Legal Update

Discretionary Trusts Remain a Valuable Asset Protection Tool

A decision recently handed down by the Queensland Supreme Court has provided overdue clarity and relief for users of discretionary trusts for asset protection, and of course for the legal fraternity at large.

The judgement in *Fordyce v Ryan; Fordyce v Quinn* [2016] QSC 307, delivered on 20th December 2016, was something of an early Christmas gift to those concerned with the future definition of proprietary interests in bankruptcy, and whether beneficiaries of discretionary trusts have them.

It is well established that the beneficiaries of a discretionary trust have no more than a 'mere expectancy' of receiving an interest in trust property somewhere down the line. This principle is frequently used to provide asset protection to a beneficiary involved in legal conflict. Where that is bankruptcy of the beneficiary, assets held in discretionary trusts are shielded from creditors and receivers because the beneficiary has no real legal interest in the trust asset.

That once resolute principle was however tainted in 2006 by the Federal Court's decision in *Richstar*[1]. That case alarmed practitioners and astute asset-holders alike where it sought to redefine the bounds of the discretionary trust principle described above. The Federal Court said that where the relationship between beneficiary and trustee boiled down to one of control — that is, that the trustee was really a trustee for show, over which the beneficiary had ultimate control — that the beneficiary could be said to have a proprietary interest in trust assets. The Federal Court sought to justify this serious bending of the rules by describing this scenario as the exception to 'ordinary' discretionary trust structures, and thus open to judicial rule-bending.

Interestingly, the Federal Court relied on a number of Family Court decisions to support its meddling with sound trust law principles to achieve an 'equitable' outcome. Given that *Richstar* concerned corporate liquidation one might consider that a stretch to justify such a kerfuffle.

[1] Australian Securities and Investments Commission In the Matter of Richstar Enterprises Pty Ltd v Carey (No. 6) **[2006] FCA 814**

Clearly *Richstar* raised serious concerns as to whether assets formerly protected by a carefully planned discretionary trust structure might be compromised. Of course on the flip side, premature moves to avoid the possible consequences of *Richstar* could have had risky tax consequences.

Fortunately, the *Fordyce* decision provides reassurance that the *Richstar* decision has neither been followed in subsequent bankruptcy cases, nor accepted in the academic realm. Justice Jackson of the Queensland Supreme Court dismissed an application reliant on the *Richstar* reasoning, and took the opportunity to confirm that a proprietary interest in the assets of a discretionary trust can be created only by positive action by the trustee to distribute income or capital to the beneficiary, as is the established law, and not by some legal presumption that a sufficient nexus between beneficiary and trustee effectively gives the beneficiary an enforceable interest in trust property.

It is safe to say that the decision in *Richstar* will not be followed in Queensland, and that an otherwise sound discretionary trust structure will continue to reliably protect assets in bankruptcy proceedings.

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