropriate intervene in, the administration of trusts. There is therefore in their Lordships' view no reason to draw any bright dividing line either between transmissible and non-transmissible (that is, discretionary) interests, or between the rights of an object of a discretionary trust and those of the object of a mere power (of a fiduciary character). ...*
>
> *... [No] beneficiary (and least of all a discretionary object) has any entitlement as of right to disclosure of anything which can plausibly be described as a trust document. Especially when there are issues as to personal or commercial confidentiality, the court may have to balance the competing interests of different beneficiaries, the trustees themselves, and third parties. Disclosure may have to be limited and safeguards may have to be put in place. Evaluation of the claims of a beneficiary (and especially of a discretionary object) may be an important part of the balancing exercise which the court has to perform on the materials placed before it. In many cases the court may no difficulty in concluding that an applicant with no more than a theoretical possibility of benefit ought not to be granted any relief.*

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22 See the discussion in *Rouse*, ibid, [88]-[92].

23 [2003] 2 AC 709.

82. A decision of the Privy Council does not bind an Australian court, at least where given on appeal from a different country. But a decision of this ultimate appellate court can be persuasive.[24]

83. There has been a recent case sticking with a proprietary approach in Australia: *Chan v Valmorbida Custodians Pty Ltd*.[25] But the authorities are split on the point.

84. Pragmatically, there is much to commend the decision of Colvin J in *Thomson v Colonial First State Investments Ltd (No. 2).*[26] After noting the difference in views between the proprietary theory and the more flexible approach, the court pointed out that "the supervisory jurisdiction extends to being able to compel a trustee to provide information". Thus, it might be that parties with a proprietary interest have a right to access documents, and parties with a lesser interest will need to persuade the court "that it is necessary or appropriate to do so in the exercise of its supervisory jurisdiction".

85. I think we will eventually go down the more flexible course. And I think we will follow the New Zealand Supreme Court.

86. We are seeing citations in Australia of the New Zealand Supreme Court decision, *Erceg*.[27]

87. *Erceg* involves a multi-factorial approach, which I consider gives effect to *Schmidt v Rosewood Trust Ltd*. The New Zealand Supreme Court draws together the various

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24 A decision of the Privy Council, given on Australian law before termination of appeals to that body, can be highly persuasive, if not in conflict with a decision of the High Court of Australia: *Viro v The Queen* (1978) 141 CLR 88. This decision is not in that category, given after termination of appeals.

Thus, we do not have to resolve a conflict in the authorities on a subsidiary point: On one view, unless the High Court of Australia has also spoken, such a decision of the Privy Council binds the Supreme Court of Queensland: *Sun North Investments v Dale* [2014] 1 QdR 369, [113] & fn 49. Opposite views have been expressed by individual judges interstate: *Hawkins v Clayton* (1986) 5 NSWLR 109, 136-137 (McHugh JA) & *R v Judge Bland; Ex parte Director of Public Prosecutions* [1987] VR 225, 231-232.

25 [2020] VSC 590, [71].

26 (2021) 153 ACSR 663, [62]-[65].

27 [2017] 1 NZLR 320.

threads in the cases. The matters that need to be evaluated in relation to an application for the disclosure of trust documents include the following:[28]

(a) What documents are sought? If a number of documents are sought, decisions may need to be made about each document or class of documents. This is because different considerations might apply to the basic documents such as a trust deed, and "more remote documents" such as a memorandum of wishes.

(b) The context of the request, and the objective of the beneficiary in making the request. A case for disclosure will be more compelling if it is otherwise not possible to monitor the trustee's compliance with the trust deed. It might also be relevant that disclosure has been made to other beneficiaries, though that is unlikely to be a decisive factor against disclosure, so long as there is no improper motive on the part of the applicant beneficiary.

(c) Nature of interest of beneficiary seeking access. The "degree of proximity" of the beneficiary to the trust, or the likelihood of the beneficiary (or others in the same class as that beneficiary) benefitting from the trust is a relevant factor.

(d) Any issues of personal or commercial confidentiality? The court will take account of the need to protect such matters. It will also look for any indications in the trust deed relevant to the need for confidentiality for such matters.

(e) Any practical difficulty in providing the information. The court will look at any difficulty or expense that may be caused in doing so.

(f) Whether the documents sought will disclose trustee's reasons for decisions made by them. The New Zealand Supreme Court follows earlier authority, but in a

28 *Ibid*, [56].

qualified way, in saying that it would "not normally be appropriate to require disclosure of the trustee's reasons for particular decisions.

(g) Likely impact on trustee and other beneficiaries if disclosure made. In particular, the focus is on whether there would be an adverse impact on the beneficiaries as a whole. A balancing exercise is involved. The New Zealand Supreme Court was prepared to take into account the possibility of disclosure making family relationships more difficult, if it was a family trust, including the relationship between trustees and beneficiaries if that would be to the detriment of beneficiaries as a whole. However non-disclosure is recognised as possibly having a similar effect.

(h) Likely impact on settlor and third parties.

(i) Whether disclosure can be made while still protecting confidentiality. Here we are talking about possible redactions. Also see the next point.

(j) Imposing safeguards? Things the New Zealand Supreme Court was prepared to consider included undertakings and a provision for inspection of documents only by professional advisers.

5.4.1 Claims of privilege

88. Overlaying the debate about entitlement to trust information and trust documents would be any claim for legal professional privilege on the part of the trustees, as against the beneficiaries.

89. A recent New Zealand Supreme Court authority, *Lambie Trust Ltd v Addleman*, follows what I considered to be orthodox lines, according to the literature, but is significant as

being the first ultimate appellate court decision on issues of joint privilege between beneficiaries and trustees, at least in the context of now heated litigation.[29]

90. It upholds the idea that advice for which the trustees have sought indemnity from the trust fund will generally be the subject of a joint privilege, shared between the trustee and the beneficiaries. Thus, the trustee cannot claim privilege as against the object or beneficiary.[30]

91. Unfortunately, it is not as simple as that. Trustees may be in litigation against a beneficiary, and may be properly defending their actions using the resources of the trust to do so. In that case, the trustees will be entitled to assert legal professional privilege, as against the litigious beneficiary.[31]

92. The New Zealand Supreme Court said that, with one exception involving an unusual fact pattern, a beneficiary would not have a joint interest in trustee-commissioned legal advice received after litigation had been commenced ("or perhaps when it was very imminent"). The Court did say that there was little help in the case law "as to the persistence of the joint interest in the period between contemplation and commencement of litigation".[32]

93. I understand that although the New Zealand Supreme Court invited submissions about a particular period relevant to the facts of that case, and that the trustees filed such submissions, no decision from the court has been received about that controversial period, and any advice that might have been received during that period. We await developments.[33]

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29 [2021] 1 NZLR 307.

30 This accords with the leading text, Passmore, *Privilege*, (4th Edition), paragraph 6-022.

31 [2021] 1 NZLR 307, and see also *Dawson-Damer v Taylor Wessing* [2020] Ch 746. I have simplified the analysis, as this article is not about access to trust information as such, but rather this article means to signpost areas of potential dispute in gaining access to trust documents and information.

32 [2021] 1 NZLR 307, [91].

33 I have been following this litigation closely, and observe that this separate issue has now been reserved by the New Zealand Supreme Court for the better part of a year.

94. In summary, where litigation is against a third party (not a beneficiary requesting information or documents), a beneficiary may be denied access, where the requesting beneficiary may use the documents to prejudice the trustee in its conduct of the litigation, or prejudice other beneficiaries.[34]

95. Where the litigation is against the requesting beneficiary, the beneficiary is not entitled to advice sought by the trustee about the substance of a dispute with the trustee.[35]

96. A final point remains unresolved. This is the case where a trustee (or prospective trustee) pays for legal advice itself. It might want to know, privately, what its responsibilities or downsides are, personally, of doing something.

97. I gather there is a view that such advice, though privileged, might be accessed by a beneficiary, as subject to joint privilege with the beneficiaries. For myself, I should think that would be a hard result, and contrary to the point of the privilege – to enable a person to obtain frank advice from a lawyer about one's own position.

98. Nevertheless, the question was distinctly raised (though not finally answered) in *Lambie Trust Ltd v Addleman*, in the New Zealand Supreme Court. In argument, Mr Ross QC for the respondent said:[36]

> *If the advice relates to the administration of the trust it is trust property even if the trustee pays for it (Re Arpettaz Settlement [2020] JRC 161 at [8], [51]-[53]).*

99. Delivering the judgment of the New Zealand Supreme Court, William Young J said:[37]

> *That said, where the information consists of legal advice, some considerations (for instance who paid for the advice) may be material to both issues. As a rough rule of thumb, advice paid for using trust money is most unlikely to be personal to a trustee. This is because trustees must not use trust funds for their own purposes.*

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34 *Webster v Murray Goulburn Co-op* [2018] FCA 990.

35 Passmore, *Privilege* (4th Edition), paragraph 6-022.

36 [2021] 1 NZLR 307, 312

37 [2021] 1 NZLR 307, [51]

100. Significantly, however, William Young J added as follows:[38]

> *This may not work the other way and advice paid for by a trustee may nevertheless be trustee information.*

6 Disappointment with Investments

101. The power to invest is administrative, not donative. But many administrative powers are important, too.

102. While the Direct Property has done fantastically well, recall that the Dud Investment was unsuccessful.

6.1 Abel gets accounts

103. As a default beneficiary attempting to investigate, for the first time, his rights and entitlements under the trust, Abel will have access to the accounts. And the accounts must be disclosed to him without time limit, in principle.[39]

104. Abel will have access to the trust deed, to know the extent and nature of his entitlement.

105. On perusing the accounts, Abel will doubtless understand that the trustees invested half the initial fund in Dud Properties Pty Ltd, a proprietary company whose connection with the family will be obvious from search.

106. The accounts may reveal the losses; or his investigations (including a request to the trustee to provide the accounts of Dud Properties Pty Ltd)[40] may show the losses.

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38 [2021] 1 NZLR 307, fn 33

39 Compare *Addleman v Lambie Trustee Ltd* [2019] NZCA 480, [23]. Note in South Australia that there are specific regulations dealing with record keeping, which at least provide some finality after termination of the trust. In accordance with the *Trustee Regulations 2011 (SA)*, section 5(3), the records referred to in the Regulation "must be retained by the trustee … for at least five years after the termination of the trust". Recall that South Australia has abolished the rule against perpetuities. It is possible that records of a trustee will need to be maintained forever, but that may well be the position under the general law anyway, subject only to discretionary defences such as laches.

40 This was the course taken in *Addleman v Lambie Trustee Ltd* [2017] NZHC 2054, [23].

6.2 Standard

107. In the mid to late 1990s, the Australian States followed New Zealand law reform, and introduced template laws modernising the rules about trust investment.[41] The laws were changed in each State over a period, and it is necessary to study the legislative history carefully in the State with which the trust has connection. The reform in South Australia was enacted in 1995.[42]

108. For ease of reference, I will refer to the present trust investment law as the ***post-1995 SA law***. And for ease of analysis, we will assume that the post-1995 SA Law applies.

109. Nevertheless, I must mention for comparison the state of the law immediately prior, since the new law assumes that the older standard applies to some extent.

110. Under section 6 of the *Trustee Act 1936 (SA)*, the law has been modified so that a trustee may (unless expressly forbidden by the instrument creating the trust) invest trust funds in any form of investment. The trustee can vary or realise an investment, and re-invest an amount resulting from the realisation in any form of investment.

111. The prior rule confined the trustee in the sorts of investments that could be made, but there was a statutory power to invest in certain authorised securities. That concept is no longer retained.

112. Despite this apparent freedom under section 6, the trustee is nevertheless subject to duties in exercising a power of investment in accordance with section 7. A non-professional trustee (which we will assume for the purposes of this exercise is applicable to the facts discussed today), is held to this standard – the trustee must:

> *... exercise the care, diligence and skill a prudent person of business would exercise in managing the affairs of other persons.*

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41 Ford & Lee, *Law of Trusts*, paragraph 10.1000. The New Zealand reforms of 1988 have themselves been overtaken by section 30 of the *Trusts Act 2019 (NZ)*.

42 It was proclaimed to commence on 1 July 1995.

113. Section 7 also refers the trustee back to the trust deed, requiring the trustee to comply with a provision of the instrument creating the trust, if there is a provision requiring consent or approval, or compliance with a direction, for trust investments.

114. Finally, under section 7(3), the trustee must at least once in each year review the performance, individually and as a whole, of trust investments.

115. Under the general law, before the law reform of 1995, Abel was not obliged to give credit to the trustees for success, and could attack their failures without set-off.[43]

116. Now, on a discretionary basis, the court may allow set-off. The matters to which the court has regard under section 13C appear to be listed by section 13B:

    (a) the nature and purpose of the trust;

    (b) whether the trustee had regard to the matters set out in section 9 (see below) so far as appropriate to the circumstances of the trust;

    (c) whether the trust investments had been made under an investment strategy. Sections 8(3) & 9(2) contemplate the trustee recovering reasonable costs of obtaining advice;

    (d) the extent the trustee acted on the independent and impartial advice of a person competent (or apparently competent) to give advice.

117. Reference is made above to having regard to matters set out in section 9 of the Act:

    (a) the purposes of the trust and the needs and circumstances of the beneficiaries;

    (b) the desirability of diversifying trust investments;

    (c) the nature of and risk associated with existing trust investments and other trust properties;

    (d) the need to maintain the real value of the capital or income of the trust;

43 Ford & Lee, *Law of Trusts*, paragraph 10.18120.

(e) the risk of capital or income loss or depreciation;

(f) the potential for capital appreciation;

(g) the likely income return and the timing of income return;

(h) the length of the term of the proposed investment;

(i) the probable duration of the trust;

(j) the liquidity and marketability of the proposed investment during, and at the end of, the term of the proposed investment;

(k) the total value of the trust estate;

(l) the effect of the proposed investment for the tax liability of the trust;

(m) the likelihood of inflation affecting the value of the proposed investment or other trust property;

(n) the cost (including commissions, fees, charges and duties payable) of making the proposed investment;

(o) the results of a review of existing trust investments. (Note again the obligation under section 7(3) upon the trustee, at least once in each year, to review the performance, individually and as a whole, of trust investments.)

6.3 Review of the investment decision – Dud Investment

118. The halving of the value of the Dud Investment can be attacked with ease, but defended only meticulously and at expense.

119. A basic issue here was lack of diversification, contrary to section 9(1)(b). Property development might also be said to involve high risk, with consequent risk of loss of capital and thus loss of ongoing income: section 9(1)(e).

120. Thus, making such an investment, and retaining it, requires a balancing act between risk and return overall. Half the fund went into an illiquid, high-risk investment run by the

brother-in-law. Worse, the trustees admit they ought to have better supervised the Dud Investment. After all, the property development they made directly themselves, prospered, and they are in danger of being held to a higher standard as experienced investors. (Section 7(1)(a) imposes a higher standard on trustees whose profession, business or employment is, or includes, "acting as a trustee or investing money for other persons".)

121. Under the general law, the trustee is obliged to supervise the investment, if made through a company. This is so at least where there is capacity to control the company. As is explained in Gallagher, *Equity and Trusts in Hong Kong*:[44]

> *... if a trust has a large investment in shares of a company, the share ownership usually comes with consequent right to vote and control the company's actions. As it is generally accepted that the starting point for trustees in their duties to the trust is to safeguard the trust and ensure its investments is protected, this is interpreted as a duty to monitor any underlying corporate structure. However, many family trusts are settled with shares in underlying family companies, and the settlors often wish to retain their control over the actions of the underlying company free from interference from the trustees ...*

122. This follows from the leading English case, *Bartlett v Barclays Trust Co (No. 1)*.[45]

123. Some trust deeds attempt to overcome the onerous duties of a trustee, to supervise investments made through a company such as Dud Properties Pty Ltd, by a so-called "anti-Bartlett" clause. Such a clause was upheld by the Hong Court of Final Appeal in 2019.[46] While that decision will be highly persuasive, it is untested in Australia.

124. The remedy which was sought in that case was to have the trustees reconstitute the fund. In the present case, such a liability would be ruinous for the non-professional trustees of the Wolfram Trust.

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44 2nd Edition, Sweet & Maxwell, paragraph 17.12.2.

45 [1980] Ch 515.

46 *Zhang Hong Li v DBS Bank (Hong Kong) Ltd* [2019] HKCFA 45.

125. It would be said against the trustees that they ought not to have made the investment, and (in any case) ought to have supervised it more carefully.

126. As a comparator, it is interesting to note developments elsewhere. Nowadays, an efficient way of seeking remedy in Queensland is by application under section 8 of the *Trusts Act 1973*. The analogue was section 94 of the *Trustees Act 1962 (WA)*, but Queensland has gone a step further in allowing the exercise of non-statutory powers also to be reviewed by this simplified means.

127. In other States, such as South Australia, longer form proceedings would be commenced instead.

128. In short, the proceedings would call into question, and seek remedy for, the unsuccessful investment in the Dud Investment.

7 Reviewing Exclusion as Beneficiary

129. A discretionary trust contains powers to appoint income, capital, or both. Often Australian trust deeds contain provisions stating which beneficiaries (and in which order of priority) will take in default of a valid appointment of the income, the capital, or both.

130. In the present scenario, the trustees are the parents of Abel and Cain. The parents are now old and frail.

131. They have been concerned about Abel's request for information. They have now been served with legal process calling into question the investment decisions (including supervision of the investments) to do with the Dud Investment.

132. They consult their lawyers and express the view that Abel should be removed as a beneficiary.

133. The lawyers point out the complications with stamp duty and direct taxes. They also point out that the question is timely, since Abel now lives overseas. In some of the States where the trust holds land, there are provisions penalising the trustees of a trust that owns

land if a beneficiary is a foreigner. Abel falls within the definition of "foreigner" for these purposes.

134. At this stage, it seems that the advisers have overlooked removing Abel's children. (More of that below.)

135. Can the trustees exercise the following power to exclude Abel from any further benefit?[47]

> *The Trustee may at any time exclude a beneficiary from the class of beneficiaries hereunder and such person shall not thereafter form a member of the class of General Beneficiaries for the purpose of this Deed and no further sums whether of income or of capital shall be allocated set aside paid to or otherwise applied to or for the benefit of such persons provided however that any such notice shall not affect the beneficial entitlement to any amount set aside for such beneficiary or amount held in trust for such beneficiary.*

7.1 Powers of exclusion

136. The above power is not uncommon. It was useful where having someone as a beneficiary jeopardised the future of a trust, say in a tax haven. I have also seen such a clause used to cut off a sibling who had had her portion (from other sources), to simplify her life in the high-tax jurisdiction to which she had moved. Such powers have now come into their own given surcharges and levies based on a beneficiary being a foreigner.

137. In the present case, it is apparent that the trustees could have two reasons for acting to remove Abel, the foreigner.

138. The first reason concerns the substantial additional land tax levy payable each year in the State where some of the real property is located.

139. The second reason that they might think to act is to remove a beneficiary from future benefit in a case where his actions are causing disturbance to them, as trustees.

140. One would have thought that the latter reason is not a good reason to act. On the face of it, a beneficiary who is simply trying to hold trustees to account, by asking measured

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47 This has been adapted from a clause in a model deed in Grbich, Munn & Reicher, *Modern Trusts and Taxation*, Butterworths, 1978, pages 294-295. The model clause was a self-exclusion clause, able to be used by the beneficiary. I have changed it to be a clause enabling the trustee to exclude.

questions about the investments and trust documents, is doing no more than the beneficiary is entitled to do.

141. The kind of dispute does happen.

142. In *Curwen v Vanbreck Pty Ltd*,[48] the trust deed empowered the trustee, in its absolute and uncontrolled discretion, to exclude from the class of beneficiaries a person who would otherwise be a beneficiary.

143. A dispute arose among the family about the directorship of the trustee company. One of the brothers made a formal request to access trust documents.

144. Shortly afterward, and without giving a reason, the trustee exercised its power to exclude that person as well as his brother as beneficiaries. The first brother had not even been given access to the trust documents.

7.1.1 Principles for deciding these cases

145. As with many cases about powers, the questions revolve around whether the disappointed beneficiary can show that the power (here a power of exclusion) had been exercised for some purpose other than a proper purpose. Often, this will come down to the construction of the trust deed as a whole, and to matters of inference that the court is invited to draw.

146. An important question is whether the rule in *Jones v Dunkel* applies. In most civil litigation, an inference might be drawn from the failure to tender a document or call a witness, where that document or witness might be adverse to the defendant's case.[49]

147. If such an inference were available here, it would be valuable, as you may not get reasons from the trustee about why it exercised a power, and thus may be unable properly to commence litigation absent any other factual basis.

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48 (2009) 26 VR 335; 4 ASTLR 71; [2009] VSCA 284.

49 *Jones v Dunkel* (1959) 101 CLR 298.

148. Recall that such reasons are regarded as private documents, and not trust documents, and thus probably will not be given to a beneficiary when disclosing "trust documents". Also, however, note that during civil litigation, disclosure obligations may turn up such documents, even if they are not trust documents to which a beneficiary is entitled in the absence of litigation. But to commence litigation, without evidence, is a serious matter.

149. But the Victorian Court of Appeal has recently confirmed that the *Jones v Dunkel* inference is not available in circumstances where the trustees were not obliged to give reasons. Refer *Owies v JJE Nominees Pty Ltd*.[50] Nevertheless, standing mute does have some consequence for a trustee, as the Victorian Court of Appeal said:[51]

> *Ultimately, the trustee chose not to explain its reasons, leaving the stark pattern of distributions to speak for itself.*

150. I return to *Curwen v Vanbreck*, above. The Victorian Court of Appeal said that the former beneficiaries in that case had the onus to establish that the trustee's exercise of discretion was not made for a proper purpose.[52]

151. What the beneficiary in that case had to establish was a fraud on a power. Classically, that required that the former beneficiary established that the trustee has trespassed beyond what is permitted in this sense:[53]

> *The donee of a limited power must exercise it bona fide for the end designed by the donor, which requires that the power can be exercised only in favour of the objects of that power and in furtherance of the purpose for which it is conferred. If the donee, in good faith, exercises a power in favour of a stranger or in some other way which is not consistent with the terms and scope of his power, such exercise ... is excessive. If, however, the donee deliberately attempts "to secure the effect of an excessive execution without actually making one", the exercise of the power is not simply excessive: it is in fact fraudulent and void.*

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50 [2022] VSCA 142, [119]

51 At [133].

52 At [30].

53 Thomas, *Thomas on Powers* (2nd Edition), page 400.

152. The above passage about defective exercise of a power does not take into account the peculiar feature of a power of exclusion, that the person excluded will quite often not benefit, though that person was originally a beneficiary or object.

153. The difference between an excessive appointment, and a fraudulent appointment, can be difficult to discern. For the purposes of this exercise, we have been let inside the solicitor's office to listen to the conversation between the elderly trustees and the long-time adviser, and we know the two reasons possibly actuating the trustees to act to remove Abel as a beneficiary.

154. The trustees have now excluded Abel, but have not provided any reasons to Abel. They have provided him with a brief letter pointing to the power in the trust deed and the fact of its execution depriving him of any further benefit under the trust deed.

7.1.2 Result in *Curwen v Vanbreck*

155. The Victorian Court of Appeal said that if a trustee, in deciding to exercise the power, "acted upon the dual consideration of whether the beneficiaries ought to be entitled to a potential distribution of trust assets and whether those beneficiaries ought to be given access to trust documents, so that the latter consideration should be regarded as part of the trustee's primary intention, it would be an invalid exercise of power".[54]

156. In other words, there was no requirement that the improper purpose be the "primary or dominant purpose". The improper purpose "will constitute a fraud on the power if it be an operative or actuating purpose".

157. So, in the present case, if an operative or actuating purpose was to retaliate against Abel for his requests for documents, or for his seeking to review investment decisions, it does not matter that there is another perfectly good reason, being the desire to save the trust as

54 At [42].

a whole from heavy annual taxes which were avoidable by removing Abel as a beneficiary.

158. The difficulty for Abel, of course, is that Abel is not party to the conversation that the trustees have had with the solicitor.

159. He has difficulties of proof.

160. As in *Curwen v Vanbreck*, Abel may not be able to draw together the threads sufficiently to prove such fraud on a power. The result in that Victorian case was that the two brothers who were excluded from benefit under that trust were unable to draw together the threads sufficiently. As the Victorian Court of Appeal said:[55]

> *Neither at trial nor on the appeal did the appellants' case rise higher than the suggestion that, because the trustee's decision was made in the context of the beneficiary's request for access to the documents, that must have been a reason for the exercise of the power of exclusion.*

8 Appointments of Income and Capital to Cain

161. From the books of account, Abel has deduced that Cain has been favoured with income and capital distributions over many years.

162. The actual identity of the beneficiary favoured is sometimes hidden, as this is regarded as private. Nevertheless, by dint of the fact that Cain has no children or other close relatives with whom he associates, and by further dint of the fact that the accounts show large distributions of income and capital over many years, Abel has been able to deduce that Cain could only be maintaining his luxury lifestyle because of distributions from the fund.

163. As shown above, subject to section 84B of the *Trustee Act (SA)*, Abel will be unable to obtain, as trust documents, any notes or resolutions concerning consideration of the merits of distributions to the various objects, until litigation is commenced. Abel would be able to seek disclosure in litigation of some of those documents, probably, but faces a "chicken

55 At [49].

and egg" problem that he is not properly able to commence litigation to impugn distributions without some solid basis.

164. This is a usual problem faced by many litigants. However, three cases indicate how this kind of problem can be approached.

8.1 Ioppolo v Conti

165. From the Western Australian Court of Appeal, *Ioppolo v Conti*[56] is a case about a superannuation fund. While I have had the argument over the years about whether superannuation is a fixed trust or a discretionary trust, and have heard people defend superannuation trust deeds as fixed trusts, the level of discretion given by most deeds, particularly (and relevantly) in relation to death benefits and reconstitutions of the fund on exit, is so large that no one can deny those elements of discretion. Thus, it is proper to consider superannuation funds in the current context.

166. The simple facts in this case involved a husband and wife who were the trustees and beneficiaries of a self-managed superannuation fund. When the wife died, the husband became the sole trustee. He exercised a power under the deed to transfer benefits in his wife's account to himself.

167. Martin CJ said that the question came down to whether the remaining trustee "failed to address the question of whether it would be inequitable or inappropriate to pay the benefit to himself, as the Nominated Dependant.[57]

168. Again, the matter came down to evidence. The Chief Justice considered that there was no evidence available to support an attack on exercise of the discretion by the remaining

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56 (2015) 293 FLR 412; [2015] WASCA 45. The case is largely about the superannuation regulations. But it is also useful for the passage in the judgment concerning an exercise of the power to allocate the benefit from the wife's account to the husband's account.

57 (2015) 293 FLR 412; [2015] WASCA 45, [75].

trustee. The question came down to whether "the exercise of the trustee's discretion miscarried because he did not give full and proper consideration to the competing interests of the prospect beneficiaries".[58]

169. The court concluded that there was no evidence that there was a sham, and there was no cogent evidence that the trustee's determination miscarried.

170. The important point that sometimes arises in this context is whether the trustee faced a conflict between his duty as trustee and his interest as a beneficiary. That was covered by a clause in the deed which excused such conflicts. Such conflicts cannot be ignored more generally.

8.2 Sinclair v Moss

171. The opposite result occurred in *Sinclair v Moss*.[59]

172. This case involved a testamentary trust under which there was power to pay income to a widow, but only such income as necessary and sufficient for her support.

173. The trustees failed to consider her other sources of income. This looks like an elementary error in exercising the power. Although it is an unusual power and thus an unusual case, it is nevertheless instructive.

174. The appointments of income to the widow were attacked on the principle that the trustees had considered the wrong question, or (in considering the right question) they did "not really apply their minds to it or perversely shut their eyes to the facts, or that they did not act honestly or in good faith".[60]

58 (2015) 293 FLR 412; [2015] WASCA 45, [77].

59 [2006] VSC 130.

60 [2006] VSC 130, [17].

175. In that case, there was a requirement to consider the extent to which the widow required support. It was proved by the claimant that the trustees simply determined how much income was available each year, and decided as between the widow and her stepchildren how that income "should be fairly distributed" without taking into account the question of need of the widow.[61]

176. The important decision in this case was that the determinations of the trustees were void. This required the widow to repay the distributions.[62]

177. The like argument also occurred in Western Australian litigation, where it had earlier been determined that the subject family trust had vested many years earlier, but that discretionary distributions had unarguably continued to be made. A claim was brought against beneficiaries who had been given discretionary distributions, requiring them to disgorge the amounts. But a beneficiary successfully ran a defence of change of position, on the faith of receipt of the wrongful distributions, thus terminating the action against her.[63]

8.3 Owies v JJE Nominees Pty Ltd [64]

178. The Owies had three children, Michael, Deborah and Paul. Each of the mother, father and the three children were objects or beneficiaries of the family trust and in default of appointment of income (or a resolution to accumulate) the trust deed provided that the net income would be held for each of the children in equal shares.

179. This was substantial litigation, and I will cover only one aspect of it here, challenging the distributions of income. In all but one of the years the subject of dispute, income was

61 [2006] VSC 130, [18].

62 [2006] VSC 130, [91].

63 *Clay v James* [2001] WASC 101.

64 [2022] VSCA 142

distributed to the mother, the father and Michael in precise, and repeated, percentages. In the last year, 100% of the income was distributed to the father. It is also true in that last financial year that there was a distribution of capital to Deborah in the form of a residential unit in which Deborah had been living.

180. In terms of the part of the litigation with which we are concerned, Paul and Deborah challenged the distributions of income on the ground that the trustee had failed to give real and genuine consideration to the objects under the trust, with the consequence that the distributions were made in breach of trust. One difficulty that later came to light was that they did not seek any order that money be repaid by those to whom distributions had been made.

181. At trial, the Victorian Supreme Court found that distributions had indeed been made in each of the relevant years, and that finding was not challenged on appeal. The judge found that the trustee had failed to give proper consideration to the position of Paul and Deborah in 2015 and 2016, and to the position of Deborah in 2018. He otherwise rejected this ground in relation to distributions for the years ended 2015 and later, having accepted a limitation defence in relation to earlier years.

182. The judge correctly found that it was necessary to look at each year in turn, as each year involved separate exercise of the discretion. Ultimately the Court of Appel nevertheless found that the judge was entitled to (and should have) looked at the cumulative effect of the pattern of distributions over the period.[65]

183. The evidence run in the case showed that there had been difficult relationships within the family, and disclosed periods of estrangement. The trustee made no enquiry of either Paul or Deborah as to any need they might have for a distribution of income. The case

65 At [125].

put by the trustee was that it was informed about their circumstances through the knowledge which directors of the trustee had, which knowledge was said to be imputed to the trustee.[66]

184. The case is instructive in terms of the evidence led. The trust fund might have been worth about $23 million. Thus, it was substantial. The contact between both Paul and Deborah, on the one hand, and their parents and Michael, on the other hand, was set out in detail in the evidence recited by the trial judge.

185. Deborah's circumstances were more necessitous than those of Paul. Deborah suffered developmental trauma, needed psychiatric attention, had been diagnosed with Crohn's Disease, and could only manage part-time work. Her taxable income was modest, but her medical expenses were large. Her mother had declined to assist her further with her medical expenses on one occasion, though by 2019 the trustee resolved to make a capital distribution to Deborah of an apartment at South Yarra, owned by the trust, in which Deborah had been living on a modest rent. By that stage, the apartment had become dilapidated.

186. By contrast, the circumstances of John and Eva, the parents, were much more secure. Each year from 2011-2018 inclusive, the trustee distributed the trust's income in the following proportions:

    (a) 40% to John, the father;

    (b) 40% to Michael, the brother; and

    (c) 20% to Eva, the mother.

187. The lower percentage was because Eva had significant other income including a large share portfolio in her own name from which she received income.

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66 At [33].

188. In 2019, as noted, the father received 100% of the income of the trust estate, despite at that stage having no perceptible needs, and living in care. At that point he had very substantial assets available to him.

189. The above findings were, as it turned out, sufficient to tilt the scales in favour of the beneficiaries challenging the distributions. The reasoning is worth noting.

190. The Court of Appeal accepted that, even where a discretion was described as "absolute and uncontrolled", the discretionary power is not without bounds.[67]

191. Trustees must "act in good faith, responsibly and reasonably. They must inform themselves, before deciding, of matters which are relevant to the decision. These matters may not be limited to simple matters of fact but will, on occasion (indeed, quite often) include taking advice from appropriate experts …".[68]

192. Courts nevertheless apply restraint, indeed a "very high degree of restraint", lest the "court be seen to substitute its own decisions for those properly left to the trustee".[69]

193. The fundamental authority of *Karger v Paul*[70] was then cited for the proposition that, in giving content to the obligation to give real and genuine consideration, there must be the exercise of an active discretion. A trustee must consider whether to exercise the power. Another way of putting it was that failure to exercise a discretion on real or genuine consideration could be described as acting irresponsibly, capriciously or wantonly.[71]

194. There is a question arising from earlier High Court authority as to whether a discretion expressed to be absolute can only be impugned on the basis of bad faith. The Victorian

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67 At [81].

68 At [82], citing *Scott v National Trust for Places of Historic Interest or Natural Beauty* [1998] 2 All ER 705, 717.

69 At [83].

70 [1984] VR 161, 163-164.

71 At [86].

Court of Appeal considered that this was contrary to authority. The Court of Appeal did not support that higher level of scrutiny.[72]

195. What was critical in *Owies* was the obligation of the trustee to be properly informed, which on the evidence had not occurred. It was nevertheless important to decide the content of that obligation to be properly informed.

196. The size and scale of a trust, and the nature of the relationships that may subsist are important. Also relevant is the purpose of the power of appointment. It has also been said that non-professional trustees without specialist expertise should not be placed under too great a burden.[73] Sometimes, the number of potential objects could be very large. A requirement to undertake a detailed analysis of the identity and needs of each object would be "unworkable", but nevertheless:[74]

> *Having considered whether or not to exercise the power and understood the range of objects that might benefit, the trustee is required to give adequate consideration as to how to exercise the power.*

197. In the present case, the primary beneficiaries were the parents and the three children, so considerations contemplated by cases involving larger classes of beneficiaries and objects did not impact. The trust deed provided that, in default of appointment or accumulation, the children were to take in equal shares. While that did not mean that the trustee was unable to make unequal distributions across the beneficiaries, the exercise of all the powers had to take into account the purpose of the trust and the default position.[75]

198. The Court of Appeal found the following to be significant as well:[76]

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72 At [87]-[88].

73 At [94].

74 At [95].

75 At [113].

76 At [114] and following.

(a) The trustee made no enquiries of Paul or Deborah. There was no direct evidence that information imparted to the trustee via the parents found its way into the deliberations of the trustee. There was also a "long history of strained relations" and thus "there was not a free flow of information across the years".

(b) While there was no ability to fill up gaps in the evidence using the *Jones v Dunkel* inference, the "inescapable inference is that the trustee was not informed to an extent that enabled it to make a genuine decision" given the failure to make enquiry.[77]

(c) The income was very substantial each year. Despite variations in the amount of income from time to time, the payout ratio was almost always 40:40:20. There was "no obvious reason why the trustee would favour Michael, John and Eva in this way". That pattern of distributions "could not be explained by need". Indeed, John and Eva simply lent their distributions back to the trust leading to substantial loan accounts. On the other hand, Deborah and, to a lesser extent Paul, "had a demonstrable need for income". Indeed "Deborah's health and financial situation was parlous".[78]

(d) While Deborah had strong claims on a favourable exercise of discretion, that did not mean a distribution had to be made to her. But "the failure to do so, and the repetition of the same formula in each year … strongly points to a lack of due consideration of her position".[79]

(e) There seems to have been "an elision between the interests of John and Eva and the best interests of the beneficiaries under the trust" in that the parents fell under the

77 At [119].

78 At [120]-[121].

79 At [121].

power of the guardian and appointor, which had been changed to be Michael. This did not relieve them of their obligation to exercise an independent mind. The interests of John and Eva, acting as directors of the trustee, thus did not correspond to the best interests of the beneficiaries.[80]

199. Further considerations listed were:

(a) The history of antipathy between the mother, on the one hand, and each of the two applicant children. Indeed, Paul had asked for a copy of the trust deed and had been resisted.[81]

(b) By 2018, it appeared that the trustee had reached a "policy of distributions with a settled ratio that was inconsistent with a continuing obligation to consider the distribution of income for each accounting period". Here, the Court of Appeal noted that the judge "was correct to view each year separately but … that came at the cost of understating the overall picture discernible from the pattern of distributions as a whole".[82]

200. Finally, there was the appointment of 100% of the income to John, the father, in 2019, after Eva's death. He was then 96, in full time residential care, and in no need of income. He had loan accounts with the trust for millions of dollars generated from earlier distributions. If no appointment had been made, and no accumulation, the default position under clause 3 of the trust deed would have been equal distribution to the three primary beneficiaries, the children, in equal shares. This distribution of 100% to the father was described in submissions for the applicant beneficiaries as "grotesquely unreasonable".[83]

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80 At [122].

81 At [124].

82 At [125].

83 At [126].

While that is not a term of art, it does emphasise that the decision was "so aberrant that it provides a basis to infer that the exercise of the discretion has miscarried".

201. Although there was no obligation to provide reasons, the fact that the trustee "chose not to explain its reasons" left "the stark pattern of distributions to speak for itself".[84]

202. Unfortunately, there was no application at trial for any money to be repaid. There was debate before the Court of Appeal as to the effect of the proved breaches of trust, in failing to give proper consideration to the exercise of discretion. The Court of Appeal found that such a failure meant that the decisions were only voidable, not void.[85]

203. But "the insurmountable problem for the applicants … [was] that they did not seek at trial the relief that they [now sought] in this Court".[86]

9 Removal of Trustees and Removal of Appointors

9.1 Whether a fiduciary power

204. Usually, the provision to remove a trustee will be construed as a fiduciary power in Australia. However, it is truly a matter of construction.[87]

205. In *Mercanti v Mercanti*,[88] Newnes & Murphy JJA say of a clause providing for appointment and removal of a trustee:[89]

> *The object of the power under a provision such as clause 21 is to facilitate the appointment of a new or replacement trustee. A trustee is the archetype of the fiduciary and the office of trustee only exists for the benefit of the beneficiaries. A power of this kind conferred in a trust instrument has generally been construed as having been conferred by the settlor not for the purpose of advancing the personal interests of the appointor or otherwise for the personal enjoyment of the*

84 At [133].

85 At [143]-[144].

86 At [148].

87 See the lengthier analysis in DW Marks, "Discretionary Trusts – Challenging the Trustee's Discretion" (2021) 25(1) *The Tax Specialist* 39, pages 45-46.

88 (2016) 50 WAR 495; 340 ALR 290; 117 ACSR 222; [2016] WASCA 206.

89 (2016) 50 WAR 495; 340 ALR 290; 117 ACSR 222; [2016] WASCA 206, [397]. Compare Buss P on this point at [316]-[319].

> *appointor, but rather for the due execution of the trusts for the benefit of the objects of the trust.*

206. There are cases where it has been construed otherwise,[90] but the tendency at least in Australia is to require that the holder of the power, usually called an appointor or some similar designation, acts for the benefit of the beneficiaries as a whole when deciding whether to remove or replace a trustee. He may not act selfishly.

207. Likewise, we have seen cases on the Eastern seaboard where people have attempted to use powers in trust deeds to remove or replace the appointor itself. Those cases have turned, more, on the construction of the power to amend.

9.2 Present scenario

208. Assume that under the trust deed, and for historical reasons now forgotten, Abel is the appointor upon the death of his parents. This might have been done because of the concern about Cain's ability to deal with this power in the traumatic circumstances of the death of his parents, and given his disability.

209. Assume that the stress of litigation has taken its toll upon the parents, and each dies quickly in succession. This leaves a vacancy in the role of trustee, which Abel decides to fill by appointing as trustee Abel Trading Pty Ltd (***Abel Trading***).

210. Abel is the sole director of Able Trading. Abel Trading's first act as trustee is to cut off the weekly pin money on which Cain has depended for his out of pockets, such as coffee and cigarettes.

211. The next act undertaken by Abel Trading is to appoint the whole of the capital in favour of Abel's children.

212. Cain is quite concerned. He has never been capable of working except in a highly supported environment, has depended on money from the trust all his life, and will find

90 *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch).

it difficult to obtain social security support for the next five years or so, given his association with the trust, now purportedly vested.

213. Cain will probably attempt to review the appointment of Abel Trading as a trustee. He will also attempt to review the appointment away of the whole capital in favour of Abel's children.

9.3 Change of trustee

214. In *Wareham v Marsella*,[91] again a case about self-managed superannuation, the Victorian Court of Appeal upheld a decision to remove trustees who had decided to pay the whole of the death benefit to the husband of a remaining trustee. This was despite the fact that the trust deed gave the trustees a discretion as to which of a deceased beneficiary's dependants should receive a death benefit.

215. That was a case of a blended family, by the looks of it, where such debate can be willing. The remaining trustee had decided to favour her part of the family, and ignore the claim of the second husband of the deceased.

216. The Court considered that the obligation of trustees properly to inform themselves of the needs of the beneficiaries was "more intense" than in other, private discretionary trusts.[92]

217. The trial judge had found that an inference should be drawn that the trustee acted arbitrarily in distributing the fund, with ignorance of (or insolence toward) her duties. She acted in the context of uncertainty, misapprehensions as to the identity of a beneficiary, her duties as trustee, and her position of conflict. She was not therefore in a position to give real or genuine consideration to the interests of the dependants.

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91 (2020) 61 VR 262.

92 (2020) 61 VR 262, [60].

218. The conclusion to which the trial judge came was said to be supported by the outcome of the exercise of the discretion.[93]

219. Turning now to the present case, Abel Trading's first act as trustee is to deprive a disabled man of any future support. This will not go down well with the court. Further, in *Wareham v Marsella*, above, the court was moved to remove the trustee. The fact that there had been a resolution to wind up the trust was no impediment to making remedial orders,[94] and the distributions were set aside in that case.

9.4 Challenge to appointment

220. See heading 8, concerning appointments of income and capital to Cain, for the principles that apply.

10 Tax, Rectification and Disclaimer

10.1 Improper distributions

221. The language used in the cases can be difficult and inconsistent, but a fraud on a power appears to result in a distribution being void.[95]

222. Another case we have considered determined to set aside the distributions, and facilitated a new trustee re-exercising the discretion to distribute.[96]

223. It had been thought, historically, that a merely excessive exercise of a power would be upheld to the extent possible under the power, but would be void beyond that.[97]

224. This leads to difficulties in assigning a tax character to a payment <u>actually</u> made or credited.

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93 (2020) 61 VR 262, [62].

94 (2020) 61 VR 262, [106].

95 *Sinclair v Moss* [2006] VSC 130, [84].

96 *Wareham v Marsella* (2020) 61 VR 262, [105].

97 MacLean, *Trusts and Powers* (1989), p 126.

225. There is little authority in Australia on the point. The Tribunal case of *U201*[98] considers an unusual situation, where distributions were made to an accountant's trusts, unconnected with the family of the client. Although the discretions exercised were more than simply discretions about appointment of income, and although the case is thus not directly in point, the suggestion there was that the distributions were voidable. There was an argument that the recipient held on a constructive trust which had to be tested in an ordinary court of equitable jurisdiction.

226. This suggests that litigation about these issues involves sequencing, in the State courts for relief about who was actually entitled (and the consequences, such as a declaration that someone held on a constructive trust); and in the limited Federal jurisdictions for the review or appeal, once the State courts have made their determinations.

227. In a practical sense, a time-limited power of appointment of income, modelled on those in *Ramsden v Commissioner of Taxation*,[99] would mean that a failure effectively to appoint income by the end of 30 June in a year would result in the default gift. Many deeds in Australia have that version of power.

228. In light of *Owies*, above, it must now be considered that an attack on exercise of a power appointment, based on a failure to give real and genuine consideration to the objects under the trust, would result only in a voidable disposition of property.

229. Given the policy drivers enunciated in *FCT v Carter*,[100] it must be doubted that the avoidance of a distribution after year end would change imposition of tax on the person to whom the distribution was made. Redistribution to some other beneficiary, as income, does not assure absence of further tax.

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98 87 ATC 1122.

99 2004 ATC 4659.

100 (2022) 96 ALJR 325.

10.2 Retroactive solutions? Rectification and disclaimer

230. It is possible to rectify a unilateral document, such as resolution of directors.[101]

231. However, it is not possible simply to rectify documents and will. There must be good reason, which lies in some mistake, in representing in written form what was intended. A mere mistake as to the legal effect is not enough.

232. Since the court is rectifying a document to accord with the actual agreement (or the actual resolution), the result can be seen to have an element of retroactivity.

233. Again, there is no point prosecuting a review or appeal against tax, until the rectification has been ordered.[102]

234. Disclaimer has been shown, after year end, to be ineffective, by the High Court of Australia in *Commissioner of Taxation v Carter*. The difficulty resolved there was the apparent conflict between the New South Wales Court of Appeal, on the one hand, and the Full Federal Court, on the other hand, as to the retroactivity of disclaimer, at least for taxing statutes.[103]

235. Suffice to say that the old theory was that the effect of disclaimer was retroactive. *Carter* now shows that this retroactivity was not universal.

11 Conclusion

236. Though these scenarios are a work of fiction, the scenarios are inspired by real cases. Real families have this level of dysfunction.

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101 *Trani v Trani* [2018] VSC 274, [151].

102 I have set out some illustrative cases at greater length in my article, "Discretionary Trusts – Challenging the Trustee's Discretion" (2021), above, pages 47-48.

103 The New South Wales Court of Appeal decision is *Chief Commissioner of State Revenue v Smeaton Grange Holdings Pty Ltd* (2017) 106 ATR 151. The Full Federal Court case was *Carter v Commissioner of Taxation* 2020 ATC ¶20-760, and that case was supported in Federal jurisdiction by a decision of Spender J in *Ramsden v Commissioner of Taxation* 2004 ATC 4659, [51], [66], [67].

237. The tax drivers are often the last thing considered, in ridding a trust of an inconvenient beneficiary, or in reinstating monies improperly lost or paid.

238. But the tax drivers are incredibly difficult, and largely unresolved by case law.

239. You should resolve the tax dispute by orders of the ordinary civil courts, before approaching the AAT or Federal Court for your tax dispute. Indeed, there is a school of thought that you are stuck with the facts as at the time of the objection and determination. This means that you should seek any necessary orders from the State courts before filing the objection, or at least before the objection is finalised.[104]

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9 August 2022

[104] *Ramsden*, above, at [51], [66], [67].

Post scriptus - Just as I put this paper to bed, a colleague in Auckland mentioned *Pollock* [2022] NZCA 331. It is a fascinating application of these principles.

Also, it again illustrates (to me) the need for notional estate laws in Australasia. I know that is controversial, but the sky has not fallen in New South Wales. NZ Law Commission is working on succession law, and this is one of the many things under consideration. DWM