ASSET PROTECTION STRATEGIES & BANKRUPTCY

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I INTRODUCTION

The ultimate aim of the *Bankruptcy Act 1996* (Cth) is to provide a fair and orderly process for the administration of the affairs of a debtor. In many circumstances the debtor may attempt to avoid his obligations to some or all of his creditors. The *Bankruptcy Act* recognises this and has long had provisions which empower trustees in bankruptcy to recover certain assets of a bankrupt. The two types of powers given to the trustee are where:

- a debtor pays certain creditors in preference to others;[1] or
- a debtor attempts to remove property which would otherwise have been available to creditors generally (the "**claw back provisions**").[2]

The ultimate aim of the *Family Law Act* 1975 (Cth), in so far as it deals with property settlements, is to ensure the property of the parties to a marriage (or a de facto relationship that qualifies) is distributed amongst them in an orderly way congruent with the policy and principles of that Act and the cases interpreting it.

This paper will analyse the claw back provisions in the context of a number of common strategies which bankrupts or potential bankrupts may consider in attempting to limit the assets that would otherwise be available to the creditors of the bankrupt. In particular, the paper will look at:

- briefly, the consequences of bankruptcy to the bankrupt's property;
- purported asset protection strategies and how they attempt to defeat the rights of creditors;
- the powers available to a trustee to claw back assets that a bankrupt has attempted to alienate from his estate in bankruptcy;
- the effectiveness of the asset protection strategies given the trustee's powers to claw back certain transfers and dispositions of property; and
- the recent decision of *Australian Securities and Investments Commission In the Matter of Richstar Enterprises Pty Limited v Carey (No. 6)*.

It will also consider the current position of the Family Court in relation to trusts and including the assets they hold in the marital pool of assets.

In these times of growing litigation and divorce these are appropriate considerations for anyone of means. Further, because of the greater likelihood of professional negligence claims now being made against professional persons the paper will also consider how easy it is for those professionals to avoid their obligations to their creditors.

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[1] Section 122 of the *Bankruptcy Act*.
[2] Sections 120 and 121 of the *Bankruptcy Act*.

II CONSEQUENCES OF BANKRUPTCY

A “bankrupt"[3] is a person:

1. against whose estate a sequestration order has been made; or

2. who has become a bankrupt by virtue of the presentation of a debtor's petition.

The Federal Court of Australia is empowered to make a sequestration order against the estate of a debtor where the debtor has committed an “act of bankruptcy” and the person has a necessary connection with Australia.[4] The *Bankruptcy Act* provides a list of "acts of bankruptcy".[5] The most common act of bankruptcy relied on by creditors is where the debtor has failed to comply with the requirements of a bankruptcy notice[6] which has been served by the creditor on the debtor in respect of a final judgement or final order (being a judgement or order which has not been stayed) obtained by the creditor against the debtor. Upon the making of a sequestration order the debtor becomes a bankrupt and continues to be bankrupt until the bankruptcy is discharged or annulled.[7] A bankruptcy will usually last 3 years, though on application it may be extended.

A debtor can become a bankrupt themselves by presenting to the Official Receiver a petition in the approved form.[8] If the debtor's petition is accepted by the Official Receiver, then the debtor becomes a bankrupt upon the Official Receiver endorsing the petition.[9] A person who becomes a bankrupt as a consequence of lodging a debtor's petition, continues to be a bankrupt until the bankruptcy is discharged or annulled.[10]

Where a debtor becomes a bankrupt, s 58 of the *Bankruptcy Act* provides that:

(a) the property of the bankrupt (not being after acquired property), vests in the trustee in bankruptcy; and

(b) after acquired property of the bankrupt vests, as soon as it is acquired by or devolves upon the bankrupt, in the trustee in bankruptcy.

What constitutes "the property of the bankrupt" is defined in section 5 to mean the property divisible amongst the bankrupt's creditors and any rights and powers in relation to that property that would have been exercisable by the bankrupt if he or she had not become a bankrupt.

The property divisible amongst the creditors of the bankrupt is defined in sub-section 116(1) to be:

(a) All property that belonged to or is vested in a bankrupt at the commencement of the bankruptcy or has been acquired or is acquired by

[3] Section 5 of the *Bankruptcy Act*.
[4] Sub-section 43(1) of the *Bankruptcy Act*).
[5] Section 40 of the *Bankruptcy Act*.
[6] Paragraph 40(1)(g) of the *Bankruptcy Act*.
[7] Sub-section 43(2) of the *Bankruptcy Act*.
[8] Section 55 of the *Bankruptcy Act*.
[9] Sub-section 55(4A) of the *Bankruptcy Act*.
[10] Sub-section 55(8) of the *Bankruptcy Act*.

him or her or has devolved or devolves on him or her after the commencement of the bankruptcy and before his or her discharge.

(b) The capacity to exercise or to take proceedings for exercising all such powers in, over or in respect of property as might have been exercised by the bankrupt for his or her own benefit at the commencement of the bankruptcy or any other time after the commencement of the bankruptcy and before his or her discharge.

(c) Money and property of a third party acquired through direct or indirect financial contributions by a bankrupt that is vested in the trustee of the bankrupt's estate.[11]

(d) Money and property of a controlled third party arising from the provision of personal services by the bankrupt to that entity where the bankrupt received no or substantially less consideration for those services than might reasonably be expected that is vested in the trustee of the bankrupt's estate.[12]

(e) Certain superannuation interests of the bankrupt[13]

'Property' is defined in section 5 as follows:

> **"property"** means real or personal property of every description, whether situate in Australia or elsewhere, and includes any estate, interest or profit, whether present or future, vested or contingent, arising out of or incident to any such real or personal property.

It must be noted that the property is not limited to that in Australia; it is real or personal property '*in Australia or elsewhere*'.

Australian courts give the term 'property' a broad interpretation.[14] So far as trust relationships go, the right of a mere object of a discretionary trust will be 'property' for the purposes of s 116 of the *Bankruptcy Act*.[15] However, it will merely entitle the trustee in bankruptcy to compel due administration of the discretionary trust. This, it is well known, is the main asset protection advantage of discretionary trusts.

Care must be taken in this regard as the Federal Court has (relatively) recently held that as assignment to a trustee in bankruptcy, which sought to transfer proceedings rather than the bankrupt's right to prosecute the proceedings, was to be interpreted in a commercial way.[16] The courts may therefore seek to give effect to a trustee in bankruptcy's actions in more instances than a strict reading of the provisions would allow.

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[11] pursuant to section 139DA of the *Bankruptcy Act.*
[12] pursuant to Sections 139D and 139E of the *Bankruptcy Act*.
[13] pursuant to sections 128K, 139ZQ and 139ZU of the *Bankruptcy Act.*
[14] *Cummings v Claremont Petroleum NL* (1996) 185 CLR 124
[15] See *Official Receiver v Schultz* (1990) 170 CLR 306, where the High Court cited *Commissioner of Stamp Duties (Qld) v Livingston* (1964) 112 CLR 12. See also *Silvia v Thomson* (1989) 87 ALR 695.
[16] *Meriton Apartments Pty Ltd v Industrial Court of New South Wales* (2008) 171 FCR 380 at 436,[229] per Perram J.

If property is acquired after the date of bankruptcy it will vest in the bankruptcy trustee. For instance, a bequest received by a bankrupt under a will[17] or a lottery win[18] or an income tax refund[19] are after acquired property that vest in the trustee in bankruptcy. An equitable right itself is also plainly such after-acquired property.[20]

Sub-section 116(2) of the *Bankruptcy Act* then excludes certain property from the class of property that would otherwise be divisible amongst creditors pursuant to sub-section 116(1). Of particular relevance to this paper is that the following property is not property divisible amongst creditors:

(a) Property held by the bankrupt in trust for another person; and

(b) The interest of the bankrupt in a regulated superannuation fund within the meaning of the *Superannuation Industry (Supervision) Act* 1993 (Cth) that have not been made for the purpose of defeating creditors.

The exclusion in paragraph (a) recognises that the trustee's title to property cannot be any higher than that of the bankrupt.[21] Consequently, if the bankrupt only holds a legal interest in property then there will be no value in that interest that will be divisible amongst the creditors of the bankrupt.

The property divisible amongst creditors includes all property (other than that excluded by the operation of sub-section 116(2)) that belongs to the bankrupt after the "commencement of the bankruptcy". The commencement of the bankruptcy is deemed to have relation back to the time of the commission of the earliest act of bankruptcy committed by the bankrupt within the period of six months immediately preceding the date on which the creditor's petition was presented or the application for the making of the sequestration order was made or the date on which the debtor's petition was presented.[22] In the case of a debtor's petition, if there was no act of bankruptcy within the 6-month period then the commencement of bankruptcy will be the time of presentation of the petition.

A bankrupt is obligated to disclose all property acquired by him or her before he or she will be able to be discharged from their bankruptcy.[23] Further, a bankrupt may be examined by the trustee before a Registrar to determine the affairs of the bankrupt.[24] Failure to comply with these obligations can be a criminal offence potentially resulting in arrest and gaol.[25] It is with these powers and sanctions that the trustee in bankruptcy will become aware of the antecedent transactions of the bankrupt.

[17] *Re Pesvsner* (1983) 68 FLR 254
[18] *Randall & Albaugh* [2009] FMCAfam 475.
[19] Whether the income was earned before or after the date of bankruptcy: *Commissioner of Taxation v Kavich* (1996) 68 FCR 519.
[20] In *Official Receiver v Delation Pty Ltd* (1996) 130 FLR 207 and in *Donnelly v McIntyre* [1999] FCA 450 the courts held that an equitable interest in a business received after the date of bankruptcy was an interest within the definition of property.
[21] *Sonenco (No. 77) Pty Limited v Silvia* (1989) 40 ALR 569.
[22] Section 115 of the *Bankruptcy Act*.
[23] Paragraphs 77(b), (ba) of the *Bankruptcy Act*.
[24] Section 81 of the *Bankruptcy Act*.
[25] Section 264B of the *Bankruptcy Act*.

The doctrine of relation back preserves property that is available to creditors although it may have been transferred by the bankrupt before the bankruptcy petition was presented. Any transfer made within the relation back period being at most six months before the making of the sequestration order, will not be effective as the bankrupt has no title in that property. As the property is vested in the trustee in bankruptcy from the commencement of bankruptcy, the bankrupt has no right or title to deal with the property and any transfer by the bankrupt during the relation back period will be void.

The remedy available to creditors where a debtor becomes bankrupt, is to share in the property of the bankrupt.[26] Consequently, a debtor trying to defeat his creditors will try to minimise the property he or she has available to satisfy those claims. This can be done by either transferring the property away from the bankrupt or converting it to property that is protected pursuant to sub-section 116(2) prior to the commencement of the relation back period.

III PURPORTED STRATEGIES TO AVOID BANKRUPTCY

The paper will concentrate on three strategies that are commonly contemplated by persons that may become bankrupt at some point in time. These strategies are not meant to be an exhaustive list of the potential arrangements that debtors may undertake in an attempt to defeat the legitimate rights of creditors.

Transfer of assets to a spouse

The first strategy to be considered is the transfer of assets to the spouse of a potential bankrupt. There are a number of potential scenarios including:

- Gift of an interest in the family home for no consideration prior to becoming a bankrupt.

- Transfer of an interest in the family home for full consideration prior to becoming a bankrupt.

  The transfer of an interest in a home (whether for full consideration or otherwise) may, in fact, occur many years or even decades before the person becomes a bankrupt.

  In either case at the time of the professional person becoming a bankrupt, provided that the transfer or gift is made before the commencement of the relation back period, the asset does not belong to the bankrupt. In the absence of the claw back provisions the asset would not be available to creditors.

[26] There are also entitlements to the future income of the bankrupt pursuant to section 139K of the *Bankruptcy Act* and to the money and property of certain entities controlled by the bankrupt pursuant to sections 139D and 139E. These provisions are beyond the scope of this paper.

- The bankrupt and spouse enter into a financial agreement in accordance with Part VIIIA of the *Family Law Act.*[27]

  Once again in this instance the aim of the bankrupt is not to have assets belonging to him at the commencement of the bankruptcy. However, family law arrangements have held a special position in bankruptcy – particularly in respect of the power of the court to avoid transfers made pursuant to a financial agreement in accordance with the claw back provisions. Amendments have attempted to ensure a fairer outcome between the trustee in bankruptcy and spouse of a bankrupt in sharing the assets of the bankrupt.

It should be noted the position of trusts under a Family Law property proceeding is considered at heading "VI" below.

It should also be noted some creditors will actively intervene in and Family Law Proceedings where their interests are concerned. The most common example is the Commissioner of Taxation. The current, and various, family law proceedings involving members of the "Punters Club" are relevant examples.

Transfer of assets to a discretionary trust

The second strategy is the transfer of assets to or the accumulation of assets in a family discretionary trust. A family discretionary trust is not a legal entity in its own right but rather a relationship between the legal owner of the assets being the trustee and the beneficial owners being the beneficiaries. In the case of a discretionary trust, the beneficiaries only have a right or entitlement to the assets of the trust where the trustee exercises its discretion to apply those assets or the income from those assets to the benefit of a particular beneficiary.[28] As the beneficiary has no right or entitlement to the assets of the trust, there is no value in that interest which can be divided amongst the creditors.

The transfer of assets to a discretionary trust in the context of the claw back provisions raises similar issues as raised by the transfer of assets to a spouse. Accordingly, the paper will not address these same issues again. Rather the paper will look at whether the trustee in bankruptcy can somehow gain control of the discretionary trust for the benefit of the creditors.

Superannuation

The third asset protection strategy involves the moving of assets into the superannuation environment.[29] Not only does this provide tax concessions but

[27] Part VIIIA of the *Family Law Act* is effective from 27 December 2000 and replaces sections 86 and 87 dealing with maintenance agreements.
[28] *Gartside v IRC* [1968] AC 553 per Lord Reid.
[29] The paper assumes that the interest in the superannuation fund is a totally preserved benefit and that the member does not have a vested interest. Where the member of the superannuation fund has an entitlement to the amount in the superannuation fund (say, they have satisfied a trigger event that entitles them to draw the benefits from the fund) then different consequences may arise: see *Bond v Ramsey* (1992) 25 ATR 61; (1994) 119 ALR 215. The paper does not consider these issues.

also purportedly provides some level of asset protection for the member of the superannuation fund.

The making of superannuation contributions by a person who may become a bankrupt does not remove the asset from "belonging to" the bankrupt. An asset is retained by the bankrupt in the form of their interest in the superannuation fund. The moving of assets into superannuation is an attempt in the context of bankruptcy to rely on one of the specific exclusions in sub-section 116(2) of the *Bankruptcy Act* so that that interest in the superannuation fund does not become divisible amongst the creditors of the bankrupt.

Under sub-section 116(5) the exception only applied to the pension reasonable benefits limit for the bankrupt, but the reasonable benefits limit was removed as from 1 July 2007 by the *Superannuation Legislation Amendments (Simplification) Act* 2007 (Cth) as part of the simpler super regime. Accordingly, as from that date, the entire interest of the bankrupt in an appropriate fund is protected.

By transferring assets of a person who may at some time become a bankrupt to the spouse of that person or a discretionary trust controlled by that person, the asset is no longer property that belongs to the bankrupt. As such the property is not divisible amongst the creditors of the bankrupt. By transferring assets into superannuation for the benefit of the bankrupt the assets become specifically excluded from being property that is divisible amongst the creditors of the bankrupt.

In either case and in the absence of the claw back provisions the rights of the creditors are compromised by the reduction in the size of the estate of the debtor.

IV CLAW BACK PROVISIONS

The claw back provisions are found in sections 120 and 121 of the *Bankruptcy Act*. The purpose of the claw back provisions is to ensure that a person cannot in certain circumstances subtract assets from their estate so that in the event of bankruptcy those assets are no longer available (or at least readily available) to be distributed rateably among creditors.[30]

Importantly, and not obviously on its face, the term “creditors” in this context includes persons who were not creditors at the time of the disposition.

Section 120 - Undervalued Transactions

Sub-section 120(1) provides:

> *"A transfer of property by a person who later becomes a bankrupt (the "transferor") to another person (the "transferee") is void against the trustee in the transferor's bankruptcy if:*

[30] *Cannane v Official Trustee* (1998) 192 CLR 557.

(a) the transfer took place in the period beginning 5 years before the commencement of the bankruptcy and ending on the date of the bankruptcy; and

(b) the transferee gave no consideration for the transfer or gave consideration of less value than the market value of the property."

The reference to "void" means "voidable".[31] Where the trustee in bankruptcy relies on the provision to avoid a transfer, the trustee must repay any consideration paid by the transferee to the bankrupt.[32]

Section 120 however, does not apply where the transfer of property to a related entity took place more than four years before the commencement of bankruptcy (or two years where transfer to an unrelated entity) and the transferee can prove at the time of the transfer that the transferor (being the person who later becomes the bankrupt) was solvent.[33]

The elements therefore that the trustee in bankruptcy must satisfy to claw back a transfer pursuant to section 120 are that:

1. there has been a transfer of property by the bankrupt to another person; and

2. the transfer to the related entity occurred:

   (a) if at the time of the transfer the bankrupt was solvent - during the period from the commencement of bankruptcy to no more than 4 years before the commencement of bankruptcy; and

   (b) if the bankrupt was not solvent at the time of the transfer - from the commencement of the bankruptcy to the period not more than 5 years before the commencement of bankruptcy; and

3. the transfer was for less than market value.

<u>Transfer of Property</u>

A transfer of property includes a payment of money.[34] Further, a person who does something that results in another person becoming the owner of property that did not previously exist is also taken to have transferred the property to another person.[35] Certain transfers of property are expressly exempted from the provisions, including the payment of a tax and a transfer to meet all or part of a liability under a maintenance agreement or maintenance order.[36]

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[31] *Official Trustee in Bankruptcy v Alvaro* (1996) 66 FCR 372; *Lumsden v Snelson* [2001] FCA 83.
[32] Sub-section 120(4) of the *Bankruptcy Act*.
[33] Sub-section 120(3) of the *Bankruptcy Act*.
[34] Paragraph 120(7)(a) of the *Bankruptcy Act*.
[35] Paragraph 120(7)(b) of the *Bankruptcy Act*; for an application of the provision see *Sutherland v Brien* [1999] NSWSC 255.
[36] Sub-section 120(2) of the *Bankruptcy Act*.

Insolvency

The period of time at which transfers may be at risk depends on whether the bankrupt was solvent or insolvent at the time of the particular transfer. If at a particular time of transfer it can be shown that the bankrupt was solvent, then the trustee can only avoid transfers made up to 4 years before the commencement of bankruptcy. On the other hand, if the trustee in bankruptcy can show that the bankrupt was insolvent at the time of the transfer, then the trustee can avoid transfers that occurred up to 5 years before the commencement of bankruptcy.

The trustee of an estate of a bankrupt cannot commence an action under section 120 after the expiration of 6 years from the date from which the bankrupt becomes a bankrupt.[37]

A person is insolvent if they are not solvent.[38] A person is "solvent" if, and only if, the person is able to pay all the person's debts as and when they become due and payable.[39]

The definition of solvency has removed the concept that the bankrupt be able to pay his debts from his own money. The leading case on this aspect is *Sandell v Porter* (1966) 115 CLR 666 where Barwick CJ held that a debtor was not limited to their own cash resources in considering whether they were able to meet their debts as and when they fall due, but could also take into account their ability to sell or mortgage assets to raise funds. The Chief Justice imposed a time limit on the sale or mortgage of assets and said that the money to be realised from the sale or mortgage must be available in a relatively short period of time, determination of which was a matter for the court to decide in each case, although regard is to be had to the nature and amount of the debts, the prevailing circumstances and the nature of the debtor's business (see page 671 of the decision).

Solvency and liquidity are not the same thing. The availability of cash is only one factor to be considered in determining solvency. In *Bank of Australasia v Hall* (1907) 4 CLR 1514 at 1528 Isaacs J said:

> *"This does not mean that he is always bound to keep by him in cash a sum sufficient to meet all his outstanding indebtedness however distant the date of payment may be. If … the debtor's position is such that he has property either in the form of assets in possession or debts which if realised would produce sufficient money to pay all his indebtedness, and if that property is in such a position as to title and otherwise that it could be realised in time to meet the indebtedness as claims mature with money thus belonging to the debtor, he cannot be said to be unable to pay his debts as they become due from his own moneys."*

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[37] Sub-section 127(3) of the *Bankruptcy Act*.
[38] Sub-section 5(3) of the *Bankruptcy Act*.
[39] Sub-section 5(2) of the *Bankruptcy Act*.

Further, insolvency is to be tested upon when debts become due and payable as opposed to solely when they become due.

Where the bankrupt carried on a business and did not maintain or has not preserved proper and usual books and records in relation to the period in which the transfer took place then there is a rebuttal presumption that the bankrupt was insolvent at the time of a transfer.[40]

Market Value

The "market value" test replaces the previous “valuable consideration” test which applied before 1996. A purchaser for valuable consideration under the old test in sub-section 120(1) of the *Bankruptcy Act* was one who had given consideration for his purchase “which has a real and substantial value and not one which is merely nominal or trivial or colourable".[41] Consideration need not have been adequate. For example, it had been held that a payment of 65% of the market value was sufficient to be valuable consideration to prevent the trustee from avoiding a transfer.[42]

Under the “market value” test, the transfer for 65% of the market value would be able to be avoided by the trustee in bankruptcy provided the transfer was within the relevant 2 year or 5 year timeframe. The trustee would however be required to repay the 65% of the market value paid by the transferee. This would benefit the estate of the bankrupt and creditors by increasing the assets available for distribution amongst the creditors by the 35% value of the asset plus any increase in the market value since the date of the transfer.

The relevant date for determining the market value of property is the market value at the time of the transfer.[43] Determining what is the market value of particular assets may present difficulties – this was acknowledged at the time of the introduction of the market value test.[44] When discussing how to calculate the market value the explanatory memorandum states:

> *"The expression "market value" is intended to refer to the value of the property concerned if it were disposed of to an unrelated purchaser bidding in a market on an ordinary commercial basis for property of the kind disposed of without any sort of discount or incentive for purchase being offered. The expression is not intended to include a situation where the property was being disposed of at a "fire sale" at discounted prices because of some immediate need on the part of the owner to liquidate his or her assets."*[45]

The following transactions are expressly excluded as having value:[46]

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[40] Sub-section 120(3A) of the *Bankruptcy Act*.
[41] *Barton v Official Receiver* (1986) 161 CLR 75.
[42] *Official Trustee v Mitchell* (1992) 38 FCR 364.
[43] Paragraph 120(7)(c) of the *Bankruptcy Act*.
[44] Explanatory memorandum: supra note 23 at paragraph 84.13.
[45] Ibid, see also *Cannane v Official Trustee* (1996) 136 ALR 406 at 420.
[46] Sub-section 120(5) of the *Bankruptcy Act*.

(a) the fact that the transferee is related to the transferor;

(b) if the transferee is the spouse or de facto spouse of the transferor – the transferee making a deed in favour of the transferor;

(c) the transferee's promise to marry, or to become the de facto spouse of, the transferor;

(d) the transferee's love or affection for the transferor;

(e) if the transferee is the spouse of the transferor – the transferee granting the transferor a right to live at the transferred property, unless the grant relates to a transfer or settlement of property, or an agreement, under the *Family Law Act 1975*.

The burden of proof in this circumstance will be on the party seeking to set aside the transaction.[47] However in dealing with the exception the onus is on the transferee.[48]

This safety net, of paying market value, whilst not reducing the net worth of the transferor immediately, does enable the transferor and his/her dependants or family to consume that value on lifestyle expenses (such as living expenses, school fees and holidaying, etc).

Section 121 – Transfers to defeat creditors

Sub-section 121(1) states:

"A transfer of property by a person who later becomes a bankrupt (the transferor") to another person (the "transferee") is void against the trustee in the transferor's bankruptcy if:

(a) the property would probably have become part of the transferor's estate or would probably have been available to creditors if the property had not been transferred; and

(b) the transferor's main purpose in making the transfer was:

(i) to prevent the transferred property from becoming divisible amongst the transfer's creditors; or

(ii) to hinder or delay the process of making property available for division among the transferor's creditors."

There is no time limit on when the transfer must have occurred. The trustee in bankruptcy can commence an action under section 121 with respect of a transfer of

[47] *PT Garuda Indonesia Limited v Grellman* (1992) 35 FCR 515 at 527 to 528.
[48] *Ashton v Prentice: Re Jury* (1999) 92 FCR 68 at 84.

property at any time.[49] Consequently, if the relevant purpose can be found then a transfer made many years, or even decades before the transferor becomes a bankrupt, could be clawed back pursuant to this provision.

However, if:

1. the consideration that the transferee gave for the transfer was at least as valuable as the market value of the property; and

2. the transferee did not know and could not reasonably have inferred that the transferor's main purpose in making the transfer was to prevent the transferred property from becoming divisible amongst the transferor's creditors or to hinder or delay the process of making property available for division among the transferor's creditors; and

3. the transferee could not reasonably have inferred that at the time the transferor was or was about to become insolvent,

then the trustee in bankruptcy will not be able to avoid the transfer.[50]

The burden of proof in this circumstance will be on the party seeking to set aside the transaction.[51] However in dealing with the exception the onus is on the transferee.[52]

The elements therefore that the trustee in bankruptcy must satisfy to claw back a transfer pursuant to section 121 are that:

1. there has been a transfer of property by the bankrupt to another person; and

2. the property would probably have become part of the bankrupt's estate; and

3. the bankrupt's main purpose was to prevent the transferred property from becoming divisible amongst the bankrupt's creditors; and

4. the transferee did not acquire the property for market value and did not know and could not reasonably have inferred that the bankrupt's main purpose, and it could not have reasonably been inferred, that the bankrupt was or was about to become insolvent ("good faith test").

Main Purpose

In determining what the transferor's main purpose was, if it can be reasonably inferred from the all the circumstances that at the time of the transfer, the transferor was, or was about to become insolvent, then the transferor's main

[49] Sub-section 127(4) of the *Bankruptcy Act*.
[50] Sub-section 121(4) of the *Bankruptcy Act*.
[51] *PT Garuda Indonesia Limited v Grellman* (1992) 35 FCR 515 at 527 to 528.
[52] *Ashton v Prentice: Re Jury* (1999) 92 FCR 68 at 84.

purposes will be taken to be the relevant purpose to enable the trustee in bankruptcy to invoke section 121 and avoid that transfer.[53]

Again, where the bankrupt carried on a business and did not maintain or has not preserved proper and usual books and records in relation to the period in which the transfer took place then there is a rebuttable presumption that the bankrupt was or was about to become insolvent at the time of a transfer.[54]

In *Ashton v Prentice: Re Jury*[55] the Full Court of the Federal Court held that if the conditions of sub-section 121(2) of the *Bankruptcy Act* are satisfied the section conclusively determines that the transfer was made with the requisite “main purpose” of preventing the property from becoming divisible amongst the bankrupt’s creditors. This is despite the fact that the bankrupt may have otherwise been able to bring in other evidence to show that the transfer was done for some reason other than defeating creditors.

The notion of defrauding creditors is not limited to those creditors in existence at the time the transfer is made. If it can be shown that the transfer was made with the view to hindering or delaying **future** creditors from recovering their debts or the transfer was made at a time when the bankrupt was about to embark on a hazardous or risky business with a view to placing the property beyond the reach of any possible future creditors[56] then the section can potentially be applied.

The main purpose of a transfer can be inferred from all of the circumstances at the time of the transfer[57]. For example, doctors transferring assets immediately after the collapse of the medical negligence insurer UMP, may have difficulty showing that the transfer was done for the reason other than defeating potential or future creditors. Such transfers may however be protected under the exclusion in sub-section 121(4) being purchasers for market value in good faith.

Good Faith

Where the transferee acquires the property for its market value and is acting in good faith, then any increase in the market value of the property from the date of the transfer is protected and will never be available to creditors. If however the transferee was or is deemed to have been aware that the main purpose of the transfer was to defeat creditors, then even where market value was paid for the property, that transfer can be clawed back. This would result in any increase in the market value of the property from the date of the transfer, being available to creditors. For transfers made some time before the bankruptcy, this increase in value could be significant. Consequently, the need for the transferee to acquire the asset in good faith, is very important.

[53] Sub-section 121(2) of the *Bankruptcy Act*.
[54] Sub-section 121(4A) of the *Bankruptcy Act*.
[55] [1999] FCA 671, (1999) 92 FCR 68.
[56] *Ex parte Russell; Re Butterworh* (1882) 19 Ch D 588; *Lloyd v Blumenthal* (1884) 5 LR (NSW) Eq 99; *Perpetual Executors Limited v Wright* (1917) 23 CLR 185 at pages 193 and 198.
[57] Supra note 39; *Cannane v J Cannane Pty Limited (in liquidation)* [1998] 192 CLR 577 per Brennan CJ & McHugh J at 566-7 Gaudron J at 572 and Kirby at 591/2.

Section 121A – Transferee paying consideration to third party

Section 121A was introduced in 2006 to strengthen the ability of trustees to claw back amounts under sections 120 and 121 where the transferee pays consideration to a third party. In such circumstances the payment by the transferee will be deemed for the purposes of sections 120 and 121 to be a transfer by the bankrupt which a trustee in bankruptcy can seek to claw back from that third party.

The explanatory memorandum introducing the section provides the following example of how the section is intended to operate:

> *Example 1*
>
> *46. In the 18 months prior to his bankruptcy, John transfers a house property with a market value of $350 000 to Steven. The $350 000 consideration is forwarded by Steven to James (John's brother). As Steven paid market value consideration for the transfer (albeit to a third party), the transfer between John and Steven is not affected by the current provisions in section 120. Steven is able to retain the property. However, pursuant to these proposed changes, the transaction will be deemed to be a transfer between John and James for the purposes of sections 120 and 121.*
>
> *47. The question will then be whether the current provision in sections 120 and 121 apply. If James had earlier lent $200 000 to John, and John had directed the payment be made in order to extinguish that debt, then James had not provided market value consideration to John for the payment of $350 000. That deemed transfer would be void against the trustee.*
>
> *48. Current subsection 120(4) would also be relevant. By virtue of that provision, the trustee would be obliged to refund to James the $200,000 consideration he had earlier paid.*

Section 139DA – Property owned by another natural person

A major change to the Bankruptcy Act introduced in 2006 greatly enhances the powers of a trustee in bankruptcy clawing back assets held in the name of a spouse of a bankrupt.

Section 139DA provides:

> *If, on an application under section 139A for an order in relation to a respondent entity that is a natural person, the Court is satisfied that:*
>
> *(a) during the examinable period, the entity acquired an estate in particular property as a direct or indirect result of financial contributions made by the bankrupt during that period; and*
>
> *(b) the bankrupt used, or derived (whether directly or indirectly) a benefit from, the property at a time or times during the examinable period; and*
>
> *(c) the entity still has the estate in the property;*

the Court may make an order of a kind referred to in subsections 139D(2) and (3), whether or not the bankrupt has ever had an estate in the property.

The application can be made at any time within 6 years after the date of bankruptcy.[58]

The 'examinable period' is, in relation to a 'related entity', either 4 years prior to the commencement of the bankruptcy, or from the first point of insolvency in the year previous to that if the bankrupt became insolvent during that year and in any other case, the 'examinable period' is either 2 years prior the commencement of the bankruptcy, or from the first point of insolvency in the 3 years previous to that if the bankrupt became insolvent during that period[59]. A presumption will arise that the bankrupt became insolvent during the first year of the 5 years prior to bankruptcy (or, for orders in relation to non-related entities, the first 3 of the 5 years prior to bankruptcy) if it is established that the transferor had not, in respect of that time, kept proper 'books, accounts and records'; or where, having kept the appropriate books, accounts and records in relation to that time, the transferor had failed to preserve them.

The main application of section 139DA will likely arise in respect of a family home in the name of the bankrupt's spouse where the mortgage has been funded by the bankrupt's income.

In such circumstances the Court may vest in a trustee in bankruptcy the property or a specified part of the property owned by the non bankrupt. The issue will be how the court will determine what part of the property to vest – merely the mortgage payments made during the requisite four year period or some greater share relevant to any increase in value of the property during that time.

Section 37A - Conveyancing Act

Section 37A of the *Conveyancing Act* 1919 (NSW) derived from the Statute of Elizabeth I enacted in 1570. Section 37A has in the bankruptcy context been overridden to a large extent by section 121 but does remain a separate alternative remedy available to creditors. Section 37A allows the creditor to itself recover an asset for its own benefit rather than funding the trustee in bankruptcy to recover the asset for all of the creditors of the bankrupt.

Section 37A of the *Conveyancing Act* states:

> *"(1) Save as provided in this section, every alienation of property made whether before or after the commencement of the Conveyancing (Amendment Act) 1930, with intent to defraud creditors shall be voidable at the instance of any person thereby prejudiced.*
>
> *(2) This section does not affect the law of bankruptcy for the time being in force.*

[58] Section 139A of the *Bankruptcy Act*.
[59] Section 139CA of the *Bankruptcy Act*.

> (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 intent to defraud creditors."*

Whilst section 37A allows a creditor to recover an asset itself, the section cannot be used by a creditor where the debtor has used assets to pay out other creditors. The section is directed at transfers of property to a third party who is not a creditor, and then only if that transfer is made with the intention to defeat the interest of the creditors of the debtor as a whole.[60]

An action under section 37A of the *Conveyancing Act* must be made within the normal statute of limitations period. This provides one disadvantage as compared to section 121 of the *Bankruptcy Act* which has no such time limit on seeking to avoid the transfer.

Like section 121, the intention to defraud creditors may be inferred from the circumstances in which the transfer took place.[61]

Whilst section 37A of the *Conveyancing Act* is an alternative remedy, it has very rarely been utilised.[62] One reason why the provision may not be relied upon as much as the claw back provisions in bankruptcy, is that there are no examination powers available to persons who wish to rely on section 37A to have access to the necessary information to become aware of the potential action and to provide the necessary information to assist in succeeding in such an action.

V APPLICATION OF CLAW BACK PROVISIONS TO ASSET PROTECTION STRATEGIES

Where a potential bankrupt has transferred assets at a time prior to the commencement of their bankruptcy, then the following hurdles have to be overcome to ensure that those assets cannot be clawed back by the trustee.

- First, if the transfer has been made within the period of relation back, being at most 6 months before the making of the sequestration order, then the transfer will be void as the bankrupt had no title in the property as it has already vested in the trustee in bankruptcy.

- Secondly, if the transfer to a related party has been made within 4 years of the commencement of bankruptcy, then the transfer must have been made for market value.

- Thirdly, if the transfer has been made within 5 years of the commencement of bankruptcy, the transferee must show that at the time of that transfer that the bankrupt was not insolvent, or that the transfer was made at market value.

[60] *Alati v Wei Sheung and Others* [2000] NSWSC 601.
[61] *Cannane v J Cannane Pty Limited (in liquidation)* [1998] 192 CLR 577 per Brennan CJ & McHugh J at 566-7 Gaudron J at 572 and Kirby at 591/2.
[62] See *Turnbull v Gorgievski & Gorgievski* [2000] NSW SC 365 as a recent example.

- Finally, irrespective of the date that the transfer of the property was made, the bankrupt must show that their main purpose in making the transfer was not to prevent the transferred property from becoming divisible amongst the transferor's creditors, or, it was not done to hinder or delay the process of making property available for division amongst the transferor's creditors.

Failure to pass any of these hurdles will allow the trustee in bankruptcy to avoid the transfer so that the asset, after returning any payment actually made by the transferee, can be distributed amongst the creditors of the bankrupt.

Further, even where these hurdles can be passed if the trustee in bankruptcy can show the bankrupt has made a financial contribution in respect of property owned by a third party and the bankrupt derived a benefit from that property then part of the asset will be available to be distributed amongst the creditors of the bankrupt.

Gift to Spouse or Family Trust

Where a gift of property is made for no consideration, then the requirement in section 120 of the *Bankruptcy Act* that the transfer be for market value, will not be able to be satisfied. Consequently, to avoid the potential application of section 120, such gifts would need to be made more than 4 years before the commencement of the bankruptcy, and the transferee must be able to prove that at the time of the transfer the bankrupt was solvent.

Even where this can be shown, the transfer will not be saved if the trustee in bankruptcy can show that the main purpose for the transfer was to hinder or delay the assets becoming available to creditors. If at the time of the transfer, the transferor was, or was about to become insolvent, then the bankrupt will be taken to have the requisite purpose allowing the trustee in bankruptcy to succeed in respect of avoiding a transfer under section 121 of the *Bankruptcy Act*.

Where the transfer was done many years prior to becoming a bankrupt, and at the time of the transfer the transferor was or was about to become insolvent, then that by itself does not protect the transfer. It is still necessary to establish the main purpose of the transfer.[63] Section 121 of the *Bankruptcy Act* is concerned with the intention to defraud any present or future creditor and it is not concerned with the realisation of the intention. If the requisite intention exists at the time of the transfer in relation to a person not already a creditor it is immaterial whether or not that person in fact later becomes a creditor.[64]

To overcome any potential operation of the claw back provisions, the transfer of a property to the spouse or discretionary trust would need to be done at market value and the spouse or discretionary trust, as the case may be, would need to be able to show that they did not know or could not reasonably infer that the transferor's main purposes was hindering or delaying creditors, and further, that they could not reasonably infer that the transferor was, or was about to become, insolvent.

In the case of a transfer to a discretionary trust where the bankrupt has a controlling mind over the trustee then it may be difficult to prove that the discretionary trust as transferee

[63] Sub-section 121(3) of the *Bankruptcy Act*; supra note 45.
[64] *Ebner v Official Trustee in Bankruptcy* (1999) 91 FCR 353.

did not know the bankrupt's purpose or should not have been able to infer that the bankrupt was, or was about to become, bankrupt.[65]

Whilst the market value of the property of the bankrupt at that time will remain an asset of the bankrupt, provided the good faith element for the transferee can be met in section 121 of the *Bankruptcy Act*, any future increase in value of the property should be fully protected against creditors.

The bankrupt may then attempt to deal with the asset representing the value of the property as at the date of the transfer by either dissipating it or separately transferring it. To the extent that the asset is transferred, then that transfer itself may potentially be subject to claw back under section 120 of section 121 as described above. However, the bankrupt would have quarantined the value of the assets that may one day be available to creditors.

Trustees of the Property of John Daniel Cummins v Cummins [2006] HCA 6

At law where a husband made a greater contribution than his wife there was a presumption that the greater contribution was a gift in favour of the wife. Such gift would be protected from creditors of the husband if made more than 4 years before coming a bankrupt where the husband was solvent at the time of making the gift.

This presumption has been overturned by the High Court such that now the presumption for married persons is that the owner of the property holds it for themselves and their spouse in equal shares. The High Court states:

> *71. The present case concerns the traditional matrimonial relationship. Here, the following view expressed in the present edition of Professor Scott's work [The Law of Trusts, 4th ed (1989)] respecting beneficial ownership of the matrimonial home should be accepted:*
>
> > *"It is often a purely accidental circumstance whether money of the husband or of the wife is actually used to pay the purchase price to the vendor, where both are contributing by money or labor to the various expenses of the household. It is often a matter of chance whether the family expenses are incurred and discharged or services are rendered in the maintenance of the home before or after the purchase."*
>
> *To that may be added the statement in the same work:*
>
> > *"Where a husband and wife purchase a matrimonial home, each contributing to the purchase price and title is taken in the name of one of them, it may be inferred that it was intended that each of the spouses should have a one-half interest in the property, regardless of the amounts contributed by them."*

A trustee in bankruptcy is likely to fair much better for the interest of creditors by relying on this presumption enabling them to access half of the value of the family home rather

[65] For an example see *Official Trustee in Bankruptcy v Trevor Newton Small Superannuation Fund Pty Limited* [2001] FCA 1267.

than a potentially more limiting return under the new section 139DA of the *Bankruptcy Act*.

The issue for practitioners is how the presumption that it was intended that each of the spouses should have a one-half interest in the property, regardless of the amounts contributed by them and the owner of title can be rebutted. Much greater care of documenting arrangements at the time of purchase of a property will be necessary to seek to overcome this new presumption.

Practitioners should warn clients to ensure that their intentions in purchasing a property in the name of one spouse are made clear at the time of purchase to enable the presumption to be rebutted. The evidence must have existed before the entry into the transaction. The court, in *Cummins Case*, stated that the only admissible evidence of acts and declarations made before or at the time of purchase or "so immediately after as to constitute a part of the transaction".

Family Law Arrangements

From 27 December 2000 Part VIIIA[66] of the *Family Law Act* commenced and introduced binding financial agreements between spouses to a marriage. The effect of a binding financial agreement is that where both parties to a marriage have validly executed a financial agreement[67], the Family Court is prevented from exercising normal jurisdiction in relation to the financial matters to which the financial agreement applies.[68] The introduction of binding financial agreements has brought an end to the maintenance agreements that were previously registered by the Family Court.[69]

There are three types of binding financial agreements. A financial agreement can be made before a marriage,[70] during a marriage[71] or after dissolution of a marriage.[72] Irrespective of when the binding financial agreement is entered into it will be a "financial agreement" for the purposes of the *Family Law Act.*[73]

The importance of family law in the context of bankruptcy arises from the fact that both areas of law are governed by 3 separate courts: the Family Court of Australia for family law matters and the Federal Court of Australia for bankruptcy matters or the Federal Circuit Court of Australia for both; all 3 have federal jurisdiction. The "Baxter Principle"[74] establishes the inability of the Federal Court to interfere with an order of the Family Court and vice versa. The position of the two courts to a large extent, has in the past resulted in the relative rights of spouses and creditors of a bankrupt being settled on a "first come

[66] Introduced by the *Family Law Amendment Act 2000*, Act No 143 of 2000.
[67] See section 90G of the *Family Law Act* for the requirements to make the financial agreement binding.
[68] Sub-section 85A(3) of the *Family Law Act*.
[69] see section 86A, sub-section 86(1A) and sub-section 87(1A) of the *Family Law Act*.
[70] Section 90B of the *Family Law Act*.
[71] Section 90C of the *Family Law Act*.
[72] Section 90D of the *Family Law Act*.
[73] see the definition of "financial agreement" in section 4 of the *Family Law Act*.
[74] *Re Baxter; ex parte Official Trustee and Bankruptcy v Baxter* (1986) FLC 91-715.

first serve" basis[75]. Consequently, this interaction between bankruptcy and family law involved either a divesting of assets through bankruptcy to the detriment of the spouse and family or the passing of assets to the family in anticipation of pending bankruptcy to the detriment of creditors. Legislation to overcome these problems came into effect on 18 September 2005 and now provides a more equal footing for interested parties as follows:

- Bankruptcy after separation and prior to final orders dealing with matrimonial property – the trustee in bankruptcy will stand in the shoes of the bankrupt spouse in the matrimonial proceedings to represent the interests of creditors

- Bankruptcy after separation and after final orders dealing with matrimonial property – the trustee in bankruptcy may bring an application to have the matrimonial proceedings reheard to take into account the interests of creditors where those interests have not been properly taken into account

- Separation after bankruptcy but prior to trustee in bankruptcy dealing with property – the non-bankrupt spouse is required to commence matrimonial proceedings to have his or her interest in the bankrupt's property recognised.

Position of Appointor of Discretionary Trust

The value of a discretionary beneficiary's interest in a discretionary trust is nominal. This is on the basis that the beneficiary is only entitled to income or capital of the trust fund where the trustee exercises its discretion to pay an amount to the particular beneficiary. But in many cases it is the bankrupt who ultimately controls the trustee by being the nominated appointor of the particular discretionary trust. The appointor of the discretionary trust is the person who can appoint and remove the trustee. As the trustee is the person who determines who is entitled to receive any income or capital of the trust, the appointor can control the distribution of income and capital by appointing the appropriate trustee.

Consequently, if the trustee in bankruptcy can stand in the shoes of the bankrupt as appointor of a particular family trust, then potentially the trustee in bankruptcy could appoint a "friendly" trustee to cause a distribution of the assets of the trust fund to the bankrupt. This distribution would be after acquired property of the bankrupt which would vest in the trustee and then be available to be divisible amongst the creditors.

The current position however is that the power of appointment of the trustee of a trust is not property for the purposes of the *Bankruptcy Act.*[76] The position of the appointor is a fiduciary one that must be exercised for the benefit of the beneficiaries and can not be executed in the interests of the appointor. In *Re Burton*, Davies J concluded:

> *"Thus, as the interests of the beneficiaries must be taken into account, and the power exercised in their interest, the power which Mr Burton holds as Appointor is not "property" which vests in the trustee in bankruptcy nor a power "as might have*

[75] For example see *Hannah and Hannah; Tozer and Tozer* (1989) FLC 92-052 where Elliot J refused to set aside a consent order which transferred to husband's interest in the matrimonial home to the wife despite the insolvency of the husband.
[76] *Re Burton; Wiley v Burton* (1994) 126 ALR 557.

> *been exercised by the bankrupt for his own benefit". The power is not as encompassed by paras (a) and (b) of s. 116(1) of the [Bankruptcy] Act. Cf. In Re Taylors Settlement Trusts (1928) 1 Ch 435. Re FJ Matheson; Ex parte Worrell (Applicant), Matheson (Respondent) (unreported, Federal Court, Spender J, 14 April 1994)."*[77]

Division 4A of Part VI of the *Bankruptcy Act* specifically contemplates and makes provision for the circumstances where a bankrupt controls a trust.[78] In these circumstances it can be argued that the *Bankruptcy Act* recognises that the interest of the bankrupt in a discretionary trust is not attainable by a trustee in bankruptcy. For a somewhat contradictory view see Branson's J paper for ITS in 2006.[79]

This position of not "looking through" the trust to allow creditors the benefits of the assets of the trust to assist in satisfying their claims differs from the approach adopted by the Family Court in determining whether a spouse has an entitlement to the assets of a discretionary trust of which the husband is the appointor. In the Family Court the assets of discretionary trusts where the husband has control through his role as appointor, are taken into account in determining the distribution of assets of the marriage.[80] But see heading "VI" below for more details.

Australian Securities and Investments Commission in the matter of Richstar Enterprises Pty Limited v Carey (No. 6)

These proceedings relate to the *Corporations Act* 2001 (Cth) and not the *Bankruptcy Act.* ASIC was trying to prevent the dissipation of assets of persons related to the collapse of the Westpoint group who may be found liable to pay money whether in respect of a debt, by way of damages or compensation or otherwise. Section 1323 of the *Corporations Act* allows ASIC to seek an order form the Court to have a receiver appointed to the property of that person.

Section 9 of the *Corporations Act* defines 'property' as follows:

> ***property*** *means any legal or equitable estate or interest (whether present or future and whether vested or contingent) in real or personal property of any description and includes a thing in action.*

In the current proceedings ASIC was seeking to have a receiver appointed to discretionary trusts of which the relevant persons where beneficiaries. Prior to this decision it was widely thought that beneficiaries of discretionary trusts did not have an interest that was capable of being attributed value[81].

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[77] Ibid at para 12.
[78] Division 4A relates to entities controlled by the bankrupt and 'entity' includes a trust.
[79] *The Bankrupt, His or Her Spouse and the Family Trust: A consideration of Part VI Division 4A of the Bankruptcy Act* delivered at the Bi-Annual Congress.
[80] *In the marriage of Ashton* (1986) 11 Fam LR 457; but see *Spellson and Spellson* (1989) FLC 92-044 and *Knight and Knight* (1987) FLC 91-854 where the party to the marriage did not have the necessary control to result in the assets being divided up in a family settlement. See also *In the marriage of Davidson* (1990) 14 Fam LR 817, *In the marriage of Goodwin* (1990) 14 Fam LR 801, *In the marriage of Harris* (1991) 15 Fam LR 26.
[81] *Gartside v Inland Revenue Commissioners* [1968] AC 553; *R & I Bank of Western Australia v Anchorage Investments Pty Limited* (1992) 10 WAR 59.

Justice French endorsed the widely thought view where he stated:

> *Nevertheless, in my opinion, in the ordinary case the beneficiary of a discretionary trust, other than perhaps the sole beneficiary of an exhaustive trust, does not have an equitable interest in the trust income or property which would fall within even the most generous definition of 'property' in s 9 of the Act and be amenable to control by receivers under s 1323.*[82]
>
> *I am inclined to think that a beneficiary in such a case, at arms length from the trustee, does not have a 'contingent interest' but rather an expectancy or mere possibility of a distribution.*[83]

Both comments however were limited to the 'ordinary case'. Where a beneficiary effectively controls the trustee's power of distribution or the trustee is in truth the alter ego of the beneficiary then " at very least a contingent interest **may** be identified because, to use the words of Nourse J, 'it is as good as certain' that the beneficiary will receive the benefits of distributions either of income or capital or both" (emphasis added).[84]

Justice French then relied on Family Court cases to support his contention that the value of such trusts should be attributed to the respective beneficiaries. Justice French accordingly made orders which allowed for the appointment of a receiver to discretionary trusts where it was found that the requisite control by the beneficiary existed. Those circumstances related to situations where the beneficiary or their spouse control the trustee or appointor positions in the trust.

Importantly, the proceedings were interlocutory only and relate solely to the application of a preventative order in respect of the potential dissipation of assets. The substantive orders are still to be made.

The appointment of a receiver whilst inconvenient may not necessarily result in creditors of a bankrupt accessing such assets. The definition of property in which the trustee in bankrupt is vested is different to the definition considered in *Richstar*. Further, the nature of the respective proceedings is very different. The decision of Re Burton was not considered by Justice French in the *Richstar* decision. In my view it is not certain that the views set out by Justice French will have the consequence that trustees in bankruptcy will have access to assets of discretionary trusts controlled by bankrupt beneficiaries.

Practitioners will need to wait for future proceedings to determine the extent of the consequences flowing from the *Richstar* decision.

There is an obvious concern however that the decision may have broader application and be adopted in the bankruptcy context. If this does occur many discretionary trust structures will not be effective in providing the asset protection claimed. It will be necessary to review and possibly change the persons holding the roles of the trustee and appointor to obtain the protection being sought from such structures.

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[82] Paragraph 29
[83] Paragraph 36
[84] Paragraph 36.

The *Richstar* decision is however a timely reminder of the importance of treating any structures established faithfully and not ignoring the proper mechanisms that should be followed with such structures. Persons failing to treat their structures with proper respect are more likely to be at risk of losing assets to creditors.

Where the assets of the trust may be at risk is where the bankrupt has a history of receiving distributions from the trust and these distributions stop on the beneficiary becoming bankrupt. A trustee in bankruptcy will be entitled[85] to commence proceedings against the trustee of the discretionary trust asserting that it is not properly exercising its powers and considering all of the beneficiaries. A court in such circumstances could possibly appoint a new trustee who would properly carry out the terms of the trust in the interest of the beneficiaries. This would include the bankrupt who had a history of receiving distributions but for no other reason than his bankruptcy stopped receiving such distributions.[86]

Superannuation

A transfer to a superannuation fund is in a different position to transfers made to a spouse or a discretionary trust. This is because the interest in the superannuation fund, whilst still an asset of the bankrupt, is excepted from the property that is divisible amongst creditors pursuant to sub-section 116(2) of the *Bankruptcy Act*. In the case of transfers to a spouse or a discretionary trust the assets transferred do not fall within sub-section 116(2).

Does the fact that the superannuation interest is protected in sub-section 116(2) have any affect when applying the claw back provisions? A decision[87] of the High Court provided considerable protection in respect of superannuation contributions made by bankrupts prior to bankruptcy. To overcome this decision specific anti-avoidance provisions have been introduced in respect of contributions made after 27 July 2006, allowing creditors to claw back certain amounts paid to superannuation by bankrupts.

Any payments made by a bankrupt to a superannuation fund during the relation back period will be void[88] and can be recovered by the trustee in bankruptcy.[89]

Contributions made before 28 July 2006

Any payments made by a bankrupt to a superannuation fund during the period within 2 years of the commencement of bankruptcy will be void[90] unless it can be shown that the fund gave consideration for the contribution that was equal to the market value of the contribution.

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[85] *Cummings v Claremont Petroleum NL* (1995-1996) 185 CLR 124 per Brennan CJ, Gaudron and McHugh JJ at 134.
[86] *Pope v DPR Nominees Pty Limited* [1999] SASC 337 (13 August 1999).
[87] *Cook v Benson* [2003] HCA 36 (19 June 2003)
[88] Section 58 of the *Bankruptcy Act*.
[89] Pursuant to sub-section 129(4) of the *Bankruptcy Act*.
[90] Section 120 of the *Bankruptcy Act*.

The High Court endorsed the opinion of the majority of the Full Court of the Federal Court in the decision of *Benson v Cook*[91] where it was held[92] that the fund had provided valuable consideration.

If the bankrupt was insolvent at the time of the contribution to the superannuation fund, all personal contributions within 5 years of commencing bankruptcy can be avoided[93] by the trustee in bankruptcy.

Any payments made by a bankrupt as contributions to a superannuation fund with the intention to defeat creditors at any time can also be avoided[94] by the trustee in bankruptcy.

Presumably most bankrupts when making personal contributions that potentially can be recovered under the claw back provisions will be able to prove that the contribution was made for the main purpose of providing retirement benefits. However, if it can be inferred from the circumstances that at the time of the contribution the bankrupt was, or was about to become, insolvent then the trustee in bankruptcy can recover the contribution.[95]

Contributions made after 27 July 2006

From 27 July 2006 section 128B provides a specific claw back provision relating to superannuation contributions made by a bankrupt:

> ***128B Superannuation contributions made to defeat creditors—contributor is a person who later becomes a bankrupt***
>
> *Transfers that are void*
>
> *(1) A transfer of property by a person who later becomes a bankrupt (the **"transferor"**) to another person (the **"transferee"**) is void against the trustee in the transferor's bankruptcy if:*
>
> *(a) the transfer is made by way of a contribution to an eligible superannuation plan; and*
>
> *(b) the property would probably have become part of the transferor's estate or would probably have been available to creditors if the property had not been transferred; and*
>
> *(c) the transferor's main purpose in making the transfer was:*
>
> *(i) to prevent the transferred property from becoming divisible among the transferor's creditors; or*
> *(ii) to hinder or delay the process of making property available for division among the transferor's creditors; and*

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[91] Supra note 90.
[92] Per Beaumont and Kiefel JJ, Hely J dissenting.
[93] Paragraph 120(1)(a) of the *Bankruptcy Act*.
[94] Section 121 of the *Bankruptcy Act*.
[95] Sub-section 121(2) of the *Bankruptcy Act*.

(d) the transfer occurs on or after 28 July 2006.

In determining whether the transferor's main purpose in making the transfer was the purpose described in paragraph (1)(c), regard must be had to whether, during any period ending before the transfer, the transferor had established a pattern of making contributions to one or more eligible superannuation plans and if so, whether the transfer, when considered in the light of that pattern, is out of character[96]. It is interesting to speculate whether a massive contribution prior to 30 June 2007 under the transitional rules to the new system could be justified on the grounds of tax planning, and not avoidance of creditors.

Any transfer made at a time when the member of the fund was, or was about to become, insolvent will be deemed to have been made for the requisite purpose. Again failure to keep or preserve books and records will amount to a rebuttable presumption that the requisite purpose is in existence for the claw back provision to operate.

Payments by third parties for the benefit of a person who becomes a bankrupt may also be clawed back in favour of the creditors of the bankrupt. In the superannuation context section 128C provides a similar claw back provision in respect of contributions made by a party for the benefit of a person who later becomes a bankrupt.

VI TRUSTS UNDER THE FAMILY LAW ACT

Recent years have been a turbulent time for the controllers of trusts and their advisors. Some the reasons are set out above, such as amendments to the *Bankruptcy Act* to widen situations in which trusts may be exposed, attacks on the position of appointor by trustees in bankruptcy and the *Richstar Case*. Others are tax related such as the Commissioner of Taxation's position on deemed dividends,[97] the governments decision to abolish the capital gains tax exemption for trust cloning in late 2008 and the decisions in *Bamford,*[98] *Colonial*[99] and *Clark*[100] and subsequent Australian Taxation Office.

One of the most significant issues involving trusts has been the high Court's decision in *Kennon v Spry* [2008] HCA 56. Many commentators consider it to have altered the longstanding principles relating to asset protection in the break down of a marriage or a relevant de facto relationship. The author doesn't agree. However, this development, the cases that follow it and, of course, the Family Court's power under the *Family Law Act* are significant issues for trusts and asset protection generally.

The Family Court's Powers Relating to Trusts

The asset protection typically understood to be afforded by trusts is derived fro the fact an object of a discretionary trust is a mere object (see above for further details). However, the Family Court has far reaching powers in dealing with trusts.

[96] Sub-section 128B(3) of the *Bankruptcy Act*.
[97] See *Taxation Ruling TR 2010/3* in relation to Division 7A of Part III of the *Income Tax Assessment Act* 1936 (Cth).
[98] *FCT v Bamford* [2010] HCA 10.
[99] *Colonial First State Investments Ltd v FCT* [2011] FCA 16.
[100] *FCT v David Clark; FCT v Helen Clark* [2011] FCAFC 5.

The starting point of a property division is determining the nature of assets and liabilities of the parties to the marriage, and to classify those assets and liabilities as either property of the parties or a financial resource or, potentially, neither. If a court determines as part of this process that the trust's assets fall under the definition of a financial resource (as opposed to being the property of the parties), then those assets cannot be divided between the parties under a court order. They will, however, be taken into account in dividing what is the "property" of the parties.

Section 4 of the *Family Law Act* defines "property" as '*property to which those parties are, or that party is, as the case may be, entitled, whether in possession or reversion.'* If an asset is property of a party to a marriage, the *Family Law Act* confers a wide power on the court to vary the legal interests in the property and to make orders for a settlement of property in substitution for any interest in the property.[101]

The definition of "property" in the *Family Law Act* can be contrasted with its definition under the *Bankruptcy Act*. Due to the very broad definition in the *Family Law Act* the Family Court (or Federal Circuit Court) has much wider ability to deal with trust property than the courts dealing with other regimes, such as bankruptcy or insolvency.

Section 79 of the *Family Law Act* applies where the court finds that the trust assets are property of a party to the marriage, rather than a financial resource. Broadly, the four powers of the court in relation to those assets held via a trust are as follows:

<u>*Bringing assets notionally into the matrimonial property pool.*</u>

Arguably the most important step in the making of a property settlement by the court is the process of determining the "pool" of assets available for distribution. Where there is clear evidence that one spouse is the true, unilateral controller of a trust holding assets accrued throughout the marriage of the parties, as well as a potential beneficiary, the court will treat the assets of the trust as property of the parties (see the discussion below). In these situations the assets of the trust will be automatically added to the pool. In *Beeton v Spence*[102] it was held that, where the trust assets are in fact used for the benefit if one (or both) of the parties of the marriage, the court can "look through the formal legal ownership by the trustee when determining the pool of assets. The rationale for these powers is that it would be contrary to the public policy to allow a spouse with full control of assets to quarantine them via a trust from property settlement proceedings where the controlling spouse has the power to determine at any point to whom income and/or capital will be distributed, including to themselves.

<u>*Setting aside transaction which would have the effect of diminishing claims under the Family Law Act.*</u>

The court has power under section 106B of the *Family Law Act* to set aside attempts to alter a trust relationship for the purpose of preventing the court from adding assets of the trust to the property pool.

[101] *Kennon v Spry* [2008] 56 at [10].
[102] *[2007] FamCA 200*

In *Kennon v Spry,* the court relied on this power to set aside the 1998 and 2002 instruments on the basis that the amendments were undertaken for the purpose of limiting the wife's access to the assets of the trust in any subsequent property settlement. At face value, the use of the power in s 106B by the court appeared to create a situation where the assets of a trust could be fully exposed, even where:

- neither party to the marriage solely controlled the trusteeship of a trust; or
- neither party to the marriage were beneficiaries of the trust.

While the husband in *Kennon v Spry* argued that it should be the four children's trusts (of which he was only a co-trustee, and neither he nor the wife were beneficiaries) that should be the subject of the court proceedings, by relying on s 106B, the court effectively ignored the establishment of those trusts and the purported removal of the wife as a potential beneficiary of the original trust.

Having effectively redefined the structure of the trusts, the decision in *Kennon v Spry* ultimately became a relatively "standard" application of how the Family Court determines the notional pool of assets and should be seen as an extension of the powers as previously understood in s 106B.

Declaring the purported trust arrangement to be a sham.[103]

The courts also have power to effectively ignore a trust structure where the trust arrangement is, in fact, a sham. A trust will be treated as a sham (and its purported existence ignored) where the parties intended to create rights and obligations different from those described in the documents. Before courts will hold a sham it must be shown that there was the intention to mislead third parties in respect of the relevant rights and obligations in dispute

In *Harris v Harris* [2011] FamFCAFC 245 the court considered whether a trust arrangement was a sham. In that case the trust had been established at the instigation of the father of the husband prior to the husband's marriage. The trustee of the trust was a company of which the husband and his sister and mother were directors. The husband's mother held 50% of the shares, and the husband and his sister each held 25% of the shares. At the time of the proceedings, the husband's mother was also the appointor of the trust. The husband was listed as a potential beneficiary of the trust, together with his other family members. The trust owned, among other assets, all of the share sin a company which ran a business initially operated by the husband and wife and, after their separation, by the husband alone.

The wife argued that the control arrangement put in place were a sham, and that the trading company (of which there was no dispute that the husband was the managing director) was an alter ego of the husband and, on this basis, the husband had sufficient control of the trust itself such that the assets of both the trust and trading company should be regarded as being included in the property pool. Alternatively, the wife alleged that the husband's mother was "a puppet" of the husband, and he had indirect control of the trust through her.

[103] Though as to the now recognized limited role of sham in relation to trusts see Leeming's JA decision in *Lewis v Condon; Condon v Lewis* [2013] NSWCA 204

The court applied the principles set out by French CJ in *Kennon v Spry* (see below) and found that, whilst the husband was a "beneficiary of the trust, he did not control the trustee directly or indirectly …" and there was no basis to notionally include the assets of the trust (including its shares in the trading company) as part of the pool of assets. In relation to the sham argument the court found that the wife did not advance sufficient evidence to support the finding that the husband's mother was "a puppet", through which he exercised de facto control of the trustee company and the trust. The fact that the trust had been established by the father of the husband, and that virtually every change in the management and direction of the trust could be at least partially referrable to the ongoing estate and succession planning arrangements of the husband's parents, provided strong support to the conclusion that the trust was not a sham.

> *Altering the ownership of a third party and making binding orders on the third parties.*

Under the court's powers under sections 90AC and 90AE of the *Family Law Act*, the court effectively has power to make the following orders:

- direct a third party to do a thing in relation to the property of the marriage, or alter the rights, liabilities or property interests of a third party in relation to the marriage: s 90AE(2)(a).

- restrain a person from repossession of property of a party to the marriage or grant an injunction restraining a person from commencing legal proceedings against a party to the marriage: s 90AF(1).

- Direct a third party to do a thing in relation to the property of the marriage or alter the rights, liabilities or property interest of a third party in relation to the marriage: 90AF(2).

The practical implications of this power were demonstrated in the enforcement action following *Kennon v Spry* in the matter of *Stephens & Stephens (Enforcement)* [2009] FamFCAFC 240 at [355] where it was held:

> *In our view, it follows that an order may be made that enables an entitlement of a party to the marriage who is an object of the trust, or ceased to be an object by reason of divorce, to be satisfied out of the assets of the trust. Put another way, an order may be made that enables a party to the marriage who is in control of the trust to satisfy his or her personal liability to the other party to the marriage who is an object of the trust from the assets of the trust.*

Therefore, trusts, and even discretionary trusts, are fair game for the Family Court or the Federal Circuit Court. But in what circumstances will they make such an order?

Kennon v Spry

Relevantly the facts with regard to the trust in *Kennon v Spry* were, in part, as follows:

- The husband was the only person entitled in possession to the assets of the trust.

- No object of the trust had any fixed or vested entitlement.
- The husband (Dr Spry) was, after execution of the 1983 instrument, left in possession of the assets of the trust, with the legal title to them, and to the income which they generated, unless and until the husband should decide to apply any of the capital or income to any of the continuing beneficiaries.
- The husband was not obliged to distribute to anyone.
- The default distribution gave mal beneficiaries other than the husband no more than a contingent remainder. None had a vested interest subject to divesture.
- The husband was the sole trustee of a discretionary family trust and the person with the only interest in its assets as well as the holder of a power, inter alia, to appoint them entirely to the wife.

After considering the above factual scenario French CJ said that the "true character" of the trust was a vehicle for the husband, wife and their children to enjoy assets.

Majority Judgments

The majority comprised all judges other than Heydon J.

In summary, Gummow and Hayne JJ held that for the purposes of section 79 of the *Family Law Act* the trust property was the wife's property because the wife had a right to due administration, the husband had a duty as trustee to consider how to exercise the power of distribution and the power could have been exercised entirely in favour of the wife.

Chief Justice French held that the trust assets were '*property of a party to the marriage'* because the husband had legal ownership of the trust assets, he had power as trustee to appoint the assets to his spouse and the wife had a right to be considered. At [59] to [62] French CJ held that the assets of the trust could be made the subject of s 79 orders because those assets constituted '*property of the parties to the marriage*'.

When property is held by a party to a marriage under a non-exhaustive discretionary trust with an open class of beneficiaries and there is no obligation to apply the assets or income of the trust to anyone, and where this property has been acquired by or through the efforts of that party of his or her spouse, whether before or during the marriage, the property does not necessarily lost its character as '*property of parties to the marriage'* just because the party has declared a trust of which he or she is trustee and can, under the terms of that trust, give the property away to other family or extended family members at his or her discretion: see French CJ at [62] to [80].

Aside from the fact that by the execution of the 1983 instrument the husband excluded himself from the class of beneficial objects of the trust, the circumstances remarked upon by French CJ were entirely commonplace in the context of discretionary trusts: see *Thurlstone (Aust) Pty Ltd v Andco Nominees Pty Ltd* [1997] NSWSC 517. This is one of the reasons the author says *Kennon v Spry* does not alter the landscape of trusts and family law cases.

Minority Judgment

Justice Heydon dissented and held:

- The objects of a discretionary trust do not have "property" in the assets of the trust in the sense in which "property" is understood in general law or in the way in which the word is used in a number of important statutes (such as those considered in this paper).

- The word "property" as used in s 79 of the *Family Law Act* should not be given an extended meaning.

- Even if, contrary to the foregoing, Mrs Spry did have "property" rights (e.g. by virtue of her position as an eligible beneficiary of the trust and thereby having a right to compel the trustee to duly administer the trust) within the meaning of s 79, the orders she sought were directed to gaining access to the assets of the Trust (as opposed to access to the "property right" just described) and she had no property in those assets. As such, the "asset orders" sought by Mrs Spry did not meet the description '*proceedings with respect to the property of the parties to the marriage or either of them'*.

- The definition of "property" in s 4(1) does not contemplate entitlements to property as trustee.

- The Family Court, in making orders under s 79 of the *Family Law Act*, cannot ignore the existence of trust obligations which limit the rights of a party who owns the property and holds the office of trustee.

Many advisers to the controllers of trusts would hope that Heydon J had been it he majority.

Control Analysis

The concept of "control" has been addressed in a number of cases in the Full Court of the Family Court.[104] Further, cases prior and since *Kennon v Spry* make clear the control test is important and, significantly, does not alter the pre *Kennon v Spry* landscape significantly.

Beeson & Spence [2007] FamCA 200 involved a trust established by the wife during the marriage. The wife argued that the trust was established with the purpose of benefitting the children of the relationship and should not be treated as property of the marriage. On establishment of the trust, the wife's father and her solicitor were appointed as trustees and the wife was the appointor. At a time during when the husband was going through financial difficulties, the deed was varied to exclude the wife and the husband as potential beneficiaries of the trust, as well as to resign the wife as appointor. A new appointor, being the wife's sister, was nominated in her place. The husband argued that the trust was established for the benefit of the family and not just the children.

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[104] See *Stephens v Stephens* [2009] FamFCAFC at [37] per May, Boland and O'Ryan JJ; *In the Marriage of Kelly (No 2)* (1981) 7 Fam LR 762; and *Ashton and Ashton* [1986] FamCA 20.

The court ignored the release of direct control by the wife (through her resignation as the appointor) and held that the wife still retained sufficient control of the trust to support a conclusion that the assets should be treated as property of the marriage, citing the following reasons at [28]:

> *The Deed of Variation recognised the resignation of the wife as the appointor and brought about important and fundamental changes to the Trust by appointing a new appointor and by removing the wife and the husband as beneficiaries. Until then, the wife could have continued to lawfully control the Trust by ensuring it was administered in a manner of her choosing, including administered to her sole benefit, both as to income and capital.* (emphasis added)

In contrast, the recent case of *Morton & Morton* [2012] FamFC 30 saw the court decide that, as the husband was merely a potential beneficiary and did not in fact control the trust, the trust was not his “alter ego” on the basis that there was not sufficient control over the trust. Therefore, there was nothing to support a finding that the assets of the trust should be held the property of the husband. In summary, the facts of the case were as follows:

- The couple were married approximately 10 years and had no children;
- At the time of the relationship breakdown, the husband was a beneficiary of a discretionary trust, the Morton Trust.
- The beneficiaries of the trust included the husband, the husband’s brother, mother, any grandchildren or remote relatives and any company or trust in which the husband and his brother had an interest.
- The trustee of the Morton Trust was a trustee company, J Pty Ltd, of which the husband and his brother were equal shareholders and both were directors.
- J Pty Ltd, in turn, owned a “bucket company” on behalf of the trust, known as T Pty Ltd (to which unpaid present entitlements were owed). The husband’s brother was the sole director of T Pty Ltd.
- Finally, the husband and his brother were the joint appointors of the Morton Trust.

The wife argued that, as the two brothers each had a 50% share of the Morton Trust and T Pty Ltd, a 50% interest should be treated as the husband’s property in the property settlement. The wife claimed that the husband, in his capacity as director of J Pty Ltd, had sufficient control of the trust to support this conclusion (see at [35]).

The husband argued that neither he nor his brother had control of J Pty Ltd as neither had a better right than the other in their standings as directors, shareholders or appointors.

The Court accepted the husband’s argument and held that the trust assets should not form part of the pool. It was the case, as accepted by the husband, that the trust assets were his financial resource.

This is a big planning opportunity!!

The decision in *Harris v Harris* [2011] FamFCAFC 245 provides further guidance about the relevance of actual control and, in particular, held at [65] to [67] as follows:

> *In the present case and on the basis of the material before us the husband appears to be no more than a beneficiary of a trust. He is not the appointor of the trust nor does he hold any position in the current trustee company.*
>
> <u>*On the assumption that by the use of the word 'directly', the Chief Justice [in Kennon v Spry] was referring to the strict legal position, it therefore cannot be said that the husband 'directly' controls the current trustee. Nor could it be said that he 'directly' controlled the previous trustee.*</u>
>
> *On the assumption that the reference by the Chief Justice to 'indirect' control of a discretionary trust by a beneficiary was a reference to a 'puppet' situation, in the sense that the person with legal control of the trust is a puppet of a beneficiary, that could be the situation in the present case. In the sense, that is, of the mother (who is the appointor of the trust, and one of the three directors of the trustee company holding two shares in that company with each of the other two directors holding one share each) being the puppet of the husband. This, as was made clear by Counsel's oral submissions to us, has always been the wife's case.*
>
> <u>*The difficulty, however, for the wife on this appeal is to be able to point to any evidence which would support a finding that the husband's mother is his puppet, and that it is through her, or perhaps otherwise, that he exercises de facto control of the trustee company and of the Trust.*</u> (emphasis added)

<u>*Purpose of establishing the trust and range of beneficiaries*</u>

The decision of *Essex & Essex* [2009] FamFCAFC 236 considered the husband's interest in two family trusts, the S Trust and the N Trust. The circumstances of the case were:

- In relation to the S trust, the husband was a default beneficiary, and the two children from the marriage were the capital beneficiaries.
- The husband was only a general beneficiary in the N Trust, on the basis that he was the brother of the primary beneficiary.
- The assets of the two trusts had largely been contributed by the husband's parents for the purpose of providing for the husband's mother's living expenses, and benefitting the husband and his brother and their bloodline.
- The husband had not received distributions from either trust.
- The husband's brother was held by the court to be the controller of both trusts.

The trial court held (and endorsed on appeal by the Full Court) that the assets of the N Trust could not be considered to be property of the spouse parties, as it was unlikely that the husband would ever receive distributions from the trust and it was established for the primary benefit of the husband's brother's family. In reaching his decision, the trial judge considered the control of the trusts:

> *The facts in this matter are distinguishable from the majority of family law proceedings involving discretionary family trusts. Typically when discretionary trusts are involved in family law proceedings one of the parties is the appointor and, frequently, that party is also a director or major shareholder in the trustee company. In such scenarios, the requisite degree of control may be established relatively easily. This is significant distinguishing factor from the present case, where there is little evidence that the husband has or will have control of either of the trusts. Such evidence as exists … is not persuasive.*

<u>*Source of Trust Assets*</u>

As part of property settlement process, it is relevant to consider the contributions made by each of the parties to creating the relationship property. In this context, the courts normally place at least some weight on the source of assets owned via trust.

In *Simmons & Simmons* [2008] FamCA 1088 the wife argued that the husband's interest in the trust should be included in the property pool. The relevant trust was a discretionary trust settled by the husband's father in 1979. All of the members of the husband's family were potential beneficiaries. The court found that there was a sufficient nexus between the husband and the trust in that he had a significantly invested in the trust by personally making loans to the trust. This, in the court's opinion, was sufficient to consider the assets of the trust to be included as the property of the parties to the marriage.

<u>*Estate plan Trusts*</u>

Although the decision of *Ward v Ward* [2004] FMCfam 193 was before *Kennon v Spry,* it is important because it was one of the first to consider the application of the court's powers to a modern testamentary discretionary trust established under a will. There was there a 30 year marriage with 2 children. The husband's mother established a testamentary trust under her will. The husband's two sisters were its trustee and, although he was a co-trustee in an initial draft, he was taken out of that role in the final draft.

The court found the circumstances similar to those in *Bonnici & Bonnici* [1992] FLC 92-272 in which the Full Court had stated that '*property does not fall into a protected category merely because it is an inheritance'*. Despite this, it was held that he interests in the testamentary trust could not be considered property of the husband, and was a financial resource, to which the wife had contributed very little.

The recent case of *Lovine & Connor* [2011] FamCA 432 considered two testamentary trusts. The husband and his two sisters, and their children, were beneficiaries. Although each child was intended to benefit by 1/3 the husband was the controller of the testamentary trusts. This control was enough to hold the husband had a real likelihood of benefiting under the trusts and therefore they were property of the marriage.

Despite the outcome in *Lovine & Connor,* these two cases, and others on the point, make clear that a trust established by a previous generation will better withstand the suggestion that they are property rather than a financial resource.

This too is a planning tool!!

VII CONCLUSION

Professional persons attempting to defeat creditors by the transfer of assets out of their ownership prior to becoming a bankrupt must pass a number of time conditions and ultimately a test about their intention for transferring the property before the asset will be safe from the trustee in bankruptcy.

It would appear that any person who transfers assets near the time of bankruptcy or insolvency will have a difficult time in successfully challenging the trustee from avoiding the transfer. Persons who transfer assets well in advance of bankruptcy and insolvency stand a better chance of defeating their creditors. Such persons or the associated transferees however will still need to show that the transfer was not made for the main purpose of defeating creditors. Trustees in bankruptcy can succeed in the recovery of property even where there were no creditors at the time of the transfer. Professional persons will need to be able to show a purpose for the transfer that is not that of defeating creditors.

Ultimately, what might save a bankrupt is a lack of funding available to the trustee in bankruptcy to prosecute the recovery proceedings. A well funded trustee however does have the armoury in all but the most genuine of cases to claw back the assets that a professional person has transferred for the purpose of defeating creditors.

Likewise, a martial party trying to prevent their ex-partner accessing trust assets will face the challenge of a spouse. With the costs coming out of the pool of assets there is more incentive for an ex-partner than a creditor to pursue the assets. Good planning of the structure – which can sometimes require a generation of planning – will be the best defence to such a challenge.