

Extension of the vesting Day does not cause split ends

STEIN V SYBMORE HOLDINGS [2006] NSWSC 1004

On 27 September 2006, Campbell J of the Equity Division of the New South Wales Supreme Court (“the Court”) handed down the decision in *Stein v Sybmore Holdings* [2006] NSWSC 1004. The decision concerned an application to the Court to vary a trust deed under s 81 of the *Trustee Act 1925* (NSW) (“the Trustee Act”).

Although the case was primarily concerned with the Court’s ability to extend the duration of a trust under s 81 of the Trustee Act, the Court made some interesting observations with respect to an interest that a beneficiary has in a discretionary trust. Further, the Court recognised the role that “complex trusts”, such as discretionary trusts, play in tax planning.

BACKGROUND FACTS

The case concerned an application by Morrie Jack Stein (“Stein”) to vary the terms of a trust (“the Trust”) as evidenced under the terms of a deed (“the Trust Deed”) dated 1 April 1978. The Trust was established between Pruvir Pty Ltd as settlor and Sybmore Holdings Pty Ltd (“the Trustee”) as trustee.

The Trust was established when Stein was aged 50, married and had two young children. The Trust was created after Stein obtained advice regarding his financial affairs from his accountant. The express intention for the establishment of the Trust was to enable Stein “.... to provide for his wife, children and grandchildren after he was gone.”

The assets held under the Trust included six parcels of real estate (“the Properties”). The total market of the Properties was approximately \$13 - \$14 million. Further, one of the Properties was purchased in

1978, being “.... *Before the commencement date for imposition of capital gains tax on 20 September 1985*” [para 18].

The Court observed that Stein had only recently “.... *read the Trust Deed for the first time, and saw that it provided for a Vesting Day which could not be any later than 23 December 2007*”. As a result, the assets held subject to the Trust had to be distributed no later than 23 December 2007. Further, given that Stein’s children were unmarried, and without children, if the assets held subject to the Trust were distributed on 23 December 2007, then that would have meant that “.... *the Trust is not able to fulfil the purpose which Stein had in mind when he established it*”.

Clause 18 of the Trust Deed contained the general power of variation of the Trust Deed. It provided that:

The Trustee may with the consent of the person who has the power to appoint a new Trustee at any time and from time to time in its absolute discretion by Deed or memorandum in writing or oral declaration recorded in Minutes of the Trustee Vary all or any of the powers or provisions herein concerning the Trust Fund with the exception of the Vesting Day. [emphasis added]

As a result, the Trustee did not have the power to vary the Vesting Day of the Trust. Given this limitation, Stein brought an application before the Court under s 81 of the Trustee Act to vary the Vesting Date of the Trust, such that the Vesting Day would be extended to later than 23 December 2007. The Court at para 7 observed that:

In this application Mr Stein seeks an order that would empower the Trustee to make an amendment to the Trust Deed that would significantly defer the date by which the Vesting Day must occur.

Further, the Court at para 22 noted that the “.... *Trustee, and the wife and two children of Mr Stein, have each filed submitting appearances in the litigation. Each of them consents to and supports Mr Stein’s desire to defer the date by which the Vesting Day must occur by many decades*”.

CGT and stamp duty implications of the Vesting Day

A major reason for the application to the Court requesting an extension of the Vesting Day was because of the adverse capital gains tax (“CGT”) and stamp duty implications that would have arisen had the Properties been distributed to the relevant beneficiaries upon the Trust vesting. The Court discussed the CGT implications of the distribution of the assets held under the terms of the Trust at para 19:

If it were necessary to make a distribution of the Trust property in 2007, capital gains tax would be payable on distribution of all the real estate other than the parcel purchased in 1978. If each of those beneficiaries were subject to tax at the top marginal rate of tax including Medicare, the tax on the net capital gain for tax purposes would be a little over \$690,000. As well, the property which was acquired in 1978 would lose its present status as being capital gains tax exempt, so far as any increments in value it might sustain after distribution were concerned.

The Court at para 20 observed that “[t]hus, *payment of tax of the order of \$690,000 is something which I can treat only as being a*

possible worst case”, and at para 21, that the “... loss of the capital gains tax-exempt status of the property purchased in 1978 would also be a certainty”.

In relation to the stamp duty implications, the Court at para 21 considered that “... it is clear that New South Wales stamp duty, of the order of \$620,000, would be payable on transfers made to give effect to the distribution ...” as a result of the vesting of the Properties.

Further, the Court observed at para 22 that the parties:

... see it as an advantage that the extension of the Vesting Day would enable the Trust to continue to operate during Mr Stein’s lifetime and long after his death. Each of them regard it as an advantage that their children and other lineal descendants will have an opportunity to benefit.

THE TERMS OF SECTION 81 OF THE TRUSTEE ACT

Subsection 81(1) of the Trustee Act provides that:

- (1) Where in the management or administration of any property vested in the trustees, any sale, lease, mortgage, surrender, release, or disposition, or any purchase, investment, acquisition, expenditure, or transaction, is in the opinion of the Court expedient, but the same cannot be effected by reason of the absence of any power for that purpose vested in the trustees by the instrument, if any, creating the trust, or by law, the Court:
 - (a) may by order upon the trustees, either generally or in any particular instance, the necessary power for the purpose, on such terms, and subject to such provisions and conditions, including adjustment of the respective rights of the beneficiaries, as the Court may think fit, and
 - (b) may direct in what manner any money authorised to be expended and the costs of any transaction, are to be paid or borne as between capital and income.

The Court at para 14 in *Bowmil Nominees Pty Ltd* [2004] NSWSC 161 (“*Bowmil*”) considered that the following propositions arise when determining whether s 81 of the Trustee Act could be used to vary terms of a trust:

- the criterion for the exercise of the power is expediency;

- the expediency must be in the management or administration of property;
- the expediency must relate to property of the trust, not some other property;
- what must be expedient is “any sale, lease, mortgage, surrender, release, or disposition, or any purchase, investment, acquisition, expenditure or transaction”;
- when the above points have been satisfied, then the powers of the Court are ample and its discretion is unfettered; and
- the extent to which the respective rights of the beneficiaries may be affected as a result of a variation under s 81 of the Trustee is a subject matter of debate, which it was held in *Bowmil* was unnecessary to consider for the purposes of deciding that case.

Young J at para 37 observed that before an order under s 81 of the Trustee Act can be made, two pre-conditions need to be satisfied, being:

CONDITION ONE

Identification of a “... sale, lease, mortgage, surrender, release, or disposition, or any purchase, investment, acquisition, expenditure or transaction ...” (referred to as a “dealing”) that is proposed.

CONDITION TWO

An enquiry as to whether the dealing is, in the opinion of the Court, expedient.

The Court in Stein’s case held that the amendment of the Trust Deed was a “transaction”, being one of the dealings to which s 81 of the Trustee Act is concerned. The Court observed that condition one was satisfied, as the “... type of power that ... *Stein seeks to have conferred on the Trustee is within the scope of s 81.* [para 46].

With respect to condition two, the Court at paras 38-42 considered that the “... expediency to be considered under s 81 must be expediency in the management and administration of the actual property held upon trust ...”.

Further, the Court observed that s 81 of the Trustee Act requires there to be a “question” with respect to the management or administration of property vested in a trustee that is to be considered before an order under that provision is made by the Court. It was observed at para 43 that the “question” “... must be the same as a problem, rather than a topic concerning which there is real doubt”. The Court considered at para 60 that the potential CGT and stamp duty liabilities that may arise upon the vesting of the Trust was a problem with respect to the management and administration of the Trust, on the basis that the Trustee:

“... wants to avoid capital gains tax and stamp duty being payable on any of the trust property. However, it cannot do any of these things because the present provisions defining the Vesting Day require distribution no later than 23 December 2007. That is, it seems to me, a problem that has arisen in the management or administration of the trust property.”

As a result, the Court considered that the proposed alteration in the Vesting Day was a “problem” that could be resolved by the Court, and was within the scope of s 81 of the Trustee Act.

THE RIGHTS OF THE OBJECTS IN THE ASSETS UNDER THE TRUST

The class of beneficiaries in the Trust was extremely wide, and included most members of Stein’s family. The Court discussed the effect of the proposed change in Vesting Day, with specific regard to the rights of the beneficiaries under the Trust. The default beneficiaries with respect to both income and capital were called “Residuary Beneficiaries” – which were defined as the Children.

Clause 6 of the Trust Deed provided for the way in which the capital of trust was to be dealt with as at the Vesting Day:

On the Vesting Day the Trustee shall stand possessed of the capital of the Trust Fund UPON TRUST for all or such one or more of the Primary Beneficiaries as the Trustee may ... determine and if more than one in such shares as the Trustee may ... declare ... but if on the Vesting Day the Trustee has not made such a declaration then for the Residuary Beneficiaries and if more than one in equal shares PROVIDED THAT in the event of any of the Residuary Beneficiaries dying before

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The Court recognised the role that discretionary trusts played in the context of tax planning

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that Vesting Day and leaving issue surviving them then such issue shall upon attaining the age of twenty one years have the share to which the said deceased person would have been entitled if he had been alive on the Vesting Day

Clause 7 of the Trust Deed allowed the Trustee to distribute amounts of capital of the trust to a beneficiary. The Court observed at para 26 that the Children, as the Residuary Beneficiaries, have:

.... A vested but defeasible interest in the capital of the Trust. The interest [of one of the Children] is a contingent interest, because it is contingent on her surviving until the Vesting Day. It is defeasible because if the Trustee appoints the property to someone else, under the power of appointment it will no longer flow to her as a taker in default of appointment.

Clause 3 of the Trust Deed allowed the Trustee to exercise its discretion in distributing the income of the Trust to any beneficiary of the Trust. In the event that the Trustee does not exercise its discretion then, assuming that there are Residuary Beneficiaries (or issue of Residuary Beneficiaries),

“...the Trustee shall stand possessed of such income UPON TRUST for the Residuary Beneficiaries and if more than one in equal shares PROVIDED THAT in the event of any of the Residuary Beneficiaries dying and leaving issue surviving them such income shall have the share

of any income to which the said deceased person would have been entitled if he had been alive”.

The Court at para 25 discussed the interest that the Children had in the income of the Trust:

In circumstances where [the Children] are both alive and without children The income of any year is held on trust for [them] in equal shares, except to the extent that the Trustee decides to appoint that income to someone else or accumulate it in the language of property law there is a power to appoint income, and there is a gift over to [Stein's children] in default of appointment. Where there is a power to appoint property amongst members of a class, and a gift over in default of appointment, the takers in default have a vested, but defeasible, interest in the property.

The Court observed that Stein, Stein's wife, and the Children were all potential beneficiaries of the Trust, but subject to the Trustee exercising its power of appointment in respect of either the income and/or capital of the Trust. Further, it was noted that a potential object under a power of appointment does not confer any rights of property in the assets that may be appointed. However, as the Children were the Residuary Beneficiaries (ie the “default beneficiaries”), they had a present right of property in the Trust assets.

THE EFFECT OF THE EXTENSION OF THE VESTING DAY

The Court at para 28 considered that in the event that the term of the Trust was increased, and if there was a change in situation of the Children as the Residuary Beneficiaries (for example, if one was to die), then the beneficial interest that the Children have in the Trust Fund may change:

Other possible events, concerning who dies, who stays alive, will result in other changes to the beneficial interests in the Trust Fund from what those beneficial interests are now. Does the fact that there will be changes in beneficial interest mean that section 81 cannot be used to empower the Trustee to extend the date by which the Vesting Day must occur?

The parties to the proceedings conceded that changing the Vesting Date may disadvantage the beneficiaries (para 23):

They each understand that deferral of the date by which the Vesting Day must occur has some disadvantages. It is likely to delay the time at which they personally will receive any capital from the Trust, and might mean that they personally never receive any capital from the Trust. They understand that the extension of the Vesting Date will expand the class of potential beneficiaries if [some of the beneficiaries] marry, and will further expand the class of potential beneficiaries if [some of the beneficiaries have] children.

The Court considered whether s 81 of the Trustee Act could be used to change a beneficial entitlement to a Trust Fund. The Court noted that Simos J in *Audio Visual Copyright Society Ltd v Australian Record Industry Association Ltd* [1999] NSWSC 947 said that “... s 81 cannot be validly used to confer a power which produces a result” under which “...beneficial interests of the relevant beneficiaries” are altered. However, Campbell J at para 33 disagreed with Simos J and concluded that the “... correct position is that sometimes s 81 can be used in a way that alters beneficial interests”. Indeed, “... s 81(1)(a) expressly states that the power it confers extends to “adjustment of the respective rights of the beneficiaries.”

The Court in Stein's case concluded at para 35 that:

The Trust Deed itself establishes possibilities of flexible distribution of assets among members of the Stein family, and extension of the Vesting Day would enable that flexibility to continue to operate. The possibility of flexible distribution is no mere accident of the trust deed. Rather, part of the context in which the trust deed needs to be understood is that it is common for people who have more assets than they need for their own survival to seek to benefit close family members, without giving up control of the assets. Another part of the context in which the trust deed needs to be understood is that there has been for decades a system of income taxation in which a natural person is taxed on a basis whereby the first tranche of income in a year is tax-free, and successive tranches are taxed at increasingly higher rates – thus directing income from a discretionary trust in any year to the potential beneficiary who has a marginal rate of tax below the top rate will lessen the overall tax paid by the family unit. Maintaining flexibility to distribute both capital and income among members of Mr Stein's family over generations provides one basis upon which I find that the conferring of the power would be expedient. Thus, the fact that

extension of the Vesting Day will be likely to alter who ultimately has beneficial interests in the trust fund is not necessarily fatal to this application.

Whether an order may be obtained under s 81 of the Trustee Act, notwithstanding that it may effect the interests of beneficiaries of a trust, has been a vexed issue. It seems that absent a specific legislative provision, the Courts do not have the power to vary terms of trusts so as to vary beneficial interests. The Court at para 7 of *Bowmil* observed that:

The law as to the variation of trusts is not in a very satisfactory state in New South Wales. In *Chapman v Chapman* [1954] AC 429 the House of Lords is perceived to have ruled that courts of equity have no power to vary beneficial interests under trusts, absent legislative provision. There has been no full consideration at appellate level as to whether the decision in *Chapman v Chapman* should be accepted in Australia. Even so, it has been accepted that, in general terms, there is no power in the Court in New South Wales to make alterations to the terms of, or vary, the beneficial interests in a trust. That proposition is subject to some debate which there has been as to whether there may be alterations to beneficial interests incidental to a valid exercise of jurisdiction under s 81 of the Trustee Act 1925. [emphasis added]

It has previously been noted² that unlike other jurisdictions³ there “... is not in New South Wales a statutory power to vary beneficial interests in trusts.” However, the limitation on the Court’s power to approve variations in beneficial interests is mitigated by the following two factors⁴:

- the proposition that a variation by the Court is not necessary where the beneficiaries who are all ascertained and sui juris⁵ agree to the variation⁶
- the scope and extent of s 81 of the Trustee Act.

Young J, in *Re Cosaf Pty Ltd* (Supreme Court of New South Wales, 15 & 18 December 1992, unreported, BC9201398) in citing the decision in *Perpetual Trustee Co Ltd v Godsell* [1979] 2 NSWLR 785, observed that the Court:

...seems ...to have taken the view that so long as the prime purpose of the proposal of the trustee was in the area of management and administration, the Court could make an order under s 81 even though the beneficiaries

would be affected in their property.

Further, Dixon J in *Riddle v Riddle* (1952) 85 CLR 202 considered at paras 6 and 7 of that judgement that:

Section 81 is a provision conferring very large and important powers upon the Court which depend upon the Court’s opinion of what is expedient, a criterion of the widest and most flexible kind. The power necessarily carries with it responsibilities of equal extent. The responsibilities imposed involve business and financial considerations, but responsibilities of that description have always fallen on courts of administration.

I do not think that the powers given by s 81 were intended to be restricted by any implication.

Williams J at para 7 of his judgement in *Riddle* held that:

The section is couched in the widest possible terms. The sole question is whether it is expedient in the interest of the trust property as a whole that such an order should be made ...

The possibility of an exercise of a Court’s power under s 81 of the Trustee Act altering a beneficiary’s interest was discussed in *NM Superannuation Pty Ltd v Hughes and Ors* (Supreme Court of NSW, 5 March 1996, unreported, BC 9600423) (“*NM Superannuation*”), where it was recognised that:

Under s 81 the Court is empowered to alter the terms of the trust, but only for the purpose of conferring on a trustee power to effect a dealing or transaction of the kinds described in that section in the management or administration of the assets of the trust, which in the opinion of the Court is ‘expedient’.

It was further observed in *NM Superannuation* that:

The conferring on a trustee under s 81 of a power to effect a dealing or transaction in the management or administration of the trust on the ground of expediency may, in some cases, involve or require some incidental or consequential adjustment of the respective rights of beneficiaries, as it is recognised in the terms of s 81 itself.

Further:

... it is difficult, if not impossible, to conceive of circumstances where a variation in the amounts payable to different beneficiaries in the distribution of a trust fund from those

required by the terms of the trust, could substantively and independently be considered as “expedient” within the meaning of s 81.

WHETHER THE INTENTION OF THE TRUST WAS CARRIED OUT – THE ROLE OF “TAX PLANNING”

It was recognised that the “... intention ... [behind the establishment of the Trust] ... was to provide for ... [Stein’s] ... wife, children and grandchildren after he was gone” (para 3). On the basis that Stein was both alive at the time of the application to the Court, and because Stein did not have any grandchildren, it was expected that the overt intention for the establishment of the Trust would not be satisfied.

However, the Court also noted a “covert” intention behind the proposed extension of the Vesting Day – for example, at para 60:

In the present case the Trustee wants to continue to hold the Trust property past 2007, and to pay its income to whichever of the potential income recipients it decides, in the same fashion as it has done since 1978.

Interestingly, in determining whether the Vesting Day of the Trust could be extended under s 81 of the Trustee Act, the Court took into account the role that discretionary trusts (of which the Trust was one) played, particularly in the context of taxation planning.

In determining whether the Court’s power under s 81 of the Trustee Act could be used, the Court observed that it is important to consider whether the variation to the terms of the Trust would “... involve a departure from the spirit of the settlor’s intention”. Such an analysis “... involves trying to ascertain whether a departure from the strict letter of administering the trust is a departure ... that is an important part of the settlor’s intention, or a departure in a matter of inessential detail.” If it is a departure of the former, then the variation will not be allowed under s 81 of the Trustee Act, whereas if it is of the latter, then it will be. However, it was held that the subjective motivations of the person who caused the trust to be established (ie Stein) would not be relevant in the analysis.

In determining whether the Court could use its powers under s 81 of the Trustee Act, it differentiated as between “simple trusts” – such as those established “... to

invest and pay income to or for the benefit of a nominated person ...” and “complex trusts”, such as family discretionary trusts and superannuation trusts.

It was recognised at para 53 that in respect of a “complex trust” (ie a discretionary trust or a superannuation trust):

... it is within the spirit of the settlor's intention that there can be changes, within a certain ambit, in the beneficial interests in the trust property – whether by the exercise of a trustee's discretion, or by conferring discretions on someone other than a trustee, as happens with the opportunity for a member of a superannuation fund to nominate, from time to time, who will receive benefits. In the latter type of trusts there is a well understood context of law (often tax law) which the trusts are clearly intended to take advantage of – it is often not difficult to conclude that keeping advantages of that type is within the spirit of the settlor's intentions, or if that context of law were to change, it might be possible to conclude that it was within the spirit of the settlor's intention the trust should accommodate itself to whatever the new law was.

The Court recognised the role that discretionary trusts played in the context of tax planning. Indeed, the continuing tax benefits that were obtainable under the terms of the Trust were a basis upon which the Court considered that its powers under s 81 of the Trustee Act could be exercised (para 54). The Court accepted that “... the minimisation of the capital gains tax and stamp duty on the trust property provides a separate basis upon which the conferring of the power is expedient”.

RESETTLEMENTS AND A VARIATION OF THE TERM OF A TRUST

It is important to note the Commissioner of Taxation's (“the Commissioner”) views, as contained in *Creation of a new trust – Statement of Principles* August 2001 (“Statement”) regarding whether a variation of the term of a trust constitutes a “resettlement”.

In the Statement, the Commissioner considers that the following changes (amongst others) to the terms of a trust may lead to the creation of a new trust:

- change in beneficial interests in trust property;
- a new class of beneficial interest (whether introduced or altered);

- a possible redefinition of the beneficial class;
- a change in the termination date of the trust; and
- a change in the essential nature and purpose of the trust.

The Commissioner takes the view that “... the specified term ... [of a trust] ... may be an essential feature whose variation could be a factor pointing towards the creation of a new trust”. Further, if a trust is established for a limited time period and also for a given purpose, then “... the subject matter of the trust can be most accurately described as the income and other benefits arising from the trust property over a particular period”.

The Commissioner considers that there are two considerations to determine when the duration of a trust is extended, being:

- whether the extension gives rise to a new trust; and if so,
- whether a new trust arises when the variation to the term is made – that is, whether the new trust arises when the variation takes effect, or on a previous termination date.

It seems that varying the termination date is more likely to cause a resettlement if the trust is established for a specific purpose/project or to hold a particular asset for a particular period. However, the Statement does consider that an extension of the terms of a trust may constitute a resettlement if the trust deed does not confer an express power to alter the termination date.

COMMENT

The High Court in *CPT Custodian* [2005] HCA 53 made the observation that when dealing with trusts, the “... first step ... [is] ... to ascertain the terms of the trusts...”. Stein's case again highlights the importance of reviewing the particular terms of a trust deed. Further, from the perspective of a tax professional involved with the establishment of trusts for clients, the case demonstrates the importance of ascertaining the intentions of those seeking to establish trusts when having deeds and other documents drafted.

Whilst Stein's case provides guidance regarding a specific scenario – being the requirements to be satisfied when

seeking extension of the duration of a trust absent an express power to do so in trust documents – the case also makes important observations regarding interests that beneficiaries have in discretionary trusts. Practitioners will welcome such judicial commentary given the perceived flux after the decision in *CPT Custodian and Warren Halloran & Ors v Minister Administering National Parks and Wildlife Act 1974* [2006] HCA 3.

Further, an interesting aspect of the decision is the Court's approval of the use of discretionary trusts in the context of tax planning. In particular, the Court conceded that discretionary trusts have an important part to play in lessening the overall tax paid by a family unit.

However, it is yet to be seen whether the Commissioner or the respective Chief Commissioner of Stamps takes issue with extensions of vesting dates of trusts like the Steins.

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Reference notes

- 1 It was also noted that *Jacobs' Law of Trusts in Australia*, 7th edition 2006 paragraph [1706] p.373 footnote 47 considered that there was a general proposition that “... section 81 gives no power to alter the beneficial interests of the beneficiaries”.
- 2 See paragraph 8 in *Bowmil*.
- 3 In the United Kingdom and some other Australian States there is statutory power to approve, on behalf of incapable or unascertained beneficiaries, an arrangement varying or revoking trusts: section 1 of the Trusts Act 1958 (UK); section 63 of the Trustee Act 1958 (Vic) s 63 and section 95 of the Trusts Act (Qld).
- 4 See paragraphs 9 and 10 in *Bowmil*.
- 5 Definition of ‘sui juris’ – one who has attained the age of majority.
- 6 The Court in *Bowmil* considered that this was as a result of the ‘rule in *Saunders v Vautier*’. However, consideration needs to be given to the ‘rule in *Saunders v Vautier*’ as a result of comments made by the High Court at paragraphs 47-51 in *CPT Custodian Pty Ltd v Commissioner of State Revenue, Commissioner of State Revenue v Karingal 2 Holdings Pty Ltd* [2005] HCA 53 (*CPT Custodians*).
- 7 paragraph 14 of *CPT Custodians*.