



SOME ISSUES WITH THE USE OF TRUSTS IN NEW ZEALAND

REVIEW OF THE LAW OF TRUSTS
SECOND ISSUES PAPER





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The Law Commission is an independent, publicly funded, central advisory body established by statute to undertake the systematic review, reform and development of the law of New Zealand. Its purpose is to help achieve law that is just, principled, and accessible, and that reflects the heritage and aspirations of the peoples of New Zealand.

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FOREWORD

This is the second Issues Paper in the Law Commission’s review of the law of trusts. The Commission intends to produce a series of Issues Papers that explore different aspects of the law of trusts and raise questions and options for consideration and comment.

This paper, *Some issues with the law of trusts in New Zealand*, focuses on the uses of family trusts in New Zealand and potential concerns about some of these. Family trusts have increasingly become more popular. It seems that New Zealand has a high number of trusts per head of population relative to other countries. This Issues Paper looks at the reasons why people have established family trusts and raises the question whether there are some purposes for which trusts should not be used. The paper also examines the different legislative responses to trusts and also some judicial responses to the use of trusts, before raising options relating to legislative provisions that “look through” trusts and in what circumstances a trust may be found to be invalid.

The third Issues Paper of this review will address issues relating to the variation of trusts and the law against perpetuities. It will be published early in 2011.



Justice Grant Hammond

President of the Law Commission

ACKNOWLEDGMENTS

The Law Commission gratefully acknowledges the contribution of our Trusts Review Reference Group who have generously given, and continue to give, their time and expertise to assist with this review.

Members of the reference group are:

- Kerry Ayers of Helmore Ayers
- Andrew Butler of Russell McVeagh
- Chris Kelly of The New Zealand Guardian Trust Company
- Greg Kelly of Greg Kelly Law
- Jessica Palmer, Senior Lecturer of the University of Otago
- Bill Patterson of Patterson Hopkins
- Professor Nicola Peart of the University of Otago

The Commissioner responsible for this reference is George Tanner, QC.

The researchers and writers of this Issues Paper were Janet November, Senior Legal and Policy Adviser, Marion Clifford, Legal and Policy Adviser and Susan Hall, Senior Legal and Policy Adviser.

Call for submissions

Submissions or comments (formal or informal) on this Issues Paper should be sent to Marion Clifford, Legal and Policy Adviser, by **31 March 2011**

**Law Commission,
PO Box 2590,
Wellington 6011, DX SP 23534,**
or by email to trusts@lawcom.govt.nz

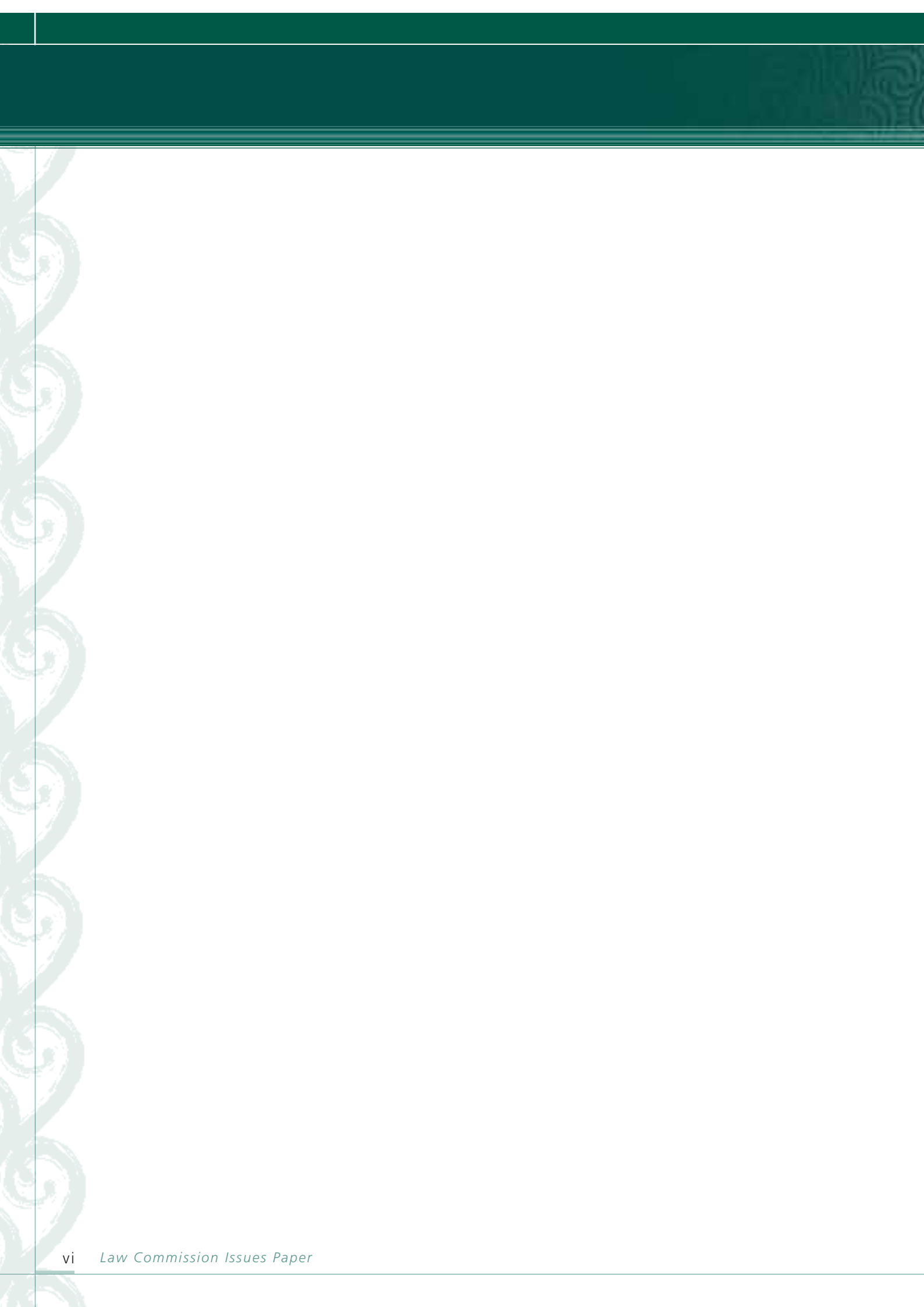
The Law Commission asks for any submissions or comments on this second Issues Paper on the review of the Law of Trusts. The submission can be set out in any format but it is helpful to specify the number of the question you are discussing.

There are some questions in chapters 2 and 5 of the paper that pinpoint the queries on which comments would be most valued. Submitters are invited to focus on any of these questions, particularly in areas that especially concern them, or about which they have particular views. It is certainly not expected that each submitter will answer every question.

Alternatively, submitters may like to make a comment about the trusts review that is not in response to a question in the paper and this is also welcomed.

Official Information Act 1982

The Law Commission's processes are essentially public, and it is subject to the Official Information Act 1982. Thus copies of submissions made to the Law Commission will normally be made available on request, and the Commission may refer to submissions in its reports. Any requests for withholding of information on grounds of confidentiality or for any other reason will be determined in accordance with the Official Information Act 1982.



Some issues with the use of trusts in New Zealand

Review of the law of trusts Second Issues Paper

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Chapter 1

Introduction

- 1.1 This is the second Issues Paper in the Law Commission's review of the law of trusts. The first Issues Paper, *Review of Trust Law in New Zealand: Introductory Issues Paper*, outlined the history of and basis for trusts and examined the role of trusts legislation. This paper examines issues relating to current uses of trusts and some associated problems. The paper canvasses a variety of policy areas that intersect with trust law, where the use of trusts may be seen to create problems and inequities that may need to be addressed. It also analyses some case law developments that address the integrity of trusts.
- 1.2 This Issues Paper is part of stage one of the Law Commission's project reviewing the law of trusts. The three stages of the project are:
 - Stage one – the Trustee Act 1956 and the Perpetuities Act 1964 and review of trusts law generally;
 - Stage two – the Charitable Trusts Act 1957;
 - Stage three – the trustee companies legislation.
- 1.3 The Issues Papers in stage one are:
 - The history and nature of trusts, recent developments in the structure of trusts, and the scope and framework of a revised Trustee Act (released November 2010);
 - Problems with the use of trusts, including issues relating to relationship property, creditor protection, and sham trusts (this paper);
 - The Perpetuities Act 1964 and the variation and resettlement of trusts (first quarter of 2011);
 - Trustees' duties and liabilities, and beneficiaries' rights, including indemnity provisions and exemption clauses (second quarter of 2011);
 - The office of trustee and trust administration, the capital and income distinction and court supervision of trusts (fourth quarter of 2011);
 - Trustees' powers, including delegation, investment and insurance (fourth quarter of 2011);
 - Any remaining issues, including trading trusts, non-charitable purpose trusts, the Hague Trusts Convention, registration of trusts and obligations on trust advisors (fourth quarter of 2011).

CONCERNS
ABOUT TRUST
USE IN NEW
ZEALAND

- 1.4 It is not possible to adequately review the law of trusts without identifying and understanding the uses to which trusts are put in modern day New Zealand. The Law Commission has had discussions with practitioners and also with government agencies that administer legislation affected by trusts. However, it is difficult to develop a comprehensive view of the trust landscape, particularly since there is no record of the number of trusts in New Zealand and because trusts are private vehicles.
- 1.5 The Commission has no doubt that trusts provide a significant number of benefits and are useful instruments for many circumstances. Trusts enable the preservation of assets for the benefit of the vulnerable, such as children, the disabled or the elderly, and for charitable purposes. Trusts provide a flexible structure for business and are useful for estate planning. There is also no doubt that many trusts are established on the basis of sound advice about the implications of establishing a trust, given by experienced trusts practitioners and advisers. However, it has been put to the Commission that in the case of some trusts the need for a trust is not clear, the trust deed is poorly drafted and the parties to it may not have been made aware of the implications of what they are doing, either in their capacity as the settlor of the trust, or of their obligations as a trustee. Sometimes trusts have been suggested by advisers in response to potentially transient government policies. We have been told that in some instances those trusts may involve settlors treating trust assets as their own property as they do not understand the legal implications of having established a trust.
- 1.6 Establishing a trust has a number of implications:
- The legal ownership of property is transferred and equitable interests in the property are created. Property transferred to trustees is no longer legally owned by the settlor. In family trusts this can have significant implications for what the settlors (often “mum and dad” home-owners and investors) can do with the property in the future. A properly run trust may make dealing with property more administratively complicated.
 - Trusts give rise to complex legal obligations. Trustees have onerous and complicated duties that require them to act for the benefit of the beneficiaries of the trust. The precise content of these duties is the subject of on-going legal argument and debate and their scope is not always easy to define.¹ Their breach can give rise to legal action. It is possible for a trust deed to vary or limit the trustee’s duties, but again the extent to which some limitations are effective is the subject of on-going legal debate.
 - There are costs to establishing trusts and many on-going associated costs. It is possible that some people transfer their property to trusts at considerable on-going cost for little financial or other gain.

1 Trustees’ duties will be the subject of a subsequent Issues Paper.

- 1.7 Our impression from the consultation to date is that in some cases, people establishing trusts have not always been made aware of these implications. Some commentators have reflected these concerns:²

It seems that many trusts have been created without a full appreciation of what trusts are and how they should properly be treated. Individuals are often treating trust assets as their own, which in turn encourages the same misapprehension in third parties with whom they interact ...

- 1.8 Some trusts advisers have gone further and asserted that many trusts in existence in New Zealand would not withstand the scrutiny of the courts should a dispute arise.³

- 1.9 At this stage of the review, however, information about these potential issues is largely anecdotal. The Law Commission is keen to gather more information on the use of trusts in New Zealand. The Commission is interested in hearing from trusts practitioners, people with trusts, settlors, trustees, beneficiaries and anyone else about whether there is validity in these concerns. If so, what is the scale of the problem? The Commission is also interested in the reasons why so many New Zealanders establish trusts, and in the sorts of trust structures they employ.

- 1.10 The Commission sees two distinct issues regarding the use of trusts. The first is whether intrinsic problems with the trust should mean that the trust itself is invalid. In exploring this concern the Commission looks at whether there should be limits on the purposes for which trusts can be used and what the requirements should be for a trust to be invalidated as a sham or for any other reason. In recent times, trusts have received some bad press. They are sometimes perceived as a means by which people shelter their true wealth and avoid liabilities. The Commission is interested in assessing whether some purposes of trusts are more acceptable than others.

- 1.11 The second issue is whether there are circumstances where valid trusts should be ignored or where dispositions to trusts should be set aside to give effect to settlor obligations. By this it is suggested that there may be some circumstances where even though property is made subject to a trust, it is not appropriate for that property to be a part of the settlor's assets because there are overriding public policy considerations which require that the settlement of the trust should be ignored or set aside. The law already disregards dispositions to a trust in some instances where the effect of the trust is contrary to public policy: for example, it is possible to disregard the establishment of a trust or transfer of property to a trust by a person within two years of his or her being adjudicated bankrupt for the purpose of the assets being available to creditors.⁴ Also, some transfers of property to a trust can be disregarded if they have the result of avoiding the equal-sharing regime under the Property (Relationships) Act 1976.⁵ Where the courts have viewed the outcome of the use of a trust as unfair, they have also

2 J Palmer "Sham Trusts" in A Butler (ed) *Equity and Trusts in New Zealand* (2 ed, Thomson Reuters, Wellington, 2009) 393 at 394.

3 See R Holmes *Sham Trusts* (Pacific Trusts, Auckland, 1999) and M Maxwell *Trusts: A Kiwi Sham?* (Phantom Publishing, Hamilton, 2007).

4 Insolvency Act 2006, s 204. See paragraph [3.15] below.

5 Property (Relationships) Act 1976, s 44. See paragraphs [3.22] to [3.26] below.

found ways of stepping in and disregarding the trust.⁶ Different legislative approaches are currently used for each distinct policy area. The Commission will raise the question of whether it should be left to each policy area to set the approach to trusts, or whether a unified or principles-based approach in trust law is called for.

SUMMARY OF THIS ISSUES PAPER

- 1.12 Chapter 2 of this Issues Paper examines family trust use in New Zealand. Although information in New Zealand on the number of trusts is far from comprehensive, the best available information is used to estimate the number of trusts. The Commission compares what is known about the number of trusts in New Zealand with the situations in England, Australia and Canada. It appears that trust use is considerably greater in proportion to the population in New Zealand. Chapter 2 considers the motivations for family trusts in recent decades, many of which are related to government policies and the advantages that can be gained by transferring assets or income splitting.
- 1.13 Chapter 3 canvasses legislation and policy that intersect with trust law, including legislation protecting creditors, relationship property legislation, income tax legislation, and government assistance such as social security benefits, the residential care subsidy and legal aid. Each legislative response is different, no doubt reflecting different policy objectives. The Commission asks whether the approach of each regime providing its own mechanism for addressing trusts is appropriate or whether an overarching approach is called for.
- 1.14 Chapter 4 looks at judicial efforts to “bust trusts” to allow third parties to gain access to trust assets. Case law developments with sham trusts, alter ego trusts and the “bundle of rights doctrine” are examined. Whether the courts’ approach is adequate or appropriate are important questions for consideration.
- 1.15 Finally, chapter 5 raises options for how the law may address the concerns about the use of trusts.
- 1.16 Questions follow the discussion in the final chapter. The Law Commission appreciates responses to any or all of these questions.

⁶ See chapter 4 below.

Chapter 2

Trust use in New Zealand

NUMBER OF TRUSTS

- 2.1 It is not possible to determine the number of trusts in New Zealand with certainty because there is no definitive record of trusts. However, the indications from the records that are kept are that New Zealand has a high number of trusts per head of population relative to other countries. There are at least 237,500 trusts, as this was the number of tax returns filed by trusts with Inland Revenue for the 2007–2008 tax year.⁷ This number increased from 145,900 in the 2000–2001 tax year. Based on the 2008 figure, the most cautious assessment is that there is one trust for every 18 people in New Zealand. Trusts are only required to file a tax return if they earn income during the financial year. However, they are not required to alert Inland Revenue (or any other agency) to their existence if they are not income-earning.⁸ Some commentators have estimated that the number of trusts may range up to 400,000.⁹
- 2.2 It appears that trust use in New Zealand is considerably greater than that of comparable countries. In the United Kingdom, 204,000 trusts were known to the Inland Revenue in 2005–2006.¹⁰ The United Kingdom HM Revenue and Customs must be notified about a trust if it will receive income or make chargeable capital gains.¹¹ Like New Zealand, this figure only indicates the income-earning trusts and there is no indication of how many trusts there are that do not earn income. It may also be the case that many trusts settled by United Kingdom citizens are based, and pay tax in, off-shore jurisdictions such as Guernsey, Jersey and the

7 Inland Revenue “Returns Filed 2001 to 2008” < www.ird.govt.nz/resources/7/1/717d3a80402acb33b6e1bee8b687b1f9/returns-filed.xls > . This number includes charitable trusts that are income-earning. The Charities Commission had 24,814 charities registered with it at 31 March 2010. Of these, 17,868 had filed annual returns for financial years ending between 1 April 2009 and 31 March 2010, as at 7 April 2010 (Charities Commission *A snapshot of New Zealand’s charitable sector* (7 April 2010) at 1).

8 Unless a New Zealand resident settlor settles a trust with a foreign resident trustee, or if a foreign trust is established with a New Zealand resident trustee: see Tax Administration Act 1994, ss 59 and 59B.

9 See, for example, Anthony Grant and Nicola Peart “The case for the spouse or partner” (paper presented to the NZLS Trusts Conference, June 2009), citing Maria Kazmierow “When not to trust” *NZ Lawyer* (New Zealand, 27 April 2007) at 14 and “Please sir, can we have some more?” *Sunday Star Times* (New Zealand, 24 August 2008) at D1.S.

10 United Kingdom HM Revenue and Customs < www.hmrc.gov.uk/stats/trusts/table13-1.pdf > , referred to in Ministry of Justice “Impact Assessment of the rule against perpetuities and excessive accumulations” (24 March 2009) < www.justice.gov.uk > .

11 United Kingdom HM Revenue and Customs “Notifying HMRC about a new trust” < www.hmrc.gov.uk > .

Isle of Man. These would not feature in the United Kingdom figures. Based on the number of those filing a return, however, there would be approximately one income-earning trust for every 294 United Kingdom citizens.

- 2.3 In Australia, an annual tax return must be lodged for a trust, regardless of the amount of income derived, even if it derives no income or incurs a loss for tax purposes. In the 2007–2008 income year, 660,324 trusts filed returns.¹² This equates to around one trust for every 34 Australians.
- 2.4 Canada’s rate of trust usage appears to be somewhat greater than the United Kingdom’s, but much less than Australia’s or New Zealand’s. For the 2009–2010 fiscal year, the Canada Revenue Agency processed around 229,000 resident trust returns and 2,200 non-resident returns.¹³ In Canada, trusts must file a tax return where income from the trust property is subject to tax.¹⁴ This equates to approximately one income-earning trust for every 148 Canadians.
- 2.5 Other sources of information on the number and scale of trusts in New Zealand include the Household Savings Survey (HSS) conducted by Statistics New Zealand in 2001 and the Census. The 2006 Census suggested that 167,925 dwellings, or 12.3 % of all occupied private dwellings were held in a family trust by the usual residents of the dwelling.¹⁵ A summary of the HSS data states that, in 2001:¹⁶
- The number of economic units (single people or couples) with family trusts was 137,800 (that is 7.7 % of all economic units).
 - Only 3.7 % of individuals have trusts, while 12 % of couples have trusts.
 - For those trusts that could supply data, the total holdings were just over \$93 billion (which amounted to 18.6 % of all household assets), with an average amount of \$707,900 per reporting trust.
 - Trust ownership generally increases with age, peaking for couples at 55–64, with 18 % of that age group having a trust.
 - Trust ownership generally increases with income bracket, with nearly half of couples with an income of over \$200,001 per annum having a trust.
- 2.6 In January 2010 the Victoria University of Wellington (VUW) Tax Working Group estimated that the ability to shelter income in trusts cost the government roughly \$300 million in tax revenue in 2007.¹⁷

12 Australian Tax Office *Taxation Statistics 2007-08* < ato.gov.au > at 71.

13 Email from Melinda Wood, Inland Revenue to Susan Hall, Law Commission regarding trust information from the Canada Revenue Agency (28 July 2010).

14 Canada Revenue Agency “T3 Trust Guide” < www.cra-arc.gc.ca > .

15 Statistics New Zealand *QuickStats About Housing: 2006 Census* (27 July 2007), Table 6 < www.stats.govt.nz > .

16 Phil Briggs “Family trusts: ownership, size and their impact on measures of wealth and home ownership” (Reserve Bank Discussion Paper, DP2006/06, July 2006). Note that the HSS treated trust assets as assets of the settlor.

17 Victoria University of Wellington Tax Working Group “A tax system for New Zealand’s future: Report of the Victoria University of Wellington Tax Working Group” (Centre for Accounting, Governance and Taxation Research, VUW, January 2010) at 29. As of 1 October 2010 changes to the tax rates have aligned the top personal tax rate with the trust rate.

- 2.7 Beyond these figures, we are reliant on anecdote for our understanding of the scale and nature of trusts in New Zealand. The Law Commission has consistently been told by government agencies and professionals that the number of trusts in New Zealand has grown. The impression gained is that the number of trusts has grown steadily over at least the last 20 to 30 years and that New Zealanders have a predilection for trusts beyond that experienced in similar countries.¹⁸

WHY ARE
NEW ZEALANDERS
SO PARTIAL
TO TRUSTS?

- 2.8 Various factors and policies over the last half century or more appear to have increased New Zealanders' familiarity with and use of the trust vehicle. This section looks at the reasons people establish family trusts.

Estate duty

- 2.9 As was discussed in *Review of Trust Law in New Zealand: Introductory Issues Paper* (the Introductory Issues Paper), trusts gained in popularity from the 1950s due to people wanting to avoid estate duty and other high rates of taxation.¹⁹ Estate duty was not charged on distributions from a trust, so it long provided an incentive for people to gradually transfer their property to a trust for distribution to others. In respect of estate duty those establishing trusts had two objectives. The first object was the transfer of assets from the estate to a trust. The consequent creation of an interest-free on-demand debt back to the settlor and the progressive forgiveness of the debt, meant the estate was not liable for gift duty. It also meant that the value of the assets was fixed at their value at the time of the transfer rather than the value at the time of death, which could have been significantly higher.
- 2.10 The incentive to settle a trust increased as inflation eroded the value of the estate duty exemption so that the burden of these taxes fell increasingly on small and medium sized estates.²⁰ The estate duty exemption was only \$25,000 in 1979, although it was increased in stages to \$250,000 by 1982. This encouraged a wider section of society to transfer assets to a trust to avoid crippling estate duties. Before its abolition in 1993, estate duty was being charged at 40% on the value of an estate over \$450,000.²¹ Although estate duty was abolished, the trusts set up when it was in force remained.

18 The trusts culture in New Zealand has been described to us as “viral”, or influenced by a “me too” syndrome: that is to say that many people are motivated to establish a trust just because someone they know has one. Even writing in 1972, R C Pope said: “There is even the element of the status symbol – every successful man should have a trust.” See R C Pope *The Practice and Pitfalls of Trusts and Wills* (New Zealand Society of Accountants, Wellington, 1972) at 7.

19 Law Commission *Review of Trust Law in New Zealand: Introductory Issues Paper* (NZLC IP 19, 2010) at [2.37]–[2.42]; W M Patterson “When is a Trust a Trust?” (paper presented at the Legal Research Foundation Seminar “A Modern Law of Trusts”, Auckland, 28 August 2009).

20 David G Duff “The Abolition of Wealth Transfer Taxes: Lessons from Canada, Australia and New Zealand” [2005] *Pittsburgh Tax Review* 71, at 117.

21 Estate duty was abolished in respect of deaths occurring after 17 December 1992: Estate Duty Abolition Act 1993. Parts 1 to 3 of the Estate and Gift Duties Act 1968, relating to estate duty, were repealed by the Estate Duty Repeal Act 1999.

Relationship property statutes

- 2.11 Trusts have had a long association with marriage,²² but it is thought that their use to protect assets from matrimonial property claims grew markedly in the wake of the Matrimonial Property Act 1976. Before that Act, on marriage breakdown, property was redistributed at the discretion of the court. Since 1976, however, the parties' matrimonial (now called relationship) property has been equally divided.²³ Because solicitors were familiar with trusts as a tool for estate planning, they became the obvious vehicle for assisting clients who wanted to avoid the impact of the matrimonial property regime. Trust usage broadened. Consultation with the legal profession suggests that the more recent expansion of the regime to de facto couples has driven further growth in trust use, and continues to do so. Both individuals wishing to avoid the equal sharing regime and parents wanting to leave property to their children (and to protect it from their children's partners, particularly where a shorter term relationship is involved) are using trusts to try to shield property from the far reaching impact of the (now) Property (Relationships) Act 1976.

Misalignment of tax rates

- 2.12 Significant differences in the income tax rates for individuals or other entities have provided an incentive to establish trusts. In the 1980s, a large gap grew between the highest and lowest income tax rates. Patterson notes that progressive rates of income tax moved upwards to a high point in the early 1980s when the top marginal tax rate reached 66 % and the lowest rate was 15 %.²⁴ Redirection of income by way of a trust to individuals on the lowest tax rate (such as children) was therefore a beneficial option for those liable to such taxes. It seems likely that this led to more family trusts being established to take advantage of the disparity.²⁵
- 2.13 On 1 April 2000, New Zealand's top personal income tax rate was increased to 39 % and the rate at which company and trustee income were taxed left at 33 %. This meant that trusts and companies could be used to shelter income from higher personal tax rates, in a manner that they could not previously. The top personal and trust rates were realigned at 33 % from 1 October 2010, thereby reducing the advantage of using trusts for income-splitting.

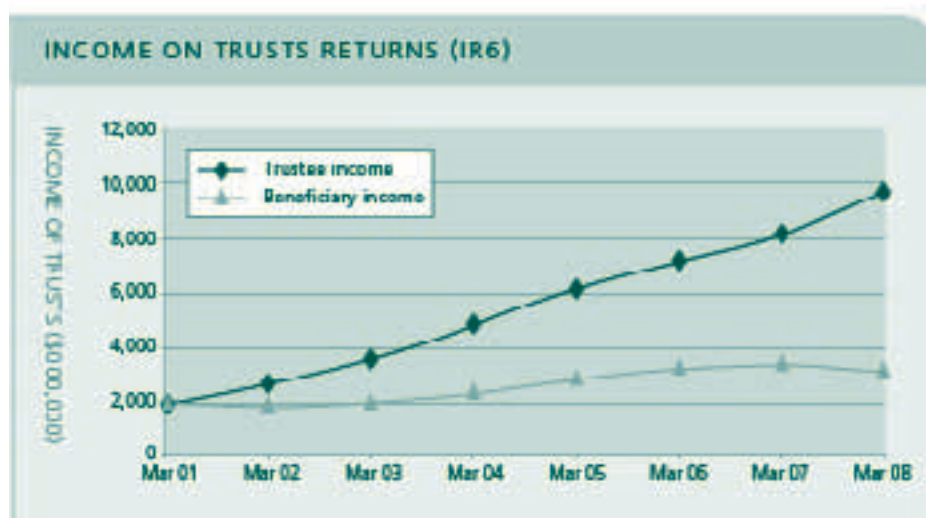
22 Grant and Peart, above n 9, at 2.

23 Unless one of the exceptions (such as short duration relationships) applies or the parties have formally contracted out of the Act's regime. See Grant and Peart, above n 9, at 2.

24 Patterson, above n 19.

25 The ability to redirect income this way was, to some extent, removed by the Taxation (Beneficiary Income of Minors, Services-Related Payments and Remedial Matters) Act 2001. The new "minor beneficiary rule" meant that certain distributions of beneficiary income to a child under 16 years would be taxed at a final tax rate of 33 %. The rule was aimed at ensuring that "families with a trust do not gain a tax advantage over families without a trust": see Commentary on the Taxation (Beneficiary Income of Minors, Services-related Payments and Remedial Matters) Bill < taxpolicy.ird.govt.nz > at 14.

- 2.14 Information derived from tax collection data since the 2000 changes indicates that there has been considerable rearrangement by taxpayers to minimise tax.²⁶ Individuals have been able to escape higher marginal and effective marginal tax rates by diverting income to lower-taxed companies or trusts. Prior to 1 October 2010 trusts had been used to shelter income by having it taxed as trustee income (at a rate of 33%) rather than having it distributed to beneficiaries and taxed as their income. This policy appears to have provided a further incentive for people to establish trusts in recent years. The graph below shows that, since the increase in the top personal tax rate, reported trustee income has grown much more quickly than beneficiaries' income. The VUW Tax Working Group suggests that this could indicate that trusts have been used to enable people to minimise their tax liability.²⁷ It is likely that the tax changes from 1 October 2010 will reduce the incentive for people to settle their assets on trusts.



- 2.15 While tax policy in New Zealand appears to have at times incentivised the use of trusts, other jurisdictions, such as Australia and the United Kingdom, have disincentivised the transfer of assets to a trust by applying a capital gains tax to property sold, including property transferred to a trust, or by applying more punitive tax rates to trust vehicles.²⁸

²⁶ Victoria University of Wellington Tax Working Group, above n 17, at 29.

²⁷ Inland Revenue "Income on trusts' returns, 2001 to 2008" < www.ird.govt.nz/aboutir/external-stats/trust-income-data/ >. This diagram is reproduced with the permission of the Inland Revenue. It does not purport to be published under government authority. The data represented by the graph are calculated based on the income tax returns from trusts (IR6) and includes only those trusts that allocated beneficiary or trustee income.

²⁸ Paper prepared by Ministry of Economic Development for the Law Commission regarding issues to consider in the review of the law of trusts (18 November 2010).

Social assistance policies

- 2.16 It is thought that means testing for social assistance measures has resulted in greater trust use. First, from 1985 to 1998, when the New Zealand superannuation surcharge was in existence, a family trust was a useful vehicle for reducing exposure to the surcharge. The surcharge was an additional tax of first 20% and later 25% on other income of superannuitants. This meant an effective marginal tax rate of 58% for the highest earning. Settling a trust allowed the elimination of the surcharge without limiting investment access to capital growth investments, life insurance, bonds and superannuation funds.
- 2.17 Secondly, the residential care subsidy, available for long term residential care, is often credited with creating a significant incentive for people to transfer assets to a trust. The legislation relating to the subsidy allows a settlor to use a trust to reduce his or her assets and income in order to satisfy the eligibility criteria for the subsidy. At 1 July 2010 the permitted asset levels were \$200,000 for a single or widowed person in care and for couples with both partners in care. Couples with one partner in care can retain \$105,000 not including the value of their house and car or \$200,000, including the value of their house and car.²⁹ If assets exceed the allowed amounts the applicant is not financially eligible for the subsidy. In the 2009–2010 year the Ministry of Social Development processed approximately 10,000 applications for the residential care subsidy that involved a trust.³⁰
- 2.18 Thirdly, the VUW Tax Working Group identified the Working for Families (WfF) benefit as another policy that has provided an incentive for the settlement of trusts. The Group noted the effect that WfF has had on effective marginal tax rates:³¹

Examination of New Zealand's current income tax and family tax credit structure shows that ... the expansion of the Working for Families tax credits in 2005 has increased the incentives for people to shelter or split income ... In particular, the extension of Working for Families meant that more taxpayers became eligible for greater amounts of assistance further up the income scale. Combined with previous increases in the top income tax rate, these WfF changes significantly increased the incentives for households to shelter or split their incomes in order to qualify for Working for Families. Some households on incomes significantly above the threshold of \$36,827 are able to use entities such as companies and trusts to structure their incomes in such a way that they qualify for WfF payments; whereas other households on similar or lower incomes do not qualify. This causes integrity problems. ... These concerns arise, of course, as a result of the design of both the tax system and the WfF scheme. ... In New Zealand, relatively high marginal tax rates arise when the abatement of WfF of 20% is added to the 33% and 38% personal tax rates.

29 See Social Security Act 1964, Sch 27, para 1.

30 Email from Jason Raven, Ministry of Social Development to Marion Clifford, Law Commission regarding the number of trusts involved in applications to Ministry of Social Development (30 November 2010).

31 Victoria University of Wellington Tax Working Group, above n 17, at 55–56.

- 2.19 While accessing other social assistance measures may not always be a driving factor in the initial establishment of a trust, it is certainly a by-product that people with trusts are able to take advantage of. Examples of other forms of government assistance that can be accessed by the channelling of funds through trusts include legal aid³² and the student allowance.³³

Avoiding creditors

- 2.20 Another motivation for the use of trusts has been to protect assets from being subject to claims from creditors. Family trusts have long provided a way for people with businesses to ensure that their private assets are not available to business creditors and can be kept for beneficiaries in the event of a bankruptcy, particularly in the case of some occupations that are unable to obtain the protection of limited liability. The Official Assignee has identified that a growing number of trusts are involved in bankruptcy. Of a total of 2,792 individuals adjudicated bankrupt to the end of June 2004, 15 instances were identified where a bankrupt had an interest in a trust. By June 2010 this figure had grown to 879 instances where the Official Assignee identified an interest in a trust, relative to 3,054 individuals adjudicated bankrupt.³⁴

Promotion of trusts

- 2.21 Some trusts advisers have actively sought to encourage the use of trusts. A search of the internet reveals numerous advertisements for trusts seminars run by trusts professionals and lawyers for the purposes of attracting clients.
- 2.22 Tappenden has suggested that there may be a concerning aspect to this trend:³⁵

Very often the companies promoting their services as trusts advisers attract clients by offering to help them avoid tax, to shield their wealth from creditors, safeguarding against future inheritance taxes, showing them how to protect themselves against possible means testing on superannuation or medical or residential care benefits. The family trust is being sold as a clever way to make someone appear poor without him or her suffering the rigours of poverty.

32 See further paras [3.70] to [3.75] below regarding legal aid.

33 The Ministry of Social Development does not collect information on the number of applications for benefits where the applicant has a trust, but it does record the number of cases involving a trust that are referred to its financial analysts because of complex financial circumstances. In the 2009–2010 year, the Ministry’s financial analysts had 479 cases referred to them specifically about trusts (Email from Jason Raven, above n 30).

34 Paper prepared by Ministry of Economic Development for the Law Commission, above n 28. Note that in 2007 the no-asset procedure (NAP) was introduced, whereby individuals with no assets can go through a less punitive form of bankruptcy. In 2010 there were approximately 3,000 individuals accepted into the NAP, some of whom would have instead been adjudicated bankrupt under the old regime.

35 Sue Tappenden “The family trust in New Zealand and the claims of ‘unwelcome beneficiaries’” (2009) 2 *Journal of Politics and Law* 17 at 17.

GIFT DUTY

- 2.23 Gift duty has applied in New Zealand since 1885. It was intended as a tax to support the estate duty requirements by discouraging the gifting of assets prior to death. Gift duty applies when the value of all gifts made by a person in a year exceeds \$27,000. Gift duty was retained when estate duty was abolished in 1992 as a measure to protect against income tax avoidance and social assistance targeting.³⁶
- 2.24 Gift duty has had a significant impact on trust practice in New Zealand. Dispositions to trusts are subject to gift duty where a settlor's gifting exceeds the gift duty threshold, currently \$27,000 per year. Consequently, gift duty has acted as a constraint on the transfer of property to trusts. In order to avoid gift duty, settlors transfer property to a trust and receive a debt for the value of the property back, which they progressively forgive at the rate of the annual gift duty threshold. As was discussed in the Introductory Issues Paper, the Court of Appeal held in 1940 that an interest-free loan made by one person to another, repayable on demand, was not a gift of the principal money lent, as the ability to demand repayment amounted to consideration.³⁷ In the later case of *Re Marshall*,³⁸ the Court of Appeal held that where interest on a debt becomes payable if demanded, but the right to call for payment is not exercised, there is no gift of the interest foregone. Such an arrangement enabled term loans to be made where there was provision for interest, payable on demand, and gift duty would not be payable. In practice this has meant that in most cases dispositions of property to trusts effectively take place over a number of years.
- 2.25 On 1 November 2010, the Minister of Revenue, Peter Dunne, announced the Government's intention to repeal gift duty from 1 October 2011.³⁹ While legislation to this effect is yet to be passed, it seems that from that date gift duty will no longer be a factor for people settling trusts. The reasons given for the decision are that gift duty no longer raises any significant revenue and that it imposes high compliance costs on the private sector.⁴⁰ Because of its impacts on trusts practice, gift duty has been seen as offering protections in the areas of income tax, creditors and social assistance and in relation to family protection claims by constraining the transfer of assets to a trust. However, this has only ever been an incidental effect of gift duty rather than a policy goal.⁴¹ Inland Revenue analysed the impacts of the removal of gift duty on the use of trusts for different purposes and assessed the risk of problems arising as low.⁴²
- 2.26 The repeal of gift duty will make it considerably easier and quicker to transfer property to a trust, since the transfer will be able to be made as a one-off disposition, without necessarily incurring any tax. It is likely that this will increase the speed with which people transfer assets to trusts, and it may result in an increase in trust use.⁴³

36 Inland Revenue *Regulatory Impact Statement: Gift Duty Repeal* (October 2010) at 3.

37 *Commissioner of Stamp Duties v Card* [1940] NZLR 637 (CA).

38 *Re Marshall (Deceased) Commissioner of Inland Revenue v Public Trustee* [1965] NZLR 851.

39 Hon Peter Dunne "Gift duty to be abolished" (press release, 1 November 2010).

40 Inland Revenue, above n 37, at 4–5. Gift duty raised \$1.6 million in 2009–2010. The amount of revenue from gift duty has decreased in recent years. It is estimated that the cost to the private sector for annual deeds of forgiveness and the filing of gift statements is more than \$70 million.

41 *Ibid*, at 20.

42 *Ibid*, at 10–19.

43 See C MacLennan "Gifting to trusts will increase if threshold is repealed" *LawNews* (23 July 2010).

PRINCIPLES

- 2.27 Because of their flexibility, trusts have been used to protect assets for many reasons. In a review such as this a basic question should be asked about whether the law should allow trusts to be used for all of the purposes discussed above. Sue Tappenden has commented:⁴⁴

Family trusts have become big business in New Zealand and are commonly used to protect a businessman's assets from creditors. While there is nothing illegal in setting up a family trust, it is my contention that the law pertaining to family trusts in New Zealand has become so far removed from the accepted principles of equity as to demand investigation.

- 2.28 There may be certain basic principles underlying the law of trusts that are relevant when considering the uses to which trusts can be put.
- 2.29 There is a perception that trusts allow some people to avoid their legal obligations (such as debts), leaving others to bear the cost. As noted in the Introductory Issues Paper, Schenkel argues that trusts allow beneficiaries (and presumably also settlors) to externalise the costs of property ownership and it is the stranger to the trust (such as a creditor or estranged spouse) who bears the cost. He suggests that "as trusts gain in popularity it seems reasonable to predict that those externalized costs will become an increasingly difficult burden for the community to bear." It would also seem to be unfair for creditors and others to bear these costs. Schenkel suggests that the question is whether trusts should be allowed to thwart important legal obligations (payment of debts, relationship property shares and taxes) leaving others to bear the costs.⁴⁵
- 2.30 In 1956 Dr Austin Scott in the United States wrote that a "trust can be created for any purpose which is not illegal, which is not against public policy".⁴⁶ Section 105 of the Uniform Trust Code reflects this principle. It is a mandatory requirement under the Code that a trust and its terms be for the benefit of the beneficiaries and that the trust have a purpose that is lawful, not contrary to public policy and possible to achieve.⁴⁷
- 2.31 Chapter 5 raises the question of whether there should be limits on what trusts may be used to achieve and whether the above principle or any other principles should be included in New Zealand trust law.

CONCLUSION

- 2.32 As noted, since there is no definitive record of trusts in New Zealand, it is hard to be sure about the number of trusts in existence. However, comparison with familiar jurisdictions suggests that we have embraced the trust structure with particular enthusiasm. An ever growing familiarity with the trust vehicle, developed over the last 50 to 60 years by both advisors and property owners, appears to have bred even more trusts.

⁴⁴ Tappenden, above n 36, at 17.

⁴⁵ Kent D Schenkel "Trust Law and the Title-Split: A Beneficial Perspective" [2009] 78 UMKC Law Review 181, at 212–213.

⁴⁶ AW Scott *The Law of Trusts* (2nd ed, Little Brown & Co, Boston, 1956) at 1.

⁴⁷ National Conference of Commissioners on Uniform State Laws *Uniform Trust Code* (National Conference of Commissioners on Uniform State Laws, Chicago, 2005) §105.

- 2.33 The Law Commission is interested in gaining more information about how common trusts are and why people establish trusts. We are keen to hear about people’s experiences with trusts.
- 2.34 Is there anything wrong with New Zealanders having a particular affinity with trusts? The large number of trusts in New Zealand may not in itself be a problem. However, sometimes the purposes for which people set up trusts and the ways they use them result in outcomes that can be seen as unfair. The following chapters will look at whether the law should address this perceived unfairness and, if so, how it should do so.

Q1 In your experience, what are the reasons that people set up trusts?

Q2 Do you think there are any purposes for which trusts should not be used? If so what are these and why?

Chapter 3

Provisions that “look through” trusts

- INTRODUCTION 3.1 Trusts have enabled and continue to enable settlors and beneficiaries to access government benefits as well as to avoid obligations. The use of trusts in this regard has been met with a variety of legislative responses that “look through” the trust, so that trust assets can be considered to be the settlor’s or beneficiaries’ own assets for certain purposes or trust assets can be accessed in order to meet certain claims. While it is not the purpose of the review to evaluate the legislative treatment of trusts in particular contexts, the mere fact of legislative intervention indicates two things. The first is that government policies regard the use of trusts in certain situations as inappropriate and potentially unfair. Examples include:
- Intentionally disadvantaging creditors in circumstances when the debtor knew or ought to have known that he or she would not be able to meet his or her debts;
 - In some circumstances, side-stepping the equal sharing regime in the relationship property legislation;
 - Avoiding tax; and
 - Artificially minimising assets or income in order to access government benefits or subsidies.
- 3.2 The second is that the legislative measures may vary depending on the area of law and the underlying policy considerations involved. No single overarching statutory provision exists to deal with every situation. There is not, for example, a legislative enactment that states that a trust has no effect to the extent that it has the purpose or effect of enabling a person to obtain a benefit or an entitlement or to avoid an obligation.
- 3.3 Some legislative responses appear to be more effective than others. In this chapter, the Commission considers examples of particular legislative interventions. These include both provisions that apply in the case of private claims, such as the claims of creditors and relationship property claims, and provisions that apply in relation to a liability to, or application for assistance from, the Government, such as income tax, social assistance benefits, the residential care subsidy and legal aid.

PROTECTION
OF CREDITORS:
PROVISIONS IN
THE PROPERTY
LAW ACTS AND
INSOLVENCY
ACTS

- 3.4 Sections 344 to 350 of the Property Law Act 2007 provide that the court can set aside certain dispositions of property⁴⁸ that “prejudice” creditors. This includes certain transfers of property to a trust. The provisions replace section 60 of the Property Law Act 1952 which enabled the court to set aside alienations of property made with “intent to defraud creditors”. However, section 60 remains relevant to creditors wishing to reverse prejudicial dispositions to trusts as it continues to apply to transactions made before 1 January 2008.
- 3.5 Section 60 provides:
- Alienation with intent to defraud creditors
- (1) Save as provided by this section, every alienation of property with *intent to defraud creditors* shall be voidable at the instance of the person thereby prejudiced.
- (2) This section does not affect the law of bankruptcy for the time being in force.
- (3) This section does not extend to any estate or interest in property alienated to a purchaser in good faith not having, at the time of the alienation, notice of the intention to defeat creditors.
- 3.6 Previously, the section had been considered of limited effectiveness since it was difficult for a creditor to prove “intent to defraud” on the part of the debtor. However, the 2008 Supreme Court decision in *Regal Castings*⁴⁹ has substantially increased its potential impact. Regal Castings Ltd was a supplier to a jewellery business (C Ltd) owned by L. L was personally responsible for a debt owed from C Ltd to Regal Castings Ltd. L subsequently transferred his home to a trust of which he, his wife and their solicitor were the trustees. Five years later, C Ltd went into liquidation, still owing Regal Castings Ltd \$165,000. Regal Castings Ltd brought a claim under section 60.
- 3.7 The judgment of Blanchard and Wilson JJ placed emphasis on the fact that L had made himself personally liable for the debts of C Ltd, but had subsequently divested himself of his only substantial asset without telling Regal Castings Ltd. The circumstances of the transfer (to a trust in a manner so that he continued to have enjoyment of the property, and for an unsecured debt repayable 7 years later), and the fact that at the time of the transfer, C Ltd was substantially indebted to Regal Castings Ltd, were also relevant.
- 3.8 Importantly, the Court placed a new, broader interpretation on the meaning of “intent to defraud”. Whereas, previously, an applicant had to show actual intent to defeat creditors’ rights at the time of the disposition,⁵⁰ Blanchard J said:⁵¹

Whenever the circumstances are such that the debtor *must have known* that in alienating property, and thereby hindering, delaying or defeating creditors’ recourse to that property, he or she was exposing them to a significantly enhanced risk of not recovering the amounts owing to them, then *the debtor must be taken to have intended this consequence*, even if it was not actually the debtor’s wish to cause them loss ...

48 Property is defined as everything that is capable of being owned, whether it is real or personal, tangible or intangible property, including any estate or interest in property and the proceeds of any property: Property Law Act 2007, ss 4 and 345(2).

49 *Regal Castings Ltd v Lightbody* [2009] 2 NZLR 433.

50 See, for example, *Swann v Secureland Mortgage Investment Nominees Ltd* [1992] 2 NZLR 144 at 152 and *Coles v Coles* (1987) 3 FRNZ 101.

51 *Regal Castings Ltd v Lightbody* [2009] 2 NZLR 433 at [53]–[56].

- 3.9 The result was a declaration that the trustees held a one-half share of their interest in the property on trust for the Official Assignee, to be dealt with by the Assignee for the benefit of L's creditors. The decision is important, as it indicates a shift in approach in favour of creditors: whereas previously it was relatively easy for a debtor to avoid his liabilities by disposing of property, the decision in *Regal Castings* suggests that the courts may be willing to do more to satisfy a creditor's claim.
- 3.10 The provisions of the Property Law Act 2007 further clarify the law relating to dispositions of property that prejudice creditors. The provisions apply to dispositions of property made by a debtor: (i) with intent to prejudice a creditor, or (ii) made by way of gift, or without receiving reasonably equivalent value in exchange, when the debtor:⁵²
- (a) was insolvent at the time, or became insolvent as a result, of making the disposition; or
 - (b) was engaged, or was about to engage, in a business or transaction for which the remaining assets of the debtor were, given the nature of the business or transaction, unreasonably small; or
 - (c) intended to incur, or believed, or reasonably should have believed, that the debtor would incur, debts beyond the debtor's ability to pay.
- 3.11 A disposition prejudices a creditor if, in language reflected in *Regal Castings*, it "hinders, delays, or defeats the creditor in the exercise of any right of recourse of the creditor in respect of the property".⁵³ The debtor does not have to have a particular creditor in mind when he or she makes the disposition. He or she is deemed to be insolvent if unable to pay all debts as they fall due from assets other than the property disposed of.⁵⁴
- 3.12 Importantly, section 346 of the Property Law Act 2007 codifies the so-called rule in *Freeman v Pope*,⁵⁵ making it clear that a disposition by gift or without receiving "reasonably equivalent value in exchange" by someone who is insolvent can be set aside without the need to show intent to prejudice creditors.⁵⁶ Whether that rule applies to dispositions before 1 January 2008 was left open by the Court in *Regal Castings*. More recently in *Taylor v Official Assignee*,⁵⁷ Heath J in the High Court concluded that the rule in *Freeman v Pope* does not apply in New Zealand to pre-2007 Act transactions.
- 3.13 Neither section 60 nor the 2007 provisions apply where the disposition was to a purchaser for value in good faith without knowledge of the fact that it had been a prejudicial disposition.⁵⁸

⁵² Property Law Act 2007, s 346(2).

⁵³ Property Law Act 2007, s 345(1)(a).

⁵⁴ Property Law Act 2007, s 345(1)(d).

⁵⁵ *Freeman v Pope* (1870) LR 5 Ch App 538 (CA). See *Taylor v Official Assignee* HC AK CIV-2006-404-7115, 25 August 2009 at [56] and E Toomey "Gifting the family home into a trust" (2009) NZLJ 131 at 133.

⁵⁶ Property Law Act 2007, s 345(1)(c).

⁵⁷ *Taylor v Official Assignee* HC AK CIV-2006-404-7115, 25 August 2009 at [67].

⁵⁸ Property Law Act 1952, s 60(3) and Property Law Act 2007, s 349.

- 3.14 At the time of writing, there is no reported case law on the new provisions. On their terms, they are likely to have a wider impact than section 60 of the old Act. As Elizabeth Toomey comments, practitioners should take note: “If your client is insolvent when he or she voluntarily transfers the family home into a trust, the property will be restored for the benefit of the creditors. A comprehensive knowledge of the client’s financial circumstances is essential.”⁵⁹
- 3.15 Part 3, sub-part 7 of the Insolvency Act 2006 provides for the Official Assignee to set aside certain transactions made by a bankrupt before he or she was adjudged bankrupt. Under section 204,⁶⁰ any gift made within two years of the adjudication may be set aside. The onus is on the Assignee to prove that the gift took place within the required timeframe. Under section 205, the Assignee may set aside gifts made between two and five years before the adjudication, provided that the bankrupt was unable to pay his or her debts at the time.⁶¹ The provisions are both favourable to creditors: section 204 does not require the debtor to have been insolvent at the time of the gift; and under section 205, the burden of proof as to the debtor’s solvency at the time of making the gift rests on the gift’s recipient.⁶² In addition, sections 194 and 195 provide for the Official Assignee to set aside “insolvent transactions”. Previously referred to as “voidable preferences”,⁶³ insolvent transactions are those that are made within 2 years of adjudication and:⁶⁴
- Are entered into at a time when the bankrupt is unable to pay his or her due debts; and
 - Enable a creditor to receive more towards satisfaction of a debt by the bankrupt than that person would receive, or would be likely to receive, in the bankruptcy.
- 3.16 A transaction made within 6 months of a person being adjudged bankrupt is presumed, unless the contrary is proved, to be made at a time when the bankrupt is unable to pay his or her due debts.⁶⁵ Sections 211 and 212 of the Insolvency Act 2006 also deal with transactions made at undervalue.
- 3.17 Section 208 of the Act provides that the court must not make an order to recover property disposed of under the provisions described above if the recipient proves that he or she:
- Acted in good faith; and
 - A reasonable person in the recipient’s position would not have suspected, and the recipient did not have reasonable grounds for suspecting, that (i) in the case of an insolvent gift, the bankrupt was, or would become, unable to pay his or her debts without the aid of the property that the gift is composed of; or (ii)

59 E Toomey “Gifting the family home into a trust” (2009) NZLJ 131 at 133.

60 Formerly Insolvency Act 1967, s 54.

61 Insolvency Act 2006, s 205(1). Note that for the period between 3 December 2007 and 16 November 2009 slightly different rules prevail. Section 204 and 205 were amended, with effect from 16 November 2009 by the Insolvency Amendment Act 2009. Those amendments effectively changed the law back to the law that existed under s 54 of the Insolvency Act 1967.

62 See P Frawley “Abuse of the Trust Device – Proposals for Reform” (1995) NZ Journal of Taxation Law and Policy 200 at 209.

63 Under the Insolvency Act 1967, s 56.

64 Insolvency Act 2006, s 195.

65 Insolvency Act 2006, s 196.

in the case of any other irregular transaction referred to in section 206(1), the bankrupt was, or would become, unable to pay his or her due debts; and

- The recipient gave value for the property or interest in the property or altered his or her position in the reasonably held belief that the transfer was valid and would not be cancelled.
- 3.18 This provision rarely prevents the Official Assignee from being able to recover property in the trusts context because in the majority of cases, the bankrupt is also a trustee of the trust to which the property has been transferred. The bankrupt's knowledge is imputed to the other trustees.⁶⁶
- 3.19 It is of note that section 104 of the Insolvency Act 2006 provides that property held by the bankrupt in trust for another person does not vest in the Official Assignee. It seems that this position would apply even where the bankrupt is a trustee of a discretionary trust under which he or she is also a discretionary beneficiary, on the basis that as such he or she had no proprietary interest in the trust.⁶⁷
- 3.20 Section 412 of the Insolvency Act 2006 provides expressly for the court to look at the real nature of a transaction. "It does not matter that the transaction appears to be, or is described by the parties to it as being, something different".⁶⁸
- 3.21 To summarise, there is no time limit on the making of dispositions for the Property Law Act 2007 provisions to apply. While some degree of intent needs to be established, this restriction has been considerably ameliorated. The Insolvency Act provisions are limited in that precise time limits apply. The provisions in both Acts are settlor-focussed, but not in same way as some described below. Here, what matters are the circumstances at the time of the disposition, while whether the transferor retains any interest, control or enjoyment over the property is irrelevant. Writing in 1995, Frawley argued, in relation to section 60 Property Law Act 1952, that "[c]reditors ... should be able to have recourse to property controlled and enjoyed ... through a trust."⁶⁹ That argument was made in the pre-*Regal Castings* and pre-2007 Act context. Despite the retention of time restrictions in the 2006 Insolvency Act, the position of creditors has therefore been enhanced in recent years. Limitations remain, however: in particular, sections 204 and 205 of the Insolvency Act 2006 are not available where property was transferred for value. In those circumstances, creditors will need to rely on court action, for example, by asserting that the trust is a sham. We return to this below.

66 See *Regal Castings Ltd v Lightbody* [2009] 2 NZLR 433 at [128] and *Diemasters Pty Ltd v Meadowcorp Ltd* (2001) 52 NSWLR 572.

67 Frawley, above n 63, at 209.

68 *In Re Cox* (1993) 4 NZBLC 102,967 at 102,971.

69 Frawley, above n 63, at 208.

- RELATIONSHIP PROPERTY** 3.22 Provisions of the Property (Relationships) Act 1976 and the Family Proceedings Act 1980 can be used to give relief to a disadvantaged spouse or partner on the breakdown of a relationship where property has been transferred to a trust. The Property (Relationships) Act 1976 provisions relate to “relationship property” and “separate property” as they are defined under that Act and apply on the breakdown of marriages, civil unions and, since 2001, de facto relationships. Section 182 of the Family Proceedings Act 1980 applies only to marriages and civil unions and allows the court to vary the terms of ante and post-nuptial settlements.

Property (Relationships) Act 1976

- 3.23 Sections 44, 44C and 33 of the Property (Relationships) Act 1976 are the relevant provisions.⁷⁰ Section 44 provides that dispositions of property may be set aside if they were made “in order to defeat the claim or rights of any person” under the Act. “Disposition” includes the settlement of assets on a trust. In keeping with the approach to section 60 of the Property Law Act 1954 discussed above, initially a limited interpretation was placed on section 44. In *Coles v Coles*,⁷¹ the Court of Appeal found that the words “in order to defeat” meant that, for a transaction to be impugned, the spouse who entered the transaction had to have done so:⁷²

... because of a conscious desire to remove some item or items of matrimonial property from the reach of the Courts. It must be shown that such was the aim or object of the transaction; the end which the transaction was intended to achieve.

- 3.24 In *Coles*, this high standard could not be met and the result was that most of what would otherwise have been matrimonial property was outside the reach of the wife. However, it seems that the decision in *Regal Castings*,⁷³ and its subsequent application in *Ryan v Unkovich*⁷⁴ may result in section 44 being used more widely.⁷⁵
- 3.25 In *Ryan* (a strike out action arising under section 44 Property (Relationships) Act 1976), the High Court adopted the approach in *Regal Castings*. Ms R had transferred two properties to trusts without Mr U’s knowledge. The transfers had taken place before the couple were married, and before the Property (Relationships) Act 1976 had been extended to de facto couples (although the legislation was before Parliament). Mr U contended that he had made full contributions to both properties during their de facto relationship and after they subsequently married. Ms R applied to have the action struck out on the grounds that it was impossible for her to have the requisite intent since the dispositions had taken place before the Act applied to de facto couples. Justice French said:⁷⁶

70 Also relevant are Property (Relationships) Act 1976, ss 43 (Dispositions may be restrained), 44A (Application of ss 44B and 44C) and 44B (Court may require party to disclose information about dispositions of property to trust).

71 *Coles v Coles* (1987) 3 FRNZ 101.

72 *Ibid*, at 105.

73 *Regal Castings Ltd v Lightbody* [2009] 2 NZLR 433.

74 *Ryan v Unkovich* [2010] 1 NZLR 434.

75 See, for example, *Brookers Family Law – Family Property* (Brookers, Wellington, 2003) at [PR44.01].

76 *Ryan v Unkovich* [2010] 1 NZLR 434 at [33].

I accept the principles enunciated in *Regal Castings* are sufficiently general to apply to section 44. In particular, I accept that in so far as the *Coles* formula fails to distinguish between intention and motive, it is contrary to the reasoning of the Supreme Court and should not be followed. Knowledge of a consequence can be equated with an intention to bring it about.

- 3.26 The Judge commented that, as a matter of general principle, an intention to defeat future claims is capable of constituting an operative intention to defeat. Thus, in the debtor/creditor context, while the intent to defraud must be determined at the time of the disposition, the intended prejudice may nevertheless be to future creditors.⁷⁷
- 3.27 While section 44 applies to any type of disposition, section 44C applies specifically to dispositions to trusts and enables the court to make an order compensating a spouse or partner whose claim or rights have been defeated by such a disposition. Importantly, under section 44C there is no need to prove intent. Orders cannot be considered under section 44C unless a claim under section 44 has been discounted.⁷⁸ Orders can be made:
- Requiring payment of a sum of money or transfer of property, whether out of relationship property or separate property;
 - Requiring the trustees of the trust to pay the whole or part of the *income* (but not the capital) of the trust.
- 3.28 Section 44C was added by the Property (Relationships) Amendment Act 2001, on the recommendation of the Working Group on Matrimonial Property and Family Protection.⁷⁹ The Group noted that the difficulty of proving the required intention under section 44 and the increasing use of trusts and companies had the effect of placing large amounts of relationship property beyond the reach of the courts, often to the detriment of one of the spouses or partners. The social purposes of the relationship property law were thereby lost. The aim of section 44C was therefore to strengthen the Act where dispositions to trusts had the effect of defeating one of the party's rights, but where intention to defeat a party's rights could not be shown.
- 3.29 The Working Group recommended that compensation payments be sourced in the first instance from the respondent's share of the relationship property or separate property. If they were insufficient, the Working Group thought, the court should have the power to not only divert income from the trust, but distribute capital from the trust and, as a last resort, to withdraw assets from the trust. The legislature, however, confined section 44C to allowing distributions of income, on the grounds that trusts were created for legitimate reasons and should be permitted to fulfil that purpose where there is no intention to defeat a relationship property claim at the time the trust was established.⁸⁰

77 Ibid, at [42].

78 *Babylon v Babylon* HC AK CIV-2006-404-3217, 12 October 2007.

79 See Department of Justice *Report of the Working Group on Matrimonial Property and Family Protection* (1988) at 28–31.

80 Government and Administration Select Committee *Report on Matrimonial Property Amendment Bill* (1999).

- 3.30 In *Equity and Trusts in New Zealand*, Professor Peart describes the limits of section 44C:⁸¹

...[i]ts ability to achieve a just division of assets produced or enhanced by the relationship is limited both by the section’s requirements and by the remedies. ... it is easy to avoid being caught by section 44C. The section cannot be involved if the trustees acquired the assets directly from third parties, rather than from either of the partners to the relationship. Nor does it apply to trusts that affect both parties equally or that were settled by third parties ... Even if the disposition does come within section 44C, the constraints on the compensation powers prevent applicants from achieving an equal share of the fruits of their efforts.

- 3.31 Finally, section 33(3)(m) of the Property (Relationships) Act 1976 empowers the court to make an ancillary order varying the terms of a trust or settlement. This power could be used to give better effect to an order under section 44C diverting income from the trust. In *S v M*,⁸² for example, the Family Court made orders under section 33(3)(m) to enable the home to be sold and the debt to be repaid so that the wife could be compensated. Where the trust does not produce an income or the investments produce little income, section 33(3)(m) of the Property (Relationships) Act 1976 might even be used to vary the investment powers of the trustees to ensure that the trust assets produce an income that can be diverted.

Family Proceedings Act 1980

- 3.32 Section 182 of the Family Proceedings Act 1980 allows the court to vary the terms of ante and post-nuptial settlements – including trusts – when the marriage or civil union of the parties comes to an end. As the Supreme Court stated in *Ward v Ward*,⁸³ historically both ante and post-nuptial settlements had one fundamental thing in common: they both envisaged and were premised on the continuance of the marriage. If that premise ceased to apply, a fundamental change in circumstances came about. Section 182 recognises that injustices can arise as a consequence and empowers the court to review the settlement on dissolution of the marriage.
- 3.33 Section 182 was retained despite the introduction of the equal sharing regime under the Matrimonial Proceedings Act 1976 and the 2001 Property (Relationships) Act 1976 amendments. The cases establish that the section 182 jurisdiction is separate from the Property (Relationships) Act 1976 rules and the concept of equal sharing is not directly relevant to a determination under section 182. What is relevant is that, whereas a trust structure might have served

81 Nicola Peart “Equity in Family Law” in A Butler (ed) *Equity and Trusts in New Zealand* (2 ed, Thomson Reuters, Wellington, 2009) 1161 at 1190–1191.

82 *S v M* DC Tauranga FAM-2004-070-823, 16 November 2006.

83 *Ward v Ward* [2009] SCNZ 125 at [15].

the interests of a couple while they were harmoniously together, the tying up of their property in such a structure upon break-up is unlikely to be able to serve them both in the way envisaged. However, in *X v X* the Court of Appeal stated that:⁸⁴

... section 182 ... must be read within the total legislative context and in light of the clear Parliamentary intention not to insert a trust-busting route into [Property (Relationships) Act 1976].

- 3.34 In *X v X*, the Court declined to interfere with the trust structure and the decisions that the trustees had made in respect of the division of the trust property following the marriage break-up. The appropriate route, if the applicant husband thought the trustees were acting wrongly, was by an action under the Trustee Act 1956. The Court noted that section 44 of the Property (Relationships) Act 1976 had to be taken into account and that when the Property (Relationships) Act 1976 was amended in 2001, Parliament declined to grant any general judicial power to go behind trust structures as part of relationship property division. Section 182 of the Family Proceedings Act 1980 had to be interpreted and applied with that in mind.
- 3.35 Section 182 was considered by the Supreme Court in *Ward v Ward*. There, relief was granted under section 182 but the trust structure was respected in the sense that the fund would effectively be divided and resettled onto two new trusts – one for the husband and one for the wife – on much the same terms as the old trust. The Court made it clear that there is no entitlement to a 50/50 or any other fractional division of the trust property under section 182. What was relevant, however, was that a nuptial settlement was premised on the continuation of the marriage. Under section 182, the court was to assess whether an order was necessary and, if so, in what terms, to reflect the fact that that fundamental premise no longer applied.⁸⁵
- 3.36 Under section 182, a “post-nuptial settlement” clearly captures a trust established after a marriage if the trust was intended to provide for the couple (and their children). To qualify as an “ante-nuptial settlement”, a trust must:⁸⁶

84 *X v X* [2009] NZFLR 956 at [44]–[45]. The Court also said that the “common thread in ... cases in which s 182 has been invoked to vary a trust is that it was necessary to achieve fairness and justice between the parties, and would not be to the detriment of the children of the marriage. The section is a route available to the courts when there is little or no relationship property available for division. It would be ‘necessary’ to interfere with a settled trust when to refrain from interference would leave one party unfairly disadvantaged ... or in a state of hardship.”

85 *Ward v Ward* [2009] SCNZ 125. In concurring with the Family Court judge’s decision in the case, the Supreme Court said at [62]: “The Judge was entitled, indeed obliged, to bear in mind the interests of the children and, to a lesser extent, the interests of the remoter beneficiaries. On that premise, his decision to maintain the trust structure as far as possible, rather than order any absolute payment out of the Trust, was a principled and entirely justified one. Having reached that point, the subdivision of the original Trust into two, with the two new trusts being for the benefit of each of the parties and the children and other beneficiaries, to the exclusion of the other party, was within a properly exercised discretion. ... This equality of division, but on the premise of continuing but separate trusts on both sides, was a logical and fair way of giving effect to Mrs Ward’s original expectation of the Trust in the changed circumstances. Equal division of the Trust represented the application of appropriate s 182 principles. It should not be seen as based on relationship property principles.”

86 *Kidd v van den Brink* HC AK CIV-2009-404-4694, 21 December 2009 at [18].

(1) be on one or both of the parties; (2) be with reference to their married state; and (3) possess a “nuptial characteristic”. ... the inquiry is into whether there is *the necessary degree of connection or proximity between the settlement (not the settled property) and the particular marriage*.

- 3.37 One outstanding question about section 182 is whether dispositions of property made after a marriage, to a trust that was formed before (and not in contemplation of) the marriage, are post-nuptial settlements. The Court of Appeal granted leave to pursue this issue in *Kidd v van den Brink*, but the case has now been settled.⁸⁷ In *Kidd*, the husband established a trust in 1990 and the husband and wife commenced living together in 1998 and married in 2001. The husband was not a beneficiary of the trust, but “any spouse of the husband” was a discretionary beneficiary. The wife asserted that during the relationship, the trust provided them with a family home, paid out-goings, provided chattels and funded by way of a loan of \$500,000 the acquisition of a business. On the marriage breakdown, the wife applied for orders under section 182 against the husband and trustees. The trustees argued that the trust was not an “ante-nuptial or post-nuptial settlement made on the parties” within section 182 and it was not made in contemplation of their marriage.
- 3.38 The High Court agreed that the trust did not have a sufficient degree of proximity to the marriage to be an ante-nuptial settlement. The Court also disagreed with the argument that each acquisition of property by a trust is a fresh settlement which, if it has taken place during the marriage, is a new or fresh post-nuptial settlement.
- 3.39 To summarise, in the relationship property context, the legislature has placed limits on the extent to which a trust structure can be disregarded. In *X v X*, the Court of Appeal noted:⁸⁸

Section 44 of the [Property (Relationships) Act 1976] was inserted by the Matrimonial Property Amendment Bill (subsequently renamed the Property (Relationships) Amendment Bill), in 2001. The Government Administration Committee noted that there was public concern at matrimonial property being disposed of to family trusts, since a spouse who is only a discretionary beneficiary has no enforceable proprietary interest. But the Committee considered that where a claimant spouse wished to challenge the apportionment of trust property, the proper route was the general law rather than broad-brush trust-breaking provisions in relationship property legislation. *Maintaining a limited role for judicial interference in trusts in this context, the Committee noted, “acknowledges that trusts are created for legitimate reasons and should be permitted to fulfil that purpose ...”.*

87 See *Kidd v van den Brink* HC AK CIV-2009-404-4694, 21 December 2009 and [2010] NZCA 169 (leave to appeal granted).

88 *X v X* [2009] NZFLR 956 at [39] emphasis added.

- 3.40 The Family Proceedings Act 1980 and Property (Relationships) Act 1976 regimes differ. The former does not apply to de facto relationships. The Property (Relationships) Act 1976 compensation provision does not enable the court to interfere with the capital of a trust, but the Family Proceedings Act 1980 regime does. The rationales for the two regimes are not the same – the Family Proceedings Act 1980 is about achieving fairness where circumstances have changed, while the Property (Relationships) Act 1976 is more clearly based on the premise that people should not be able to use trusts to side-step the legislative policy underlying that Act.⁸⁹
- 3.41 Like the creditor protection provisions, the Property (Relationships) Act 1976 focuses on the intent and circumstances of the disposition. Under the terms of the provisions, whether the settlor has any on-going interest in the trust property is not as such, relevant.

GOVERNMENT ASSISTANCE AND OBLIGATIONS TO GOVERNMENT

- 3.42 There are a wide range of situations where people apply for government assistance and or have their obligations to the Government assessed where their involvement in a trust may be relevant. Legislation has sought to provide measures that “look through” trusts in some circumstances. The different policy areas where trusts are relevant include:
- Income tax;
 - Assistance payable by the Ministry of Social Development;
 - The residential care subsidy;
 - Legal aid;
 - Working for families;
 - Fines and sentencing;
 - Applying for state housing; and
 - The student allowance.
- 3.43 The first four of these and the legislative responses to the use of trusts in these areas are discussed in detail below.

89 Section 1M of the Property (Relationships) Act 1976 sets out the purpose of this Act as follows: The purpose of this Act is –

- (a) to reform the law relating to the property of married couples and civil union couples, and of couples who live together in a de facto relationship;
- (b) to recognise the equal contribution of husband and wife to the marriage partnership, of civil union partners to the civil union, and of de facto partners to the de facto relationship partnership;
- (c) to provide for a just division of the relationship property between the spouses or partners when their relationship ends by separation or death, and in certain other circumstances, while taking account of the interests of any children of the marriage or children of the civil union or children of the de facto relationship.

Income Tax

- 3.44 The Income Tax Act 2007 contains general and targeted provisions that are relevant to the taxation of trusts. There is no express “look through” rule that gives Inland Revenue the specific power to disregard a trust and access its assets.⁹⁰ However, a number of the targeted provisions are settlor-focussed and can make the settlor liable to income tax on income from the trust fund. To that extent, they disregard traditional trust principles under which income is allocated to designated beneficiaries.
- 3.45 Section BG 1 is the Act’s general anti-avoidance provision, the effect of which is that the Commissioner can adjust taxpayers’ taxable income where he or she considers a tax avoidance arrangement exists.⁹¹ A tax avoidance arrangement is one which directly or indirectly has tax avoidance as its purpose or effect; or has tax avoidance as one of its purposes or effects, whether or not any other purpose or effect is referable to ordinary business or family dealings, if the tax avoidance purpose or effect is not merely incidental.⁹² Tax avoidance includes:
- (a) directly or indirectly altering the incidence of any income tax:
 - (b) directly or indirectly relieving a person from liability to pay income tax or from a potential or prospective liability to future income tax:
 - (c) directly or indirectly avoiding, postponing, or reducing any liability to income tax or any potential or prospective liability to future income tax.
- 3.46 The Supreme Court, in its 2008 decision in *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue*,⁹³ set out the factors to be taken into account when applying the general tax avoidance provision. For instance, the Court confirmed that compliance with specific tax provisions does not oust the application of the general anti-avoidance provision and that the general provision should not be read down where conflicting specific provisions exist. What is required is a “principled approach which gives proper overall effect to statutory language that expresses different legislative policies”.⁹⁴
- 3.47 The Court of Appeal has recently considered the application of the provision in a trusts context. *Commissioner of Inland Revenue v Penny and Hooper*⁹⁵ concerns two orthopaedic surgeons who initially conducted their practices on their own account. Each subsequently established a company to purchase their practice and the companies were owned substantially by their family trusts. From this time onwards, the surgeons were employed by their respective companies which paid them a salary that the Commissioner argued was artificially low.

90 Compare with section HD 15 of the Income Tax Act 2007 which gives IRD the power in certain circumstances to pursue company directors and shareholders in the event of non-payment of taxes by a company.

91 See Income Tax Act 2007, ss BG 1(2) and GB 1(1).

92 Income Tax Act 2007, s YA 1.

93 *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289 at [89].

94 *Ibid*, at [102].

95 *Commissioner of Inland Revenue v Penny and Hooper* [2010] NZCA 231.

- 3.48 The Court found that Mr Hooper’s salary dropped from around \$650,000 per year to around \$120,000 following the restructuring. The balance of the practice income in each case was treated as company income and paid by way of shareholder dividend to the family trusts. Importantly, the families still received the benefit of the practice income (as they did before the restructuring) by way of distributions from the trusts. In other words, life largely continued as before with the addition of a large tax benefit. The Commissioner asserted that the restructuring of the respondents’ practices and the allocation of such low salaries was a “tax avoidance arrangement” under the Act and that they had improperly taken advantage of the disparity between the lower company income tax rate (33 %) and the top individual income tax rate (39 %). Both the surgeons argued that they had other valid reasons for adopting their chosen structures, listing in particular their concerns about exposure to liability to being sued in their professional capacity. The High Court agreed that the arrangements were not tax avoidance because the surgeons had adopted valid business structures and because there was no concept in tax law of a commercially realistic salary.
- 3.49 However, the majority of the Court of Appeal upheld the Commissioner’s appeal, concluding that the only realistic inference was that one of the purposes of the arrangement was to alter the incidence of income tax. Justice Ellen France dissented, concluding that the surgeons had taken advantage of the difference in the tax rates in a way that was within the limits of acceptable commercial practice. Whereas tax avoidance requires the taxpayer to use tax provisions in a manner not contemplated by Parliament (a point also made by the majority)⁹⁶, Justice France thought the surgeons had not demonstrated any ingenuity that Parliament could not have contemplated when it raised the top personal rate.⁹⁷ The surgeons have been granted leave to appeal to the Supreme Court.
- 3.50 In the wake of the decision, Inland Revenue has issued a Revenue Alert (RA 10/01) setting out factors that will raise suspicion where a person earns income from an activity involving the supply of services to customers based on that person’s skills. These are:⁹⁸
- Where the business is operated through an entity, such as a company or trading trust;
 - Where, if the business structure has been changed, it operates substantially as before;
 - Whether the business is operating according to the terms of the arrangements entered into;
 - The degree to which the person or their family ultimately control the entity and the cash flows from the business;
 - Whether there is a redistribution of the underlying income from the entity to the person or family members;
 - The relative significance or materiality of non-tax reasons for structuring their affairs in the manner they have done; and
 - The extent to which significant tax benefits are obtained.

⁹⁶ Ibid, at [93].

⁹⁷ Ibid, at [168] and [184].

⁹⁸ See Inland Revenue “Revenue Alert RA 10/01” < www.ird.govt.nz/technical-tax/revenue-alerts > and C Bryant “Poorly paid – tax avoidance or commercial reality?” *NZLawyer* (9 July 2010).

- 3.51 Arrangements that exhibit a combination of the above features may constitute tax avoidance. The extent to which profits from an individual’s exertions are diverted to other family entities or members is a key factor.
- 3.52 In response to *Penny and Hooper* and other recent tax avoidance decisions it has been said that:⁹⁹
- the tax avoidance landscape has changed markedly, and the pendulum has swung strongly in favour of the Commissioner. There is a new approach to tax avoidance ... The focus is on contrivance and artificiality, and the commercial reality and economic effect of the arrangement.
- 3.53 As noted, the Income Tax Act 2007 contains a number of other rules which are directed specifically at the ways in which trusts can be used to minimise tax liability. In general, these rules are settlor-based. First, the usual approach of the Act is to tax the world-wide income of New Zealand residents but only the New Zealand-sourced income of non-residents. It should follow from this that in the case of a trust with non-resident trustees the trustee income would be liable to tax only to the extent it was New Zealand-sourced. However, what is instead relevant is the residence of the settlor. Where the settlor is New Zealand resident, the worldwide trustee income will be liable to New Zealand tax.¹⁰⁰
- 3.54 Secondly, the Act recently strengthened its rules defining “associated persons”.¹⁰¹ These rules are mainly used in an anti-avoidance capacity to counter non-arm’s length transactions that could undermine the intent of the income tax legislation. Again, where they relate to trusts a number of these rules are settlor-focussed. The following may be treated as “associated persons”:
- Two companies;
 - A company and a person other than a company;
 - Two relatives;
 - A person and a trustee for a relative;
 - A trustee and a beneficiary;
 - Trustees of trusts with a common settlor;
 - A trustee and a settlor;
 - A settlor and a beneficiary;
 - A trustee and a person with the power of appointment or removal of the trustee;¹⁰²
 - A partnership and a partner;
 - Two persons who are each associated with the same third person.
- 3.55 All 11 associated persons tests generally apply for the purposes of the Income Tax Act 2007. The main exception is in the land provisions where modifications are made so the associated persons definitions cover situations under the effective control of property dealers, developers and builders, but do not apply to other situations.¹⁰³

99 Bryant, above n 99.

100 Income Tax Act 2007, s BD 1(4). This rule was first introduced by the Income Tax (Amendment) Act (No 5) 1988.

101 See Taxation (International Taxation, Life Insurance, and Remedial Matters) Act 2009.

102 Income Tax Act 2007, s YB 11.

103 See Policy Advice Division of Inland Revenue *Special Report: New definitions of “associated persons”* (15 October 2009) < <http://taxpolicy.ird.govt.nz> > .

- 3.56 Notable features of the associated persons rules as they apply to trusts are that they treat a beneficiary as someone “eligible to benefit” under a trust, so that the rules cannot be side-stepped by the establishment of a discretionary trust.¹⁰⁴ The rules also treat two persons who are married, in a civil union or a de facto relationship as one person to prevent the use of mirror trusts to avoid the rules.¹⁰⁵ They also ensure that it is the true settlor of a trust that is captured so that liability cannot be avoided by use of a nominee.¹⁰⁶
- 3.57 Thirdly, in general the term “settlor” has a wide meaning under the Act. A settlor of a trust is defined broadly to mean a person who transfers value to a trust. The definition of settlor is further extended by the provisions of section HC 28, which, among other things, includes the situation where a trustee of a trust (the first trust) settles another trust (the second trust); the settlor of the second trust is treated as including any person who is a settlor of the first trust.
- 3.58 Finally, the minor beneficiary rule was introduced to stop families with a trust gaining a tax advantage over families without a trust by making distributions from the trust to their children on a low tax rate. The rule dictates that a distribution to a minor will be treated as trustee income and accordingly subject to the trustee income tax rate.¹⁰⁷

Assets and income testing for government assistance

- 3.59 A number of statutory provisions allow the Government to take account of an interest in a trust for the purposes of assessing a person’s assets or income. The provisions have arisen at different times, and in response to particular challenges facing government at those times. As a result, they vary in their scope and application.

Means testing for social assistance benefits

- 3.60 Section 74(1) of the Social Security Act 1964 is a general anti-avoidance measure relating to means testing for access to benefits under Parts 1 and 2 of the Act.¹⁰⁸ The provision gives the Ministry of Social Development (MSD) very broad discretion, and states:

... the chief executive may, in the chief executive’s discretion, refuse to grant any benefit or may terminate or reduce any benefit already granted or may grant a benefit at a reduced rate in any case where the chief executive is satisfied— ... (d) That the applicant has directly or indirectly deprived himself of any income or property which results in his qualifying for that or any other benefit or an increased rate of benefit...

104 Income Tax Act 2007, s YB 6.

105 Income Tax Act 2007, s YB 7. In mirror trusts property of partners is divided so that 50% of it is gifted respectively to each partner’s trust with the partners becoming beneficiaries of each other’s trust and not their own.

106 Income Tax Act 2007, ss YB 7–YB 9. See also s YB 21 relating to bare trusts.

107 Income Tax Act 2007, ss CX 58, HC 35.

108 See definition of “benefit” in s 3(1). Parts 1 and 2 of the Act relate to most monetary benefits, but do not apply to the long-term residential care subsidy, which is discussed at paragraphs [3.62] to [3.69].

3.61 Although there is a power to make regulations prescribing the circumstances in which section 74 applies, no regulations have been made.¹⁰⁹ MSD makes wide use of section 74 in its means testing process when the presence of a trust has been identified. If it becomes apparent that a beneficiary or applicant has a trust, MSD will seek further information about the trust structure and the manner in which dispositions have been made to it. It is of note that there is no time limit on the dispositions referred to in section 74. Feasibly, then, MSD can take into account dispositions taking place years before the application. Because of the broad discretion afforded, MSD considers section 74 to be effective for its purposes when and if involvement in a trust is identified, and provided that the assets held within the trust can be identified. The breadth of the discretion allows each case to be considered on its merits, taking into account the specific circumstances involved including the circumstances leading up to formation of the trust, and what connection the person now has to the trust.

Residential care subsidy

- 3.62 The Social Security Act 1964 provides for an assets assessment in order to determine whether a person in long-term residential care qualifies for a residential care subsidy.¹¹⁰ For those with asset levels below the asset threshold, an income assessment is applied to determine the extent of the Government’s residential care subsidy and the person’s own contribution. In order that people do not unreasonably restructure their finances or give away income and assets to meet thresholds that they otherwise would not meet, the Act allows an examination of how people have dealt with income and assets in the years prior to applying for the residential care subsidy.
- 3.63 The permitted asset level was substantially increased in 2005 (from \$15,000 for a single person to \$150,000).¹¹¹ Under the Social Security Act 1964, the asset level will be progressively increased by \$10,000 each year until 2026, when it will reach \$350,000 for a single person. While the initial intention was that the progressive increase in the asset levels may have the impact of reducing the incentive for people to minimise their assets, the property boom of the early to mid 2000s may mean that any such impact has been reduced. MSD has seen an increase in the number of residential care subsidy applications where a trust is involved, which it expects is at least partly due to the policy and legislative provisions pertaining to the subsidy.
- 3.64 In contrast with section 74(1)(d) of the Social Security Act 1964, section 147A(1) is targeted directly at the residential care subsidy. Like section 74(1)(d), it provides for the chief executive, where he or she is satisfied that a person who has applied for a means assessment has directly or indirectly deprived himself or herself or any income or property, to conduct the means assessment as if the deprivation had not occurred. However, in this case, regulations have been introduced which closely prescribe what amounts to “deprivation” for the purposes of the section.¹¹²

109 Social Security Act 1964, s 132I.

110 Social Security Act 1964, s 146.

111 From 1994 to 1998 the asset level was \$6,500 for a single person.

112 Social Security (Long-term Residential Care) Regulations 2005, reg 9B.

- 3.65 In exercising discretion under section 147A, MSD must consider the individual circumstances of the applicant. In transferring property and investments to a trust, ownership of the asset is relinquished and normally exchanged for an asset in the form of a debt owed by the trust. Any subsequent gifting of that debt will amount to the deprivation of an asset, while the transfer of income-earning assets to a trust may result in the deprivation of income. Where deprivation of income or assets has occurred, section 147A provides that the Ministry has the discretion to nominally add those assets or income back into the means assessment. It is in exercising that discretion that MSD has regard to the client's individual circumstances.
- 3.66 Section 1A of the Social Security Act 1964 sets out the purpose of the Act as follows:
- The purpose of this Act is –
- (a) to enable the provision of financial and other support as appropriate –
 - (i) to help people to support themselves and their dependants while not in paid employment; and
 - (ii) to help people to find or retain paid employment; and
 - (iii) to help people for whom work may not currently be appropriate because of sickness, injury, disability, or caring responsibilities, to support themselves and their dependants:
 - (b) to enable in certain circumstances the provision of financial support to people to help alleviate hardship:
 - (c) to ensure that the financial support referred to in paragraphs (a) and (b) is provided to people taking into account –
 - (i) that where appropriate they should use the resources available to them before seeking financial support under this Act;
 - (ii) any financial support that they are eligible for or already receive, otherwise than under this Act, from publicly funded sources:
 - (d) to impose administrative and, where appropriate, work-related requirements on people seeking or receiving financial support under this Act.
- 3.67 Drawing on section 1A(c)(i), MSD considers that the guiding principle behind section 147A is that people are expected to utilise their own resources before calling on the State. MSD's view is that if the rules were not in place it would be easy for applicants to avoid the means assessment by simply transferring their assets to a trust and gifting away the resulting debt. They consider that this would be inequitable in relation to other applicants with a similar level of assets who have not transferred (and gifted) them to a trust.¹¹³

¹¹³ Email from Jason Raven, Ministry of Social Development to Susan Hall, Law Commission regarding the residential care subsidy (30 July 2010).

- 3.68 The regulations, which adopt a similar model to the gifting rules contained in the Estates and Gift Duties Act 1968, define a gifting period that commences five years before the date of the means assessment.¹¹⁴ Restrictions are placed on the value of gifts that may be made during this five year period without the value of those gifts counting towards a person’s means assessment of assets.¹¹⁵ Regulation 9B contains a list of instances which qualify as deprivation of property or income.¹¹⁶ Under regulation 9B there is no limit on the length of time the Ministry can ‘look back’ in the calculation of excess gifting, even if the gifting programme started some time ago. Gifts exceeding \$27,000 per year in any of the years prior to the start of the five year gifting period can be considered deprivation. The disposition of property below market value or for no consideration can also be considered deprivation of assets under regulation 9B.¹¹⁷ The failure to exercise any right or entitlement to demand a payment and a waiver of a right to receive any entitlement or payment may also be considered to be deprivation of income under regulation 9B.¹¹⁸ It is conceivable that the actions of settlors and trustees could also fall within these descriptions.¹¹⁹
- 3.69 In comparison with the broad discretion under section 74 of the Social Security Act 1964, the Commission understands that the prescriptive nature of the regulations means that they have allowed for the exemption of funds that a discretion-based assessment of financial means may not have exempted. While this approach is easier to understand and administer, it has also been easier for those advising on trusts to minimise the applicant’s assets over relatively short periods of time. Provided an applicant has adhered to the monetary and time limits on gifting set out in the regulations and so reduced the total value of the assets that they own, the law provides that the subsidy can be paid, notwithstanding that the applicant may still be benefiting from or getting the enjoyment of substantial property held in the trust. It is MSD’s impression that many trusts are established for this purpose.

114 Social Security (Long-term Residential Care) Regulations 2005, reg 8.

115 During these five years a person may make “allowable gifts” of real or personal property that have a total value of up to \$5,500 per year without the value of these gifts being considered a part of the person’s assets for the purposes of the means assessment of assets (regulation 9). If all of the person’s allowable gifts under regulation 9 for each of the five years of the gifting period total less than \$27,500, the person may also be able to make an allowable gift in the year before entering residential care to a caregiver (not a spouse, partner or dependent child) who has lived in the same household and provided a high level of care for at least one year. This also will not be considered part of the person’s assets for the means assessment as long as the gift is not more than \$5,500 for each 12 month period of care provided and the total amount of any gifts in recognition of care and any allowable gifts under regulation 9 do not exceed \$27,500 (regulation 9A).

116 Social Security (Long-term Residential Care) Regulations 2005, reg 9B.

117 If the disposition of property took place in the years prior to the five year gifting period, the amount transferred for nil value or the value of the discount that exceeds \$27,000 can be considered deprivation. If the disposition of property occurred within the five year gifting period, the entire value of the property that was transferred for nil value or discounted can be considered deprivation (Social Security (Long-term Residential Care) Regulations 2005, reg 9B(b) and (c)).

118 Social Security (Long-term Residential Care) Regulations 2005, reg 9B(d) and (e).

119 Regulation 9B(d) means that the interest rate chargeable under *Re Marshall* clauses may be assessed to the applicant as deprived income. Failure to demand interest is considered to be deprivation under regulation 9B(d).

Legal aid

3.70 The Legal Services Regulations 2006 deal with financial eligibility for legal aid. Legal aid eligibility is determined on the basis of income and disposable capital. Regulation 8(4) relates to the determination of disposable capital and states:

(4) Any interest in any trust or other fund (whether the applicant's interest is held solely, jointly, or in common, and whether it is vested or contingent), or any benefit that the applicant might receive in connection with any trust (for example, a discretionary trust), must be assessed with regard to –

(a) how the trust arose or was created; and

(b) the terms and conditions of the trust; and

(c) the person or persons who have power to appoint and remove trustees or beneficiaries; and

(d) the history of the trust's transactions (for example, distributions); and

(e) any changes in the membership of the trustees; and

(f) any changes in the class of beneficiaries; and

(g) the source of income or capital that the trust receives.

3.71 Subclause (5) makes it clear that the Agency may treat all or part of the assets and income of a trust as assets and income of the applicant regardless of the interest of any other person in the trust. The regulations are made under section 113(1)(j) of the Legal Services Act 2000 which provides that regulations may be made for the purpose of:

making provision, in respect of the calculation of the income, disposable capital, or capital of an applicant for legal aid, for all or any of the following ... (v) taking into account any benefit to which the applicant is entitled or which the applicant might receive in connection with property held on trust ...

3.72 Regulation 8 replaced an earlier, more general provision in the Legal Services Regulations 2000. Then, regulation 6(2) stated that in determining an applicant's disposable capital:

... the value of any interest in a reversion or remainder (whether legal or equitable) in any property, or in a trust or other fund (whether the applicant's interest is held solely, jointly, or in common, and whether it is vested or contingent) must be computed in a manner that is both fair and reasonable.

3.73 The 2006 Regulations were drafted with the intention of getting around the limitations of regulation 6.¹²⁰ Not only do they make it clear that the assessment may take account of an applicant's position as a discretionary beneficiary of a trust, but they go further in that they allow account to be taken of the trust if, for example, it seems likely that the applicant could be made a beneficiary of the trust in the future. It seems implicit in the regulations that the Agency will consider the degree of de facto control and enjoyment that the applicant has over the trust property.

¹²⁰ See *Headley v Legal Services Agency* (2009) 19 PRNZ 314 and *Nicholl v Legal Services Agency* HC Hamilton CIV 2008-404-6896, 15 June 2009 on regulation 8.

Summary

- 3.74 In summary, the manner in which section 74 of the Social Security Act 1964 is employed, and the express terms of the Legal Services Regulations 2006 are focussed on the settlor of the trust. As such, they do not accord with the traditional concept of the trust where the settlor, once the trust has been established and the property transferred, is generally considered to be out of the picture unless he or she is a beneficiary. As noted, they clearly take into account whether the settlor is still retaining some control over the trust or benefit from the trust, or may do so in the future. The Commission’s impression is that the provisions have been devised to take account of the impact of the trust structures that the agencies concerned are encountering.
- 3.75 Neither section 74 of the Social Security Act 1964 nor the Legal Services Regulations 2006 place time limits on dispositions to or the establishment of the trust being considered. The more prescriptive residential care subsidy provisions place strict time and monetary parameters around gifting to a trust. The former provisions therefore require the exercise of considerably more discretion around when the agency will look through the trust.

CONCLUSION

- 3.76 The Law Commission has detailed the legislative provisions that allow trust assets to continue to be treated as the settlor’s assets or to continue to be subject to the claims of third parties.
- 3.77 The provisions discussed above reflect a common policy objective that trusts ought not to be permitted to frustrate the fundamental policy objectives of particular legislation. In some instances, this is achieved by the use of “look through” provisions. In others, it is achieved by treating dispositions as having no effect for the purposes of the relevant legislation. In the Social Security Act 1964, the use of a general discretion may be contrasted with detailed rules designed to achieve essentially similar ends. While each provision reflects a tailored response to the use of trusts in specific legislative contexts, collectively the provisions reflect a deliberate legislative policy aimed at abrogating the use of trusts to shelter assets and income where public policy considerations of equity and fairness are involved.
- 3.78 In most of the cases described above the transfer of property to a trust is treated no differently to other dispositions. However, the Legal Services Agency regulations and section 44C of the Property (Relationships) Act 1976 single out trust use as a particular policy problem for those regimes. Some of the provisions are premised on a situation where the settlor of a trust retains a level of interest or enjoyment in, or control over, the trust so that its assets should be treated as his or her property. While the creditor protection and family law provisions are generally directed at achieving an equitable solution between identifiable parties, the social assistance provisions give tacit recognition to broader considerations of fairness around trust use. They acknowledge that unfair outcomes result where one person can benefit by the imposition of an apparent trust structure, but a person with no trust, yet no greater de facto enjoyment of their property, does not qualify for state help.

- 3.79 The Commission is interested in understanding how effective the existing measures are, and what the scale of the problem is in relation to attempts to use trusts to artificially minimise assets to access government benefits. Is it still appropriate to leave it to each policy area to determine how to address perceived unfairness in the use of trusts, or is a more coordinated approach warranted? Are these instruments being used to such an extent and for such purposes as to call into question whether they are trusts? Or is the problem with the use of trusts, not with the trust concept itself? We discuss and ask questions on these issues in chapter 5.
- 3.80 An indication that the current legislative response may not be entirely effective arises from the fact that lawyers and the courts are seeking other ways of disregarding trusts where they perceive that unfairness is going unchecked. We canvass these developments in the next chapter.

Chapter 4

Judicial responses to some uses of trusts

RECENT RESPONSES BY THE COURTS

- 4.1 The legislative provisions discussed in chapter 3 enable third parties and government agencies to look into and in some cases access assets transferred to trusts. Third parties have long sought other means to gain access to trust-held assets through the courts, usually by attacking the validity of the trust itself.
- 4.2 There has been considerable activity in this area in the New Zealand courts in recent years, in both the creditor protection and relationship property fields. This may be coincidental. However, the growing number of trusts has led to an increased number of claims and (particularly in the family law area) the courts' responses may reveal a growing concern about the impact that trusts are having. As Jessica Palmer puts it:¹²¹

The increasing popularity of such claims is not necessarily surprising given the fondness that New Zealanders appear to have had for trusts over the last 30 years, and their subsequent misuse.
- 4.3 The cases can be seen as taking different approaches to trusts. In the creditor protection field, the Supreme Court in *Regal Castings* (discussed in chapter 3) adopted a wide interpretation section 60 of the Property Law Act 1954 that might be seen as a pro-creditor approach. In contrast the Court of Appeal's decision in *Official Assignee v Wilson* to reject the argument that the trust was a sham might be seen as unfavourable to creditors wishing to challenge the validity of trust structures. That decision, however, has been the subject of some criticism.
- 4.4 In the family law area, recent cases have seen the courts go some way to disregard trust structures to achieve what they consider to be equitable solutions where the Property (Relationships) Act 1976 and Family Proceedings Act 1980 have not assisted.

121 J Palmer "Sham Trusts" in A Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 393 at 394.

- 4.5 Three main concepts have been used in New Zealand to challenge the validity of trusts. These are the two notions of sham trusts and alter ego trusts, both of which have long been recognised in some other jurisdictions. The third is a new concept, apparently created in the New Zealand courts, and referred to as the “bundle of rights doctrine”. All three involve an element of settlor control of trusts.

SHAMS

- 4.6 The concept of a “sham” transaction has long been accepted in the context of commercial contracts. In that context, the required elements of a sham transaction are well established.
- 4.7 First, in 1967, Diplock LJ (as he then was) gave what has been adopted as the classic definition of a sham. Ruling in *Snook v London & West Riding Investments Ltd*, a case involving a hire purchase agreement, he said that:¹²²

... it is, I think, necessary to consider what, if any, legal concept is involved in the use of this popular and pejorative word. I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the “sham” which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create.

- 4.8 Commentators and courts have generally adopted this statement as capturing the concept of a sham. A sham is said to arise where the transaction or document is a mask, cloak, or façade of the true position between the parties¹²³ and where there is a “transaction the true effect of which is not its represented effect”.¹²⁴
- 4.9 Secondly, and importantly, Diplock LJ went on to state:¹²⁵

One thing I think ... is clear in legal principle, morality and the authorities ... that for acts or documents to be a “sham”, ... all the parties thereto must have a *common intention* that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating.

- 4.10 Thus, it has been considered well-established that, insofar as the concept of a “sham” itself is valid, all the parties to the transaction must share in the intention to carry it out. Again, in what was initially a commercial context, Diplock LJ’s approach has been adopted in New Zealand and in many other jurisdictions.¹²⁶

122 *Snook v London & West Riding Investments Ltd* [1967] 1 All ER 518 at 528.

123 See, for example, *Paintin and Nottingham Ltd v Miller Gale and Winter* [1971] NZLR 164 at 168 and *Marac Finance Ltd v Virtue* [1981] 1 NZLR 586 at 587–588.

124 Jessica Palmer “Dealing with the Emerging Popularity of Sham trusts” [2007] NZ Law Rev 81 at 85.

125 *Snook v London & West Riding Investments Ltd* [1967] 1 All ER 518 at 528.

126 See *Bateman Television Ltd v Coleridge Finance Co Ltd* [1969] NZLR 794 at 821, *Paintin and Nottingham Ltd v Miller Gale and Winter* [1971] NZLR 164 at 168 and 175, *Marac Finance Ltd v Virtue* [1981] 1 NZLR 586 at 593 and *Official Assignee v Wilson* [2006] 2 NZLR 841 at [52]. See also *Re Securitibank Ltd (No 2)* [1978] 2 NZLR 136.

4.11 Other considerations are also relevant. The courts appear to be cautious in finding a sham. This reflects the need for certainty in property transactions. Contractual and other legal documents are construed on the objective meaning that the terms would convey to a reasonable person.¹²⁷ In general, neither the subsequent conduct of the parties nor their subjective intentions are relevant. However, as Conaglen explains, consideration of whether a sham exists requires the abandonment of the normal rules of interpretation of documents. The very notion of a sham requires departing from that approach:¹²⁸

the relevance of the sham doctrine is that it justifies the court in stepping outside of the normal construction process in order to ascertain “the truth of the matter” by reference to material which would normally be excluded as irrelevant to that process.

4.12 In examining whether an arrangement is a sham, it is inevitable that the parties’ subjective intentions must be considered. Shams will be established on objective evidence of a subjective sham intent on the balance of probabilities. The conduct of the parties is therefore relevant.¹²⁹ A wide range of factors will be relevant to determining whether a trust is a sham.

4.13 Furthermore, it is clear that there is no sham where the parties have merely chosen one form of transaction over another where either were equally available to the parties in the circumstances.¹³⁰

4.14 The sham concept has been applied to trusts in a number of jurisdictions, in both the family law and creditor protection fields. The object of a sham (or alter ego) claim is to attack the validity of the trust so that the assets will be considered the property of the settlor against whom a proprietary claim can then be made.¹³¹ The precise elements that render a trust a sham remain the subject of debate by some commentators. In relation to trusts, generally English,¹³² Australian,¹³³ Canadian¹³⁴ and New Zealand courts have transplanted Diplock LJ’s notion of a sham – requiring the common intention of the settlor and trustee(s) – into trusts law. A trust adjudged to be a sham is void from the outset, with the assets held by the trustees on resulting trust for the settlor.

4.15 The leading New Zealand case is the Court of Appeal’s decision in *Official Assignee v Wilson*.¹³⁵ In *Wilson*, the Official Assignee claimed that a trust settled before the settlor’s bankruptcy was a sham and that the trust property should be held by the trustees for the Assignee, who could then use it to satisfy creditors’ claims. The bankrupt settlor, R, was neither a beneficiary nor trustee of the

127 M Conaglen “Sham Trusts” (2008) 67 CLJ 176 at 181–182.

128 *Ibid*, at 182.

129 Palmer “Sham Trusts”, above n 122, at 403.

130 See *Bateman Television Ltd v Coleridge Finance Co Ltd* [1969] NZLR 794 at 813–814; *Marac Finance Ltd v Virtue* [1981] 1 NZLR 586 at 587.

131 Palmer “Sham Trusts”, above n 122, at 394.

132 See *Midland Bank plc v Wyatt* [1995] 1 FLR 696, *Shalson v Russo* [2005] Ch 281.

133 *Sharrment Pty Ltd v Official Trustee in Bankruptcy* (1988) 18 FCR 449.

134 *Minister of National Revenue v Cameron* [1974] SCR 1062 at 1068.

135 *Official Assignee v Wilson* [2008] 3 NZLR 45.

trust.¹³⁶ In the High Court, Chisholm J concluded that while the settlor appeared to have considerable influence over the trustees' actions and decisions, and there were deficiencies in the manner in which the trust was managed and administered, this was not enough to establish a sham. The Judge held that the Assignee had to establish a common intention on the part of R and the trustees that the acts and documents in which they were involved were not to create the legal rights and obligations which they gave the appearance of creating. The evidence was not enough to support such a conclusion.

- 4.16 The Assignee appealed to the Court of Appeal. The Court dismissed the appeal on the technical ground that the Assignee had no standing to make a claim of sham.¹³⁷ However, it considered the sham concept and in particular the question of whose intention was relevant. In their joint judgment, Robertson and O'Regan JJ held that it was necessary to consider first what type of trust was at issue. For a self-declaratory trust dependent on only the settlor's intention, it was only the settlor's intention that was relevant. For a trust created bilaterally between the settlor and a separate trustee it was necessary to consider a shared intention.¹³⁸ The Court of Appeal went on to conclude that it was unable to disturb the High Court's finding that, on the facts, there was not enough evidence to establish the requisite sham intention on the part of the settlor or trustees.¹³⁹
- 4.17 Other New Zealand cases that have expressly considered the requirements for a sham trust have also required the common intention of the settlor and trustee(s).¹⁴⁰ In a number of cases, however, where sham trusts have been found, the courts have entered into little or no discussion of the requirements of the concept.
- 4.18 The decision in *Wilson* has been criticised.¹⁴¹ The courts' application of the law to the particular facts of the case has been described as "surprising". The facts included the intermingling and confusion between the affairs of the trust and the settlor to such an extent that even the Court of Appeal agreed that the "activities of ... the trustees... invited challenge".¹⁴² The decision has placed a very high evidential bar for third parties wishing to assert that a trust is a sham.

136 Nor did he retain a power of appointment. See A Manuel "Exorcising the alter ego" *NZLawyer* (27 June 2008) at 13.

137 *Official Assignee v Wilson* [2008] 3 NZLR 45 at [23].

138 *Ibid*, at [40]–[41].

139 *Ibid*, at [95]. See also *Official Assignee v Wilson* [2006] 2 NZLR 841 (HC).

140 See, for example, *Begum v Ali* FC Auckland FP004/128/00, 10 December 2004 at [60] and *O v S* FC Dunedin FAM-2004-002-80, 12 December 2006 at [33].

141 See for example, Matthew Conaglen "Shams, Trusts and Mutual Intention" [2008] NZLJ 227; J Guest "Is the trust fortress strong enough? ... Or 'one door shuts and another door opens'" (paper presented to the New Zealand Law Society Trusts Conference, June 2009) at 98. See also Anthony Grant "New Zealand's sham Trusts – facing international criticism" *NZLawyer* (19 September 2009) referring to comments by Justice David Hayton at the 2009 Transcontinental Trusts Conference in Geneva, that on the facts in *Wilson* the Assignee should have been able to make the trust property available to the creditors.

142 *Official Assignee v Wilson* [2006] 2 NZLR 841 at [96]. See J Guest "Is the trust fortress strong enough? ... Or 'one door shuts and another door opens'" (paper presented to the New Zealand Law Society Trusts Conference, June 2009) at 98. Guest goes on to state at 101 that "[a] cynical summary of *Official Assignee v Wilson* is that you can get away with anything. It appears not to matter whether the "client" is running the trust even if not a trustee, or is benefiting from the trust even if not a beneficiary".

- 4.19 Secondly, there is on-going debate in New Zealand as to whether common intention should in fact be required to establish a sham trust. Jessica Palmer has argued that the wholesale transplantation from the English commercial contract cases of the common intention requirement to trusts law is flawed.¹⁴³ She contends that the sham allegation attacks the requisite intention needed to form a trust, so it is necessary to consider whose intention is required. In contrast to standard contracts, only the intention of the settlor is relevant to the creation of a valid trust: “[t]he trustee’s intention is not and has never been determinative of the formation of a legitimate trust ...”¹⁴⁴ Palmer argues:¹⁴⁵

...the idea of sham is meaningless apart from the context within which it arises. “Sham” is no more than a descriptive label attaching to a transaction which appears to be something that it is not. Yet, it is only possible to determine whether a transaction is truly something other than it appears to be by considering what is required to be fulfilled in order for the transaction to be legitimately what it appears to be ... With respect ... it makes no sense to differentiate between unilateral and bilateral trusts when the law of trusts recognises no such distinction in the principles relating to the formation of trusts ... Whether a trust is said to be unilateral or bilateral, the law of trusts requires that the relevant intention is that of the settlor alone.

- 4.20 Palmer’s argument has some support elsewhere. For example, Matthews has noted that Jersey trust cases that have adopted the common intention approach are based on the English commercial contract cases and also that rectification of a trust requires only the intention of the settlor.¹⁴⁶ However, internationally the existing weight of judicial authority is clearly against the Palmer view.¹⁴⁷ Other legal commentators have also challenged the argument.¹⁴⁸ In particular, Conaglen argues that most trusts are bilateral arrangements. He states that:¹⁴⁹

The court needs a sound justification for ignoring the ordinary limits on the evidentiary material to which it may have regard when determining the existence and meaning of a transaction.

- 4.21 While Palmer focuses on the point that only the settlor’s intention is required to establish a trust and that therefore only the settlor’s intention should be relevant, Conaglen argues:¹⁵⁰

143 See J Palmer “Dealing with the Emerging Popularity of Sham Trusts” [2007] NZLR 81; J Palmer “What makes a trust a sham?” (2008) NZLJ 319; and Palmer “Sham Trusts”, above n 122.

144 Palmer “What makes a trust a sham?”, above n 144, at 319.

145 Ibid, at 320.

146 P Matthews “The sham trust argument and how to avoid it” [2007] 21 Trust Law International at 191, 195 and 198.

147 See for example *Shalson v Russo* [2005] Ch 281, *Re Esteem Settlement* [2003] JLR 188, [2004] WTLR 1, *MacKinnon v Regent Trust Co Ltd* [2005] JCA 198.

148 See Conaglen “Sham Trusts”, above n 128 and Conaglen “Shams, Trusts and Mutual Intention”, above n 142. See also W M Patterson “When is a trust a trust?” (paper presented at the Legal Research Foundation Seminar “A Modern Law of Trusts”, Auckland, 28 August 2009).

149 Conaglen “Sham Trusts”, above n 128, at 189. Both Conaglen and Patterson place emphasis on Langbein’s contractarian basis of trusts: J H Langbein “The Contractarian Basis of the Law of Trusts (1995) 105 Yale LJ 625.

150 Conaglen “Sham Trusts”, above n 128, at 190.

On its own, this is true. However ... this principle is not the focus of the sham doctrine and it does not justify the court ignoring a trust where the settlor's intention, objectively determined, was to create a trust and the trustee agreed to act on the basis of such a trust simply because the settlor subjectively and entirely secretly did not in fact intend to create it ... a court is not at liberty to ignore the existence of that objectively determined intention, and instead privilege the settlor's unilateral subjective intention, unless it has a justification for doing so.

- 4.22 For Conaglen, the focus of the sham doctrine is on the transaction itself. Conaglen makes reference to English dicta that may suggest a relaxation of the intention requirement on the part of the trustee(s). In *Midland Bank v Wyatt*, the Court said:¹⁵¹

I consider a sham transaction will still remain a sham transaction even if one of the parties to it merely went along with the "shammer" not either knowing or caring about what he or she was signing ... I do not accept therefore the defendant's contention that it is a necessary requirement for the plaintiff to establish that both Mr Wyatt and Mrs Wyatt had a common intention ...

- 4.23 Conaglen concludes that it seems preferable for the sham doctrine to apply where one party has an intention to mislead and the other simply goes along with that without caring what is happening. Quoting the Jersey Royal Court:¹⁵²

... the court in *Wyatt* was simply confirming that a party who goes along with a sham neither knowing or caring what he is signing (i.e. who is reckless) is to be taken as having the necessary intention.

- 4.24 For the purposes of this review, what is clear is that some commentators disagree with the application of the sham doctrine in New Zealand. *Wilson* has placed the bar high by applying the common intention test in its strictest terms, and by placing a high evidential threshold in terms of the degree of behaviour required of the parties to establish that a sham was indeed intended and is being carried out. Some commentators disagree with this approach, and as Palmer has said:¹⁵³

Given their significance to trusts both in family property and in commerce, it is important that the concepts of sham and alter ego are well understood both theoretically and in their application.

- 4.25 In view of the apparent controversy surrounding the necessary elements to constitute a sham, the Law Commission is interested in views on whether the law on sham trusts needs to be made clear. We return to this in chapter 5.

151 *Midland Bank plc v Wyatt* [1995] 1 FLR 696 at 699–700.

152 *Grupo Torras SA v Al-Sabah* [2003] JRC 092, [2004] 1 WTLR 1 at [58]. See Conaglen "Sham Trusts", above n 128, at 191.

153 Palmer "Dealing with the Emerging Popularity of Sham Trusts", above n 144, at 83.

"ALTER EGO TRUSTS"

- 4.26 An alter ego trust has been said to be "[a] kind of trust which is less than a sham, but is not watertight".¹⁵⁴ The alter ego concept involves viewing the trust as the alter ego of an external controller (usually the settlor). In *Wilson*, Robertson J described the "alter ego" concept as follows:¹⁵⁵

There are some cases and legal writing which suggest that an alter ego trust occurs where a person is held to have control over an express trust to such an extent that the trustees are considered to be "mere puppets" of the defendant. ... These are instances of where a valid trust has been established but the trustee's discretion has been subsumed by the controller to such a degree that in reality decisions made about the operation of the trust are made by the controller. It is argued that the relinquishment of control by the trustee to the controller allows the court to find that the trust structure is a façade that can be disregarded. The level of control over trust property by someone other than an appointed trustee is said to justify the court piercing the express trust and thereby making what would otherwise be trust property available to third-party claimants.

- 4.27 For a time, applicants to New Zealand courts were successful in using the concept of the alter ego trust for the purposes of challenging the validity of trusts. Before the *Wilson* decision, two High Court cases¹⁵⁶ had relied on the alter ego trust concept to disregard trusts to ensure that relationship property claims were not unfairly defeated. A number of Family Court decisions have since relied on the concept.¹⁵⁷ Each of the cases had arisen in the context of de facto or marital relationships. The two High Court cases, *Prime v Hardie*¹⁵⁸ and *Glass v Hughey*,¹⁵⁹ fell outside the scope of the Property (Relationships) Act 1976 decisions and so relied on constructive trust principles.¹⁶⁰ Salmon J's conclusion in *Prime v Hardie*¹⁶¹ was that the trust involved was the defendant's alter ego because of his position as the principal (although not only) beneficiary and because of the extent to which he had funded, dealt with and exercised control over the trust property. In finding that the trust was the defendant's alter ego in *Glass v Hughey*,¹⁶² Priestley J also referred to the degree of control that the defendant exercised over the trust. It has to be acknowledged that in neither case did the judges explain the rationale or scope of the alter ego concept. A number of factors have been relied upon to uphold an allegation of alter ego. Palmer has identified the following examples, but notes that none has been considered singularly determinative of an alter ego. What is relevant is their cumulative effect:¹⁶³

154 T Gibbons "Alter ego trusts" (2007) NZLJ 316.

155 *Official Assignee v Wilson* [2006] 2 NZLR 841 at [64].

156 *Prime v Hardie* [2003] NZFLR 481 and *Glass v Hughey* [2003] NZFLR 865.

157 See, for example, *Begum v Ali* FC Auckland, FAM 2001-004-866, 10 December 2004 and *O v S* (2006) 26 FRNZ 459.

158 *Prime v Hardie* [2003] NZFLR 481 at [30].

159 *Glass v Hughey* [2003] NZFLR 865 at [88].

160 As set out in *Lankow v Rose* [1995] 1 NZLR 277.

161 *Prime v Hardie* [2003] NZFLR 481 at [30].

162 *Glass v Hughey* [2003] NZFLR 865 at [88].

163 Palmer "Sham Trusts", above n 122, at 410–411, citing *O v S* FC Dunedin FAM-2004-002-80, 12 December 2006 at [50]–[64], *Prime v Hardie* [2003] NZFLR 481 at [30] and *Glass v Hughey* [2003] NZFLR 865 at [91] and [92].

- Lack of trustees' meetings, minute books or resolutions;
 - Intermingling of bank accounts;
 - Absence of acknowledgements of debts and advances between the trust and controlling party;
 - Effective rubber-stamping by the trustee of directions by the controlling party;
 - A controlling party's borrowing of funds to enable the trust to purchase assets;
 - Payment of trust expenses by the controlling party;
 - The controlling party receiving direct financial benefits from the trust's assets;
 - The controlling party claiming the income and/or expenses of the trust on his own personal income tax return;
 - The controlling party being the sole or principal beneficiary or trustees expressly agreeing to transfer trust property to the controlling party absolutely at some later date;
 - Any admission by the settlor that he intends to retain control over trust assets.
- 4.28 However, in the High Court's judgment in *Wilson*, Chisholm J did not apply the alter ego concept as he distinguished both *Prime* and *Glass* because they involved family property claims based on a constructive trust. He noted that in *Prime*, sham was not pleaded, and in *Glass*, the alter ego aspect represented an alternative route to the result Priestley J had already reached, with the comments, therefore, probably being obiter.¹⁶⁴ In their joint judgment in *Wilson*, Robertson and O'Regan JJ then rejected the alter ego concept as a means of "busting" trusts, concluding that:¹⁶⁵

[t]he assumption of factual control by someone other than a trustee ... or by someone without legal right to exercise such power cannot of itself invalidate a trust ... Actual control alone ... cannot be sufficient to extinguish the rights of the beneficiaries...

- 4.29 In the same case, Glazebrook J would have left open the question of whether an alter ego trust which did not amount to a sham can be treated as the property of the individual involved for the purposes, for example, of a relationship property division.¹⁶⁶
- 4.30 In *F v W*,¹⁶⁷ the High Court relied on the *Wilson* approach to shams in finding that although the trust was an alter ego this was not sufficient to find that it was a sham or for the trust to be disregarded. Gendall J stated that although the trust in the case was clearly the alter ego of the husband ("he settled it, was a trustee with his solicitor, a discretionary beneficiary and obviously controlled the trust"¹⁶⁸), if a trust was intended to be genuine and there was no intention to deceive, it could not be declared a sham.

164 *Official Assignee v Wilson* [2006] 2 NZLR 841 (HC) at [59].

165 *Ibid*, at [69]–[70].

166 *Ibid*, at [128].

167 *F v W* HC Wellington CIV-2009-485-531, 3 August 2009 at [37]–[38]. On appeal from a decision of Judge Grace in the Family Court: see *W v F* FC Lower Hutt FAM-2005-032-877, 24 February 2009.

168 *F v W* HC Wellington CIV-2009-485-531, 3 August 2009 at [37].

- 4.31 Manuel has suggested that in ruling out the concept of alter ego trusts, de facto partners or spouses will effectively be limited to the Property (Relationships) Act 1976 and Family Proceedings Act 1980 provisions in the future, since their potential equitable remedies have been narrowed.¹⁶⁹
- 4.32 There is an alternative view stemming from the understanding of “alter ego” in company law¹⁷⁰ that because trusts are merely groups of rights and obligations attaching to certain property, rather than a legal entity, it is not possible for a trust to be the “alter ego” of a person.

THE “BUNDLE OF RIGHTS” DOCTRINE

- 4.33 Recently, in what might be seen as apparent frustration at the limits on the ability of the Property (Relationships) Act 1976 provisions to deal with discretionary trusts, courts have developed a new concept termed the “bundle of rights”. Briefly, the conventional view has been that whereas vested or contingent interests under a trust meet the definition of “relationship property” under the Property (Relationships) Act 1976, a spouse or partner’s position as a discretionary beneficiary of a trust does not.¹⁷¹ Generally, courts have held that a discretionary beneficiary has no proprietary interest in the trusts assets – all they have is a “spes” – a mere expectation that they may take some benefit under the trust.¹⁷² Where property that would otherwise have been relationship property is owned by a discretionary trust, courts have sometimes been unable to achieve what they consider to be a fair division of the property between the separating couple.
- 4.34 *Keats v Keats*¹⁷³ provides an example. There, the separating husband and wife had settled a family trust, which owned the family home. The husband and wife were, along with various family members, discretionary beneficiaries. Judge Grace held that “conventional discretionary interests” did not create a right or interest in the trust property. The result was that the court felt unable to make an occupation order under the Property (Relationships) Act 1976 in respect of either the husband or wife – a result that was likely to be unsatisfactory to both.
- 4.35 The concept of the “bundle of rights” appears to have been adopted against the background of frustration with discretionary trust structures. At the time of writing, three cases – two in the Court of Appeal and one in the Family Court – have mentioned the concept in relation to trusts.¹⁷⁴ It had previously received some approval from the Court of Appeal in the context of the rights and interests a husband in a matrimonial property dispute had under a partnership agreement (rather than a trust).¹⁷⁵ No coherent basis for the bundle of rights has been articulated to date, so it is difficult to predict what course the courts will take

169 Manuel, above n 137, at 13.

170 See Peter Watts “The Company’s Alter Ego” in A Borrowdale, D Rowe and L Taylor (eds) *Company Law Writings: A New Zealand Collection* (Centre for Commercial and Corporate Law, Christchurch, 2002) 79.

171 Section 2 of the Property (Relationships) Act 1976 states: “property includes—(a) real property: (b) personal property: (c) any estate or interest in any real property or personal property: (d) any debt or any thing in action: (e) any other right or interest.”

172 See for example, *Hunt v Muollo* [2003] 2 NZLR 322 at [11]; *Johns v Johns* [2004] 3 NZLR 202. See Law Commission *Review of Trust Law in New Zealand: Introductory Issues Paper* (NZLC IP 19, 2010) at chapter 3.

173 *Keats v Keats* FC WN FAM-2004-091-900, 20 December 2005.

174 Although in essence the origins of the concept were argued in *B v M* [2005] NZFLR 730, without success.

175 See *Z v Z (No 2)* [1997] 2 NZLR 258.

in the future. The Commission raises it here because of what it says about the courts' concerns about the manner in which trusts are being used to defeat relationship property policy, and because of the potential future implications for trusts law.

4.36 In *Walker v Walker*¹⁷⁶ Chambers J, on behalf of the Court of Appeal, suggested that a party's interests in a trust "as settlor, trustee, appointor or beneficiary" may be relationship property. He also stated that "the wife seems to have conceded that certain other assets, *which were relationship property* ... were to become the husband's property." Chambers J listed those assets as:

- The directorship of the trustee company;
- The shares of the trustee company;
- The power to appoint and remove directors of the trustee company;
- The power to appoint and remove trustees of the trust;
- The parties' discretionary interests under the trust.

4.37 The question for determination in *Walker* was the value to be assigned to a debt owed to the husband by the family trust. The list set out above was mentioned when the court was discussing the husband and wife's respective assets, with a view to assigning values to those assets and dividing up the total pool. In full, Chambers J said:¹⁷⁷

We agree the fact that the debt is a private debt can lead to complications in valuation. For instance, if a debt owed by a family trust cannot be paid or can be paid only in part, the devaluation of the debt may be compensated for, at least in part, by an increase in value of one party's or both parties' interests in the trust – whether his, her or their interests as settlor, trustee, appointor or beneficiary, which interests may be relationship property.

4.38 Later, in relation to the list above, he said:¹⁷⁸

Indeed, those items of property appear never to have been valued. Those five items of property, plus the debt, formed a very valuable package, as together they confer control of the company ... clearly all six items of property forming the package should have been valued on an assumption that they were for sale together.

4.39 The judgment does not make it clear whether:

- (a) Each of the items in the list above can amount to "property" for the purposes of the Property (Relationships) Act 1976; or
- (b) It is the combined "package" that can amount to "property" for the purposes of the Property (Relationships) Act 1976; or
- (c) It is the "control" that the accumulation of the assets gives that is the relevant factor.

4.40 On one view, Chambers J may have had (a) in mind. However, it is arguable that in the two subsequent cases described below, the rationale for the bundle of rights may have been (b) or (c).

¹⁷⁶ *Walker v Walker* [2007] NZFLR 772 at [38] and [48].

¹⁷⁷ *Ibid*, at [38].

¹⁷⁸ *Ibid*, at [49] and [60].

4.41 The term “bundle of rights” was born in a subsequent judgment of Robertson J on behalf of the Court of Appeal in *Harrison v Harrison*.¹⁷⁹ *Harrison* involved husband and wife settlors of a trust (the CHFT). They jointly held the power to appoint and remove trustees. The trustee was CHTC Ltd, of which the shareholders were the husband and wife and the husband’s solicitor. The primary beneficiaries of the CHFT were the husband, wife and children. The family home was sold to the CHFT with a debt back to the husband and wife, and the husband had sold shares to the trust, with a debt back to him. In response to these facts, Robertson J said:¹⁸⁰

The position therefore was that, in law, the assets owned by Mr and Mrs Harrison which may be relationship property were the two debts owing back to them by CHFT, household furniture and effects, and the shares they each held in CHTC. There was also a *bundle of rights* associated with their positions as discretionary beneficiaries under the CHFT, and as the joint holders of the power of appointment of the CHFT trustees. Importantly, however, Mr and Mrs Harrison owned neither the family home nor any (but one) of the [shares].

4.42 The “bundle of rights” had no impact on the outcome of the case. The court found that it was at least arguable that it was bound to observe the constraints of the existing trust structure. It was better that the parties used their positions as trustees to make suitable property arrangements under the trust structure rather than to pursue litigation.¹⁸¹

4.43 The case therefore gives no more real insight into the import of the “bundle of rights”, but the emphasis on the parties’ positions as discretionary beneficiaries, accompanied by other powers they held over the trust, appears to have been relevant.

4.44 The third case is *R v R*,¹⁸² a decision of the Family Court which involved an application for an occupation order under section 27 of the Property (Relationships) Act 1976. Judge Burns noted that:

... there has to be a property interest in the dwelling house owned by one or both parties to provide jurisdiction to the Court to make an order. ... *If there is not a legitimate property interest in the dwelling house owned by both parties, or one of them, the Court cannot make an occupation order under section 27 ...*

4.45 The husband and wife in *R v R* established mirror trusts. They were both trustees of each trust. One was a discretionary beneficiary under one of the trusts, and the other a discretionary beneficiary under the other. The two trusts co-owned various properties including the family home and a beach house. The assets were managed together, pursuant to a formal partnership agreement.

179 *Harrison v Harrison* [2009] NZFLR 687 at [10].

180 *Ibid.*

181 The two debts being, virtually, the only relationship property available for distribution between them.

182 *R v R* HC AK FAM-2009-004-1627, FAM-2009-004-1628, 19 November 2009 at [43], emphasis added.

4.46 The husband and wife separated. The husband was living in the family home and the wife and two children (one of whom was disabled) lived with her mother in a two bedroom house. As Grant says, this was “an unsatisfactory arrangement that was likely to motivate a Judge to find a more ‘equitable’ solution”.¹⁸³

4.47 Hinting at what was to come, Judge Burns said:

The situation for Trusts particularly in the context of a marriage or de facto relationship do not remain static after a Trust Deed is signed. Often the parties continue to behave not only as husband and wife but as trustees, and with conduct and with change of events that occur during the course of a marriage further rights and obligations can arise which can amount to property. The question is what type of interests can give rise to the Court having jurisdiction.

4.48 The judge went on to survey the law relating to discretionary and other interests under trusts.¹⁸⁴ The judge did not go into any detailed consideration of the individual aspects identified in *Walker or Harrison* as forming part of a bundle of rights. He drew the conclusion that:¹⁸⁵

Accordingly, based on the case law there is a spectrum of interests within different trusts. Those interests have been defined as variously rights, powers and property. At one end of the continuum is a mere expectancy which does not provide a property interest. At the other end of the range are a bundle of rights which can be properly identified as relationship property.

4.49 On the facts of the case, he went on to identify a number of aspects as forming a “bundle of rights”. Although the wife was only a discretionary beneficiary under one of the mirror trusts, he concluded that the bundle of rights provided the wife with enough of an interest in the property on which he could found an occupation order.¹⁸⁶ The aspects he identified were:

- (a) A resolution passed by the trustees providing for the parties to have the right to occupy the property;
- (b) A distribution by the trustees to the parties thus converting the discretionary interest at the time of distribution to a property interest;
- (c) The formation of a partnership between the two trusts and payments made through that partnership;
- (d) The effective control held by each party in their respective trusts by virtue of the power of appointment each holds;
- (e) The fact that each was a beneficiary of each other’s trusts along with the children in each case;
- (f) The decision made by the trustees following the first separation to allow the wife to continue in exclusive occupation with the children thus providing her with a right to occupy;

183 A Grant “The bundle of rights turns trust to dust” *NZLawyer* (5 February 2010).

184 Quoting, for example, Lord Wilberforce in *Leedale (Inspector of Taxes) v Lewis* [1982] 3 All ER 808 at 816: “The word ‘interest’ is one of uncertain meaning and it remains to be decided on the terms of the applicable statute which, or possibly what other, meaning the word may bear.” The judge also surveyed the New Zealand case law on discretionary interests: see *Hunt v Muollo* [2003] 2 NZLR 322 at [11]; *Nation v Nation* [2005] 3 NZLR 46 at [74]–[76], *Q v Q* (2005) 24 FRNZ 232; *Keats v Keats* FC WN FAM-2004-091-900, 20 December 2005.

185 *R v R* HC AK FAM-2009-004-1627, FAM-2009-004-1628, 19 November 2009 at [60].

186 *Ibid*, at [61].

- (g) The ownership structure set out in the flowchart for the R Family Trust partnership which clearly passed decision making from the two respective mirror trusts to the partnership where the husband and wife have exercised decision making not only in their capacity as trustees, but in the capacity as husband and wife in relation to the various interests including a company and other commercial entities.
- 4.50 Again, there is no detailed discussion in the case of how or why each of these elements fits into the “bundle of rights”. Nor is there clear discussion of the basis on which the bundle of rights gives a “property interest” for the purpose of the Property (Relationships) Act 1976. The case demonstrates an effort to push the boundaries of trust principles in order to try to do justice in the particular circumstances. However, the suggestion that these interests or rights can, individually, or taken as a whole, amount to property interests has been described as an “alarming development”.¹⁸⁷
- 4.51 In the view of some commentators the “bundle of rights” doctrine was unnecessary as the definition of “property” in the Property (Relationships) Act 1976 is wide enough to encompass the different interests and discretionary rights relevant in those cases.¹⁸⁸ Section 2 of the Act defines “property” as including:
- (a) real property:
 - (b) personal property:
 - (c) any estate or interest in any real property or personal property:
 - (d) any debt or any thing in action:
 - (e) any other right or interest
- 4.52 It does not appear, however, that this argument has been tested.
- 4.53 The Commission agrees that the concept of the bundle of rights raises considerable questions about the future judicial treatment of what tend to be very common trust structures in New Zealand. Such a fundamental shift in the legal treatment of powers and interests related to such trust structures, and in the approach to settlor “control” of trusts, demands considerably greater consideration and debate than has taken place thus far.

IMPLICATIONS OF RECENT CASE LAW

- 4.54 While criticism of the result in *Official Assignee v Wilson* suggests that issues remain in relation to general creditor protection, most of the judicial efforts to disregard trusts, by employment of the sham or other concepts, have occurred in the relationship property field. There are several possible explanations.
- 4.55 First, it may merely suggest frustration with the limitations of the Property (Relationships) Act 1976 provisions to deliver fair outcomes with the division of property on relationship breakdown where a trust is involved. In that case, it may be that any solution, if one is required, ought to be sought by a targeted review of the Property (Relationships) Act 1976 itself.

¹⁸⁷ See Grant, above n 184.

¹⁸⁸ *Brookers Family Law – Family Property* (online looseleaf ed, Brookers) at [10.01].

- 4.56 Secondly, in consultation meetings some practitioners have questioned whether it is appropriate for Family Court judges to deal with trust cases,¹⁸⁹ suggesting that since the sham and alter ego doctrines have been limited or effectively shut down by the Court of Appeal, it may be that some members of the Family Court have been operating under a misunderstanding of trust principles when deciding the earlier cases. However, it is noted that a number of the decisions applying the sham, alter ego and bundle of rights concepts have been given at the High Court and Court of Appeal level.
- 4.57 Thirdly, it is likely that the majority of cases involving modern day trust structures that come before the courts and are in the relationship property field, and as a result, it is in this area that the courts must most frequently resolve trust issues.

189 See generally on the question of court jurisdiction and trusts A Molloy QC “Cuckoos in the nest in an otherwise promising jurisdiction” *Offshore Investment* (November 2009).

Chapter 5

Options for reform

- 5.1 The review of the law of trusts provides an opportunity to consider afresh fundamental questions about trusts and their use in New Zealand. In this Issues Paper the Law Commission has sought to describe:
- The number of trusts in New Zealand and the motivations for establishing them;
 - Legislative response to uses of trusts that undermine fundamental legislative policies; and
 - Instances where the courts have found ways to void a trust or disregard the transfer of property to a trust in order to achieve justice for creditors, spouses and others.
- 5.2 This chapter looks at whether new approaches are needed in relation to the problems that arise from trust use.

POTENTIAL CONCERNS ABOUT THE USE OF TRUSTS

- 5.3 This paper has alluded to two related areas of potential concern in the manner in which trusts may be being used. First, the Commission has been alerted to developments in the “trusts industry”, concerning the quality of many of the trusts that are in existence. There is some concern that some of these trusts would not withstand close scrutiny concerning both the quality of trust deeds and the way they are administered should a dispute arise. As noted, at this stage of the review, however, our understanding of these potential issues is largely built on anecdote. The Commission hopes to use responses to this Issues Paper to build on its understanding of the use of trusts in New Zealand. The Commission is not directly concerned in this current paper with ways to address this issue, but will return to it in a later Issues Paper.
- 5.4 Our principal concerns here are the more fundamental issues of how the law should address the need to “look through” trusts to access assets for certain purposes and when trusts should be found to be invalid.

- 5.5 Trusts have changed considerably from the traditional estate planning structure. Their inherent flexibility has enabled them to be used in such a way that the difference between trust and concepts such as agency can sometimes be difficult to distinguish.¹⁹⁰ In some cases a settlor seems to be acting as a principal would in an agency. Settlers appear able to retain enjoyment of and control over assets they have transferred to a trust (for instance, by being trustees for the trust), while being able to access the benefits offered by a trust that people without a trust cannot access. For example, they do not own the trust assets but they still enjoy them and possibly derive tax benefits or social assistance benefits. Although legislative provisions already provide some remedies to third parties in certain circumstances, and some protection to the public purse against unmerited access to government benefits, the Commission's impression from consultation is that there is a concern among some commentators and administrators that legislative responses are not always adequate when the consequences of the use of trusts defeat social policy.
- 5.6 Ultimately, the question to be considered is whether there is a threat to the integrity of the trust device itself. Highlighting the broad range of powers of control that settlors can, under legislation, exercise over trusts in tax havens such as the Cayman Islands and Bahamas, Waters describes the trust in those jurisdictions as a "settlor-responsive property management device" where there has been a lessening of the fiduciary obligation of the trustee to the beneficiary.¹⁹¹
- 5.7 Whether a solution is required, and how it should be achieved, will depend on the scale of the problem. If the problem lies with the developments in the nature of the trust itself, it may be that a solution should be found in a new Trustee or Trusts Act.¹⁹² Depending on the response to this Issues Paper, the Commission will return to these questions in detail in a subsequent Issues Paper. Here though, we make some initial observations and ask some broad questions.

EFFECTS OF THE PROPOSED REPEAL OF GIFT DUTY

- 5.8 It is possible that the repeal of gift duty may exacerbate some of the problems associated with trust use and may reduce the effectiveness of the existing legislative approaches to trusts. While gift duty was never intended as a mechanism to regulate trusts and should not be retained for this purpose alone, it has had important practical consequences that simplified the operation of the legislative schemes for looking through trusts. Gift duty created de facto record keeping requirements while a trust was still subject to a gifting programme. In insolvency cases, the Ministry of Economic Development finds these records useful for ascertaining the history of a trust, as does the Ministry of Social Development in benefit and subsidy applications. Whether new record keeping requirements are needed as a part of trust law will be considered in a later Issues Paper.

190 The distinction between a trust and an agency is discussed in Law Commission *Review of Trust Law in New Zealand: Introductory Issues Paper* (NZLC IP 19, 2010) at 25.

191 D Waters "Settlor control – what kind of problem is it?" (2009) 15 *Trusts and Trustees* 12 at 13–14.

192 See Law Commission *Review of Trust Law in New Zealand*, above n 191.

- 5.9 In insolvency situations, the unforgiven portion of a debt under a gifting programme can be demanded in order to satisfy creditor claims against the settlor.¹⁹³ Without gift duty (and therefore, without a gifting programme) none of the value of the property transferred to the trust will be immediately available to be “clawed back” for a creditor. Whether this is significant is debatable.¹⁹⁴ It is likely that the repeal of gift duty could mean that the Official Assignee needs to use the disposition provisions under the Property Law Act 2007 to meet creditor liabilities. The Property Law Act provisions do not have a time limit,¹⁹⁵ unlike the Insolvency Act 2006 provisions which have the two and five year time limits,¹⁹⁶ and without gift duty dispositions to trusts will be able to be completed at an earlier stage.
- 5.10 The Ministry of Social Development expects that the repeal of gift duty could have some limited impact on its ability to effectively target social assistance as the potential increase in the amount of gifting of assets to trusts could put more people under income and asset thresholds for assistance.¹⁹⁷ The Social Security (Long-term Residential Care) Regulations 2005 provide the flexibility for the Ministry of Social Development to look at any deprivation of assets regardless of whether gifting is complete.¹⁹⁸ However, the repeal of gift duty will allow people to transfer all their assets into a trust instantly, meaning that a greater number of people would have completely gifted away their assets prior to the five years leading up to their Residential Care Subsidy application.¹⁹⁹ The Ministry of Social Development plans to amend the information requested at the time of the initial subsidy application to better capture gifting that took place prior to the five-year look-back period and undertake more land title searches to determine whether property has been gifted by an applicant.²⁰⁰
- 5.11 There is some concern about the impact of the repeal of gift duty on relationship property issues. Without gift duty it is easier for property to be transferred out of the pool of property available for division upon separation. Commentators Deborah Hollings QC and Suzanne Robertson advocate the amendment of the Property (Relationships) Act 1976 in order to prevent the repeal of gift duty from undermining the principle of equal division and to require that individuals are made aware of the impact of the repeal of gift duty.²⁰¹ The Ministry of Justice will monitor the impact of the change, but considers that adequate protection

193 Inland Revenue *Regulatory Impact Statement: Gift Duty Repeal* (October 2010) at 11.

194 *Ibid.* Inland Revenue notes that the debt asset is perceived as being of value to creditors because of the Official Assignee’s ability to demand its repayment on behalf of the bankrupt. However, Inland Revenue’s records show that of 430,000 persons or entities filing gift statements between 1 July 2001 and 28 May 2010, less than 0.003 % have gone into bankruptcy.

195 See para [3.10] above.

196 See para [3.15] above.

197 Inland Revenue *Regulatory Impact Statement*, above n 194, at 14.

198 See paras [3.62]–[3.65] above.

199 Inland Revenue *Regulatory Impact Statement*, above n 194, at 14–15.

200 *Ibid.*, at 15.

201 Deborah Hollings and Suzanne Robertson “Gift duty repeal will affect divorce” *New Zealand Herald* (New Zealand, 12 November 2010) at 11.

already exists under the Property (Relationships) Act 1976 and the Family Proceedings Act 1980 to prevent or remedy the disposal of property where this is intended to defeat the interests of another party.²⁰²

- 5.12 While it is not the role of this review to address the consequences of the removal of gift duty on other individual statutory regimes, the Commission is interested in views on whether changes to trust law are needed to address any adverse impacts of the removal of gift duty, such as reporting requirements or registration of trusts. Any legislative changes that result from the Law Commission's review of trust law will occur well after the proposed date from which gift duty will be removed, 1 October 2011. If it is found that changes to legislation, such as the Insolvency Act 2006 or Property (Relationships) Act 1976, are necessary, they will need to be pursued by the agencies responsible for the legislation.

OPTIONS

- 5.13 This paper proposes several reform options for consideration and comment. These concentrate on two questions:
- How should legislation address the need to look through trusts in certain circumstances in order that trust property can be made available to a creditor, spouse or partner or for government asset testing?
 - Whether and how legislation should address sham trusts and the problem of trusts that are not really trusts?

Options for look-through provisions

- 5.14 Chapter 3 detailed the operation of different statutory provisions that allow trust assets to be made available to creditors, spouses and partners, and to be considered as a part of the assets of the settlor or a person with control over the trust for assessing eligibility for government assistance.
- 5.15 Each of the statutory regimes takes a different approach to trusts. Under the Property Law Act 2007 it is dispositions of property that “prejudice” a creditor that may be set aside, with a statutory test for determining when a disposition of property prejudices a creditor.²⁰³ Under the Property (Relationships) Act 1976 dispositions may be set aside if they were made “in order to defeat the claim or rights of any person”.²⁰⁴ The Income Tax Act 2007 allows a taxpayers' taxable income to be adjusted if a tax avoidance arrangement exists,²⁰⁵ while there is a wide discretion under the Social Security Act 1964 for a benefit to be refused if an applicant has deprived himself or herself of any income or property.²⁰⁶ The Social Security (Long-term Residential Care) Regulations 2005 are more prescriptive as to when a deprivation of income or property occurs. Similarly, the Legal Services Regulations 2006 provide a comprehensive list of factors that must be considered in assessing whether trust property or income is to be regarded as the applicant's property or income. Other legislation also addresses how trust property or income affects a person's obligations or entitlements in specific contexts.

202 Inland Revenue *Regulatory Impact Statement*, above n 194, at 17. See paras [3.23], [3.27]–[3.28] and [3.32]–[3.33] above.

203 Property Law Act 2007, ss 344–350.

204 Property (Relationships) Act 1976, s 44.

205 Income Tax Act 2007, ss BG1(2) and GB1(1).

206 Social Security Act 1964, s 132I.

- 5.16 This approach of having different policies for how trusts are dealt with in different contexts creates some issues. Some legislation is more effective than other legislation. In consultation both the Ministry of Economic Development and the Ministry of Social Development expressed concern at the ineffectiveness of current legislation in addressing the potential unfairness that results from the use of trusts in the creditor protection and residential care subsidy contexts. The Ministry of Economic development has found that creditors are unwilling to fund the recovery of assets by the Official Assignee where there is a trust involved because of the expense of doing so and the uncertainty as to the outcome. It estimates that the costs of recovery of a debt using the insolvent transaction provisions costs at minimum \$20,000 per transaction.²⁰⁷
- 5.17 The inconsistency in how trust property and income is treated across different legislation provisions means that some trusts are set up in a way to meet the requirements of one provision but not of another. Having different rules for different purposes is potentially confusing. Can the law be clarified and made more accessible in this area?

Look-through provisions in the Trustee Act 1956

- 5.18 One option is for a provision that sets out factors that would be considered in assessing whether a disposition of property to a trust can be disregarded in assessing a person's obligations to another person or the Government, or in assessing eligibility for government assistance. It could be similar to the factors in regulation 8 of the Legal Services Regulations 2006.
- 5.19 This option has the advantage of creating consistency in how trusts are regarded in different policy areas. In turn, this would provide greater clarity for trust advisors and participants in trusts about the effect of trusts. It would potentially lead to greater fairness in that the effect of a trust would be the same in all contexts.
- 5.20 However, such a provision could cause problems. It is arguable that different contexts need different approaches. Additionally, defining a generally applicable test may mean that it is easier for trust lawyers to draft trusts that sidestep the requirements.

207 Paper prepared by Ministry of Economic Development for the Law Commission regarding issues to consider in the review of the law of trusts (18 November 2010).

Look-through provisions in other relevant statutes

- 5.21 As an alternative, the law could continue to leave it to individual statutes to address how a disposition of property or income to a trust is to be treated in a context where such a disposition defeats a government policy. Because of the difficulties in creating look-through provisions that meet the needs of the various contexts to which they must be applied, this may be the preferred approach.

A principles provision

- 5.22 A variation on the first option is to incorporate principles, such as that noted by Dr Austin Scott, that a “trust can be created for any purpose which is not illegal, which is not against public policy”,²⁰⁸ into trusts legislation in order to set limits on the purposes for which trusts may be used. This principle would provide some framework against which to evaluate the uses of trusts and their effects on the application of revenue and other legislation and on liabilities to other parties such as creditors. Examples of public policies that trusts may need to uphold are that people should pay their debts, and the equal sharing regime underlying relationship property legislation. Such a provision would provide a context for analysing whether the use of a trust to achieve a certain end may be unacceptable. From a practical perspective, it may be helpful to expand the principle so that trusts must not have a purpose or effect that is against public policy, as the purpose may be difficult to prove. The principle that a trust should have a purpose or effect that is not against public policy is also potentially relevant to considerations of when a trust is a sham and should be invalid. We are interested in people’s views about whether principles about the uses to which trusts can be put should or could be included in trusts legislation.

An administrative response

- 5.23 An alternative approach to create consistency between the legislative and administrative responses to trusts in different policy areas is to have administrative guidelines for agencies when considering the implications of trusts in their particular policy contexts. This guide could set out fundamental principles about when it is appropriate for the Government to propose legislation to “look through” trusts. The guidelines could be established by the Legislation Advisory Committee, and included in the Legislation Advisory Committee Guidelines, or by the Ministry of Justice, the department responsible for the administration of the Trustee Act 1956.

208 AW Scott *The Law of Trusts* (2nd ed, Little Brown & Co, Boston, 1956) at 1. See paras [2.27]–[2.30] above.

Sham trusts and means of invalidating a trust

Shams

- 5.24 Chapter 4 discussed issues regarding the requirements for a trust to be considered a sham and concerns about how this is being applied.²⁰⁹ Legislation might possibly assist in determining what amounts to a sham trust. New legislative provisions would not necessarily need to be tied to the current concept of a sham trust with the focus on the intention of the settlor and trustees.
- 5.25 The Commission considers that it is difficult to transpose the analogy of contractual parties to the trust situation. There is no doubt that the reality of a contractual situation differs from the trust situation. If the sham doctrine is about the transaction, the Commission suggests that it is necessary to pin down exactly what that transaction is. From this perspective, the constituent elements of the trust – certainty of intention, subject-matter and beneficiaries – must be relevant. However, the Commission also considers that it is hard to say that a trust is a sham if the trustee has legal title to the property and is acting entirely appropriately as trustee, thus thwarting any sham intention on the settlor’s part. The trustees’ intentions and actions must therefore be relevant to some extent.
- 5.26 The Commission also considers that the threshold for invalidating a trust should not be lowered any more than is necessary. The trust structure should not be invalidated too readily. The need for certainty weighs just as heavily in trusts law as it does in the commercial context. The establishment of a trust creates and changes legal rights and entitlements, and trusts can be established for any number of valid reasons. Those rights and entitlements should not be interfered with without good reason.
- 5.27 For this reason the Commission is attracted to retaining a requirement for trustee complicity or involvement to establish or operate a sham trust. We ask whether some lowering of the threshold for establishing a trustee’s complicity – such as evidence that he or she neither knew nor cared about the validity of the trust – is appropriate.
- 5.28 There is a further issue relating to the requirement of a common intention for the definition of a sham trust. The debate thus far appears to have assumed that a sham intention of the settlor is required for a sham trust to exist and has focussed on asking whether the trustee’s intention is also required. Yet there are instances where a settlor has little or no comprehension of what a trust is. An example would involve home owners advised to put their property into a trust with no understanding that they can no longer treat the property as their own. However, they continue to do so and are given a free hand by an unscrupulous or uncaring trustee. The trustee (perhaps a solicitor) may have advised that a trust be established to access a benefit, such as the rest home subsidy, and may be happy to act, effectively, as the settlor’s agent. Could this scenario amount to a sham, notwithstanding that the settlor could not have intended to create a sham since he or she has inadequate understanding of what the difference between a true trust and a “sham trust” is?

209 See paras [4.17]–[4.24] above.

- 5.29 This scenario differs from the policy problem that the sham concept was devised to tackle – that is, where there was a clear intention to deceive. This problem raises the question of whether the policy predicament posed by trust use in New Zealand demands a broader solution. The popularity of trusts has led to some people getting trusts but not being fully aware of the implications of what they are doing or their responsibilities. Is the problem a more general one: that the reality is often that the settlor is retaining the control and enjoyment of the property to the extent that it is unfair or against public policy not to treat the property as that of the settlor? It must be acknowledged that this issue also exists in relation to any other legal structure entered into by a person.
- 5.30 The Commission wishes to hear views on whether there is an issue with the law of sham trusts that needs to be addressed.

An alternative analysis

- 5.31 It is suggested that the sham trust doctrine, as a means of analysing whether a valid trust exists, may not be the best approach. The sham requirements have been imported from the commercial law field and as a result may have a somewhat uneasy fit with the equitable concept of a trust.
- 5.32 A better starting point may be to return to the requirements for a valid trust in equity. An express trust must fulfil the “three certainties” in equity: certainty of intention, certainty of subject matter and certainty of object.²¹⁰ As regards certainty of intention, the extent to which equity requires the relevant intention to exist is one determinant of whether the trust is valid. Accordingly, the requirement for certainty of intention is relevant to the situation of settlors who may never have intended to give up control or beneficial ownership of their property despite purporting to establish a trust.
- 5.33 Where there is a trust instrument establishing a trust, it could still be possible for other evidence to show that the settlor’s intention was not in fact what is set out in the trust instrument.²¹¹ Wigram VC observed in 1840 that it can prove a difficult question to determine whether or not a trust exists where “a person not intending to give or part with the dominion over his property ... retain[s] such dominion, notwithstanding he may have vested the property in trustees, and declared a trust upon it in favour of third persons”.²¹² In Australian case law, extrinsic evidence has been used to show that declarations were never intended to operate as binding declarations of trust.²¹³ In *Hyhonie Holdings Pty Ltd v Leroy* a legal declaration of trust was found to have no effect where the settlor continued to exercise personal dominion over the so-called trust property. In this case no documentation other than the trust instrument indicated that the trust was ever carried into effect and the settlor’s affairs were consistently

210 *Knight v Knight* (1840) 3 Beav 148; 49 ER 58, D Hayton “When is a Trust not a Trust?” [1992] 1 Journal of International Planning 3 at 5.

211 G E Dal Pont and D R C Chalmers *Equity and Trusts in Australia* (4th ed, Lawbook Co, Pyrmont, NSW, 2007) at 459.

212 *Hughes v Stubbs* (1842) 1 Hare 476 at 479; 66 ER 1119 at 1120 per Wigram VC.

213 *Starr v Starr* [1935] SASR 263.

conducted without reference to any trust.²¹⁴ This approach to finding a trust invalid, based on a lack of the equitable requirement for certainty of intention, could be used by the New Zealand courts.

Limits on “settlor control” of trusts

5.34 The courts have considered that settlor control of a trust is not in itself something that can invalidate a trust. In *Wilson* the Court of Appeal abandoned the alter ego concept as a means of invalidating trusts on the grounds that “[a]ctual control alone ... cannot be sufficient to extinguish the rights of the beneficiaries...”. However, it is arguable that there is a point where the degree of control that a settlor exerts over a trust is such that a trust cannot truly be said to exist. As Waters has put it: “the question is at what point the trustee becomes a custodian of the assets, and carries out instructions of the ‘settlor’ as an agent.”²¹⁵

5.35 It seems clear that it is this situation of a settlor who has almost complete control of a trust, for instance by being sole trustee and sole beneficiary, that has encouraged the courts to attempt to intervene in trusts, particularly in the relationship property cases.

5.36 This was the implication in *Keats* where the court commented that if the couple’s relationship had not broken down, their control over the trust meant that it was inevitable that their discretionary interests were, in the future, going to be realised.²¹⁶ Similarly, in his High Court judgment in *Harrison v Harrison*, Fogarty J concluded that, in relation to that trust structure:²¹⁷

... the husband and wife have the ability at any time, without the need to give any reason to the other contingent beneficiaries, to vest the entire assets of the ‘trust’ to themselves. It appears that the intention of the husband and wife when entering into the deed was to retain complete control over the use and enjoyment of all the assets transferred to the trustee, until at some later date when they might decide to transfer some or all of the assets to other persons. Given the ability and the apparent intention, there is a serious argument, which the parties may yet engage in, that, upon a substantive analysis, for the time being the legal and equitable estates unite in the husband and wife.

5.37 He made the point that:²¹⁸

The deed was not a sham. There is no doubt that the husband and wife intended to create a trust when entering into the deed of settlement, and to provide it with assets when they jointly sold their family home and the husband sold his shares to the trustee. However, it does not follow the Court will recognise a trust relationship.

214 *Hythonic Holdings Pty Ltd v Leroy* [2003] NSWSC 624, discussed in Dal Pont and Chalmers, above n 212, at 459.

215 D Waters “Settlor control – what kind of problem is it?” (2009) 15 *Trusts and Trustees* 12 at 13, fn 4. See also Hague Trusts Convention, article 2, which includes that statement that “[t]he reservation by the settlor of certain rights and powers, and the fact that the trustee may himself have rights as a beneficiary, are not necessarily inconsistent with the existence of a trust.”

216 *Keats v Keats* FC WN FAM-2004-091-900, 20 December 2005.

217 *Harrison v Harrison* (2008) 2 NZTR 18-027 at [26].

218 *Ibid*, at [14].

- 5.38 There are a number of references to “conventional discretionary interests” in the property relationship cases that preceded the “bundle of rights” decisions, as if to suggest that there is such a thing as an “unconventional discretionary interest”. One view of Judge Burns’ approach in *R v R* is that he used the package of interests or powers that he identified to *elevate* the wife’s discretionary interest from being a “conventional discretionary interest” to being a property right. It might be inferred from the “bundle of rights” judgments that whether a discretionary interest in a trust can be regarded as a property right or not depends on the circumstances of the case and degree of control the parties have over the trust. Perhaps it is therefore no longer enough to distinguish between discretionary rights or vested/contingent interests?
- 5.39 The Law Commission is not persuaded that the “bundle of rights” concept is the way forward, not least because of the difficulties posed by legal principle as to whether purely discretionary interests can ever be classified as proprietary interests. However, the Commission considers it would be unrealistic to ignore the problem that is being increasingly identified by the courts.
- 5.40 One way of addressing this specific issue may be for the Property (Relationships) Act 1976 to be amended to make it clear that discretionary rights are “property” for the purposes of the Act.
- 5.41 We suggest that it is also worth exploring the wider issue of whether it is possible to confine the legitimate concept of a trust, based on the degree of settlor enjoyment and control. There has been criticism of the judicial use of the term “control” in the trust context.²¹⁹ On one view, the answer to the issue of settlor control is for the court to refocus its attention on the trustee’s actions. Thus, the suggested solution is that where a trustee or appointee has not abided by his or her fiduciary obligations, a sufficient remedy lies in an action for fraud on a power. A settlor would not be able to exert any illegitimate influence over a trustee who scrupulously adhered to his or her duties.
- 5.42 However, it appears to the Commission that this analysis solves a different policy problem. Such an action lies in the hands of the beneficiaries. There would seem to be no doubt that if a beneficiary has been disadvantaged by a trustee’s breach in allowing himself or herself to be illegitimately controlled by a third person (such as the settlor), or by self-dealing, the beneficiary already has adequate recourse through established trust principles. This may frequently assist in a relationship property dispute where a spouse or partner is, or has been, a beneficiary of the trust. Thus, it may be that a claim lies for a wife whose husband/trustee/appointor has swiftly removed her as a beneficiary upon marriage dissolution and thus favoured himself.
- 5.43 Yet, this issue is not resolved in this manner. The party in need of assistance is a person who has never had a proprietary interest in the trust property – such as a third party creditor or discretionary beneficiary.

219 W M Patterson “Fog, Resettlements and Fraud on a Power” (paper presented to the New Zealand Law Society Trusts Conference, 2009). See also A Grant “The Supreme Court and questionable jurisprudence” *NZLawyer* (25 June 2009), Dr N Richardson “The Supreme Court and questionable jurisprudence again” *NZLawyer* (7 August 2009) and A Grant “‘Effective control’ and sham trusts” *NZLawyer* (7 August 2009).

- 5.44 Is it necessary or desirable to place greater definition around the trust structure that constrains settlor control? And if so, how could this be done? At one extreme, the law could assert that there is no trust where, for example, a settlor is able to benefit under the trust. The avoidance of estate duty inhibited this for many years under the provisions of the Estate and Gift Duties Act 1968. Thus, sections 11 and 12 of the 1968 Act provided that (except in certain circumstances) the dutiable estate included:
- Any property comprised in any gift made by the deceased unless *bona fide* possession and enjoyment had been assumed by the donee immediately on the making of the gift or not less than 3 years before the death of the deceased; and had thenceforth “been retained to the entire exclusion of the deceased or of any benefit to him by contract or otherwise”.
 - Any property comprised in any settlement, trust, or other disposition of property made by the deceased:
 - By which an interest in that property, or in the proceeds of the sale thereof, was reserved either expressly or by implication to the deceased for his life ...; or
 - Which was accompanied by the reservation or assurance of, or a contract for, any benefit to the deceased for the term of his life ...; or
 - By which the deceased had reserved to himself the right, by the exercise of any power, to restore to himself or to reclaim that property or the proceeds of the sale thereof.
- 5.45 Thus, until the abolition of estate duty in 1992, the common practice of trust drafters was to exclude the settlor of a trust from apparent control or potential benefit under the trust. By the imposition of an indirect incentive (the avoidance of estate duty) these rules were therefore effective in influencing (and limiting) the manner in which trusts were used.

Option: A provision to invalidate a “trust”

- 5.46 Another approach could be a provision that enables the court to exercise its discretion as to whether a structure is a valid trust, and guides that discretion with a list of relevant factors. The Legal Services Regulations 2006 provide one model.²²⁰ Section 412 of the Insolvency Act 2006, based on a premise of favouring substance over form is another.²²¹ Such a provision could be drafted to ensure that action could be taken by any person with an actual or potential interest under the trust property, and by third party creditors against anyone exerting control over the trust.

220 See para [3.70] above.

221 See para [3.20] above.

5.47 The Commission would be interested in reactions to a statutory provision that enabled the courts to make an order setting aside a trust if, having regard to a range of considerations, the court was of the opinion that no trust had been established or that the trust should not be permitted to continue to exist. Relevant considerations might include –

- The intentions of the settlor in establishing the trust;
- The intentions of the trustee or trustees;
- Whether the trustee was indifferent as to whether a valid trust was intended to be established;
- How the affairs of the trust have been conducted;
- Whether property of the settlor has been intermingled with trust property;
- Whether the settlor has treated trust property as his or her own;
- The degree of control exercised by the settlor over the affairs of the trust;
- Whether the trustees have acted independently of the settlor in carrying out their duties; and
- The real nature of the arrangement irrespective of how it is described.

5.48 It might be made clear that the existence of a common intention on the part of the settlor and trustees to set up a sham is not a necessary prerequisite to making such an order. It would be necessary to make provision for orders relating to the disposition of trust property if a trust was set aside.

QUESTIONS

5.49 We are interested in hearing views on the following questions.

Q3 Should trusts be available to be used to achieve any objective or should there be limits placed on the ways in which trusts may be used?

Q4 Is the extent of the control that a settlor may retain a cause for concern? If so, how might the matter be addressed?

Q5 New Zealand appears to have a significantly higher proportion of trusts per head of population than comparable jurisdictions. Why is this? Is it:

- Concern about existing or possible future government policies?
- Prompted by a desire to protect assets from business risk?
- To control the use or destination of assets to avoid obligations to third parties
- To avoid claims by spouses or partners of children to inherited assets?
- To access state provided assistance?
- Any other reason?

Q6 Are the existing legislative mechanisms for addressing the impact of trusts adequate? If not, can they be made more effective and how? Is the solution to strengthen the current provisions or is a stronger, more uniform solution called for? If you think there should be a single provision in trust legislation, what factors should be included in this provision?

Q7 Do you think that the principle that trusts should have a purpose or effect that is lawful and not contrary to public policy, or some other principle, should be included in New Zealand's trusts legislation?

Q8 Are there any further adverse impacts of the proposed repeal of gift duty in relation to trusts? Are there changes that should be made to trust law to address these adverse impacts?

Q9 Is the law on sham and alter ego trusts satisfactory? If not, in what respects might it be altered? Is the "bundle of rights" concept satisfactory? Does it provide an acceptable way of addressing inequities in the area of relationship property? Should the law in these areas be left open to the courts to develop or is a legislative response called for?

Q10 Should there be a statutory provision, such as that proposed in paragraph 5.47, enabling the courts to set aside a trust following consideration of a range of factors? Are there any other factors that should be included?

Appendices



Appendix A

Questions

Q1 In your experience, what are the reasons that people set up trusts?

Q2 Do you think there are any purposes for which trusts should not be used? If so what are these and why?

Q3 Should trusts be available to be used to achieve any objective or should there be limits placed on the ways in which trusts may be used?

Q4 Is the extent of the control that a settlor may retain a cause for concern? If so, how might the matter be addressed?

Q5 New Zealand appears to have a significantly higher proportion of trusts per head of population than comparable jurisdictions. Why is this? Is it:

- Concern about existing or possible future government policies?
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Q10 Should there be a statutory provision, such as that proposed in paragraph 5.47, enabling the courts to set aside a trust following consideration of a range of factors? Are there any other factors that should be included?

Appendix B

Consultation list

The Law Commission has consulted with the following during the review of the law of trusts:

- Auckland Energy Trust Board
- Ayres Legal
- David Bigio
- John Brown
- Chapman Tripp
- English Law Commission
- Glaistor Ennor Solicitors
- Anthony Grant and Richard Green
- Inland Revenue
- KPMG
- Legal Services Agency
- Ministry of Economic Development
- Ministry of Justice
- Ministry of Social Development
- Anthony Molloy QC
- New Zealand Trustee Services
- Office of the Official Assignee
- Professor John Prebble
- Price Waterhouse Coopers
- Reserve Bank of New Zealand
- Scottish Law Commission
- Taylor Grant Tesiram
- The Treasury

We are grateful for their contribution.



