



## CPD Read

### Reading time:

8-10 minutes

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### Top Quote:

"Discretionary trusts are often established with tax issues in mind. However, there is more to discretionary trusts than tax. For example, there are trust law, bankruptcy/insolvency law and family law issues."

### Worth a read because:

Family discretionary trusts often create family law issues when relationships break down. For tax practitioners, it is important to understand those issues when advising on discretionary trusts.

\* Earn CPD Points by answering the short quiz at the end of this article.

# DISCRETIONARY TRUSTS AND FAMILY LAW

Ian Coleman SC and Philip de Haan

**D**iscretionary trusts are often established with tax issues in mind. However, there is more to discretionary trusts than tax. For example, there are trust law, bankruptcy/insolvency law and family law issues.

This article discusses the family law issues associated with discretionary trusts.

## The starting point in family law

Because a beneficiary of a discretionary trust does not own the assets of the trust, the Family Court cannot include those assets when making orders dividing up the property of the husband and wife. This is because neither the husband nor wife owns the assets in the discretionary trust.

However, that is just the starting point. There are a number of circumstances in which the Family Court can make orders that affect the assets of a discretionary trust, or at least take the discretionary trust into account when making orders relating to other assets owned by the husband and/or wife.

These circumstances are, broadly, where the trust is:

- A sham
- Controlled by the husband or wife, and even if not directly or indirectly legally controlled by the husband or wife, is the "alter ego" of the husband or wife

- A financial resource of the husband or wife
- A trust that received property that was transferred to it to defeat an existing or anticipated order of the Family Court
- An "anti-nuptial" or "post-nuptial" settlement made in relation to the marriage and it is just and equitable to redistribute its assets for the benefit of the husband, wife or children, or
- Subject to an order that alters the property interests of a third party.

Each of these circumstances is discussed very broadly below — in relation to both testamentary discretionary trusts (i.e. created by wills) and inter-vivos discretionary trusts (i.e. created by trust deeds).

## Sham

A sham is a transaction where the parties to it do not intend the transaction to be effective according to its terms. It involves deception where the realities of the transaction are intended to be concealed.

A discretionary trust created in a will should not be a sham.

A discretionary trust created in a deed is a sham only if the parties do not intend it to operate in accordance with its terms. This would be very rare, but it can happen if, for example, the trustee ignores the terms of the trust deed. In rare circumstances, in the tax context at least, discretionary trusts have been held to be shams.

If a discretionary trust is a sham, the Family Court will consider who the real owner of the property is. If it is the husband and/or wife, the Family Court is able to make an order in relation to the assets of the trust (e.g. divide the assets between the husband and the wife).



### Controlled by the husband or wife

If the discretionary trust is controlled by the husband or wife, the Family Court can make an order in relation to the assets of the trust (e.g. an order that has the effect that the assets of the trust must be transferred to, for example, the husband or wife).

Control can be actual or de facto control. An example of actual control is where the husband is the trustee and appointor, or the husband is the sole shareholder and director of the trustee company and is also the appointor.

De facto control is more complicated in relation to the legal issues involved, the jurisdiction of the Family Court and the facts that are necessary to show de facto control. An example of de facto control is where the trustee is an independent person, but is considered to be the “puppet” of, say, the husband (e.g. the trustee is the husband’s accountant and the facts show that the accountant simply followed the directions of the husband), so the trust is essentially the “alter ego” of the husband.

### Financial resource

The Family Court may consider that a discretionary trust is a financial resource of the husband or wife where it decides that the husband or wife is likely to receive some personal financial advantage or other benefit from the trust. This finding is an alternative to finding that the husband or wife controls the trust.

If the Family Court considers that the discretionary trust is a financial resource, but not controlled by the husband or wife, then the court will not make an order in relation to the assets of the trust.

Rather, it may take the trust into account when making an order relating to the property actually owned by the husband and/or wife. So, for example, if a discretionary trust is a financial resource of the husband, but not controlled by the husband, and the husband and wife have no children and their only asset is their home, the court may order that the home be split say 70% to the wife and 30% to the husband (in circumstances where without the discretionary trust the home would be split 50/50).

### Receiving property to defeat an order of the court

The Family Court can retrieve assets disposed of to defeat an existing or anticipated order of the court (for example, a husband, perceiving the marriage to be in difficulty, may transfer assets to a discretionary trust). This power has only been judicially-considered once, so the extent of the power remains to be seen.

This power would not be relevant in relation to discretionary trusts created in wills, where the assets of the trust come from the deceased. Whether it applies to assets transferred to the trust by the husband or wife will depend upon the precise circumstances surrounding the transfer.

### Nuptial settlements

The Family Court may make such orders as it considers just and equitable with respect to any property dealt with by anti-nuptial or post-nuptial settlements made “in relation to the marriage”. In relation to the marriage means there must be some type of appropriate connection or association between the settlement and the marriage.



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A discretionary trust which has as its beneficiaries the husband and wife and their children can be such a nuptial settlement.

It is highly unlikely that a discretionary trust created in a will would be considered to be a nuptial settlement and caught by these rules. Whether a discretionary trust established by a deed is caught will depend upon the terms of the deed (including in particular the potential beneficiaries) and how the trust is administered (in particular to whom the trustee distributes income and/or capital).

#### Power to alter property rights of a third party

The Family Court has the power to make property orders that alter the property interests of third parties. This power is quite limited, other than generally in the circumstances described above.

#### Conclusion

There are various circumstances in relation to when the Family Court can make an order relating to a discretionary trust, depending on whether the trust is created in a will or by deed. In some circumstances, the court may make orders that affect the assets of the trust. Or the court may make orders in relation to the property owned by the husband and/or wife, taking into account the trust as a financial resource of the husband or wife.

These circumstances need to be appreciated when establishing discretionary trusts, in particular in relation to deciding on who will be the controller (e.g. the trustee and appointor), who will be the beneficiaries and how the trust will be managed. **FS**



## CPD Questions

### 1. Which of the following is TRUE regarding discretionary trusts and family law?

- a) A beneficiary of a discretionary trust legally owns the assets
- b) Discretionary trusts with a husband and wife as the only beneficiaries can be divided in the Family Court
- c) Family Court includes trust assets when making orders dividing up the property
- d) Beneficiaries are not owners of the trust assets hence they cannot be divided up by Family Court

### 2. A discretionary trust created that operates incongruously to the intention of the terms and parties involved, it is:

- a) Unable to be divided up in Family Court
- b) The assets are assigned to the beneficiary(s) in equal share
- c) The real owners are determined and orders to split up the assets are made by Family Court
- d) Not a sham trust

### 3. A person who is the trustee and appointor of a trust has:

- a) Actual control
- b) De facto control
- c) Absolute entitlement to the assets of the trust
- d) All of the above

### 4. Where a discretionary trust is a financial resource but not controlled by a person, the Family Court:

- a) Will make an order to split up the assets of the trust
- b) Will not take it into account when making orders on other assets
- c) Will not split up the assets of the trust, but take it into account when making orders on other assets
- d) Will not split up the assets of the trust, and is excluded from decisions relating to other assets

### 5. Assets that are disposed of prior to an expected order of the Family Court cannot be retrieved.

- a) True
- b) False

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