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JANUARY 2006

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SMSF's: Using Trustee Act powers to appoint a trustee (Trustee Act 1925 NSW)

An SMSF trustee can use powers granted in legislation to appoint other trustees in ways not allowed under the fund's deed. (Case is from NSW and involves the NSW Act. But there is similar legislation in other states.) - ***Julian Smith and Jacqui Partridge***

The useful development

Even though an SMSF trust deed required a new trustee's appointment to be made by a majority of members, the Court held that an appointment by one member out of 2 was valid. A key fact relevant to the Court's ruling was that there had been a trustee vacancy for 19 months. (*See Katz v Grossman*[1].)

The facts

Ervin Katz and his wife Evelin Katz were the two members and trustees of a Fund. After Evelin's death, Ervin appointed his daughter, Linda Grossman, as the additional trustee of the Fund. At the time of her appointment the second member of the Fund was Evelin's legal personal representative: but this person had not been appointed as no grant of Probate had been made.

After Ervin's death, Linda's brother challenged her appointment as trustee on the grounds that it had not been made by a majority of members: The Fund still had two members but only one had appointed Linda. The action was bought by the brother because the Fund had a death benefit which amounted to approximately $1 million at the time of Ervin's death, the allocation of which was left to the discretion of the trustee.

The winning argument

Linda argued that her appointment was valid under section 6(4)(b) of the Trustee Act (**Act**) as at the time of her appointment there was no majority of members willing or able to act, her father being the only active member.

The trust deed provided that any trustee vacancy must be filled within 90 days but no appointment had been made for 19 months. The court considered that this was sufficient to invoke the power to appoint under section 6(4)(b) of the Act.

The law

Under section 6(4)(b) if there is no person willing or able to appoint a new trustee, the appointment of a new trustee may be made:

- by the surviving or continuing trustees or trustee for the time being, or
- by the legal representative of the last surviving or continuing trustee.

The Court held that the appointment was valid noting that at the time of appointment there was no majority of members that were able to act in order to appoint a new trustee or to ratify the new trustee's appointment.

If there has been a substantial delay and it could be said that there is no person having the power, either alone or jointly, who is able and willing to act, then the trustee would be conferred the power to appoint an additional trustee pursuant to section 6(4)(b) of the Act. The court noted that the continuing trustee would not have had the power conferred if the period that had lapsed had been relatively short.

[1] *[2005] NSWSC 934*

Similar legislation in other states
There are equivalent sections to section 6 of the NSW Act in the various states, for example:
- Section 12(1) of the *Trusts Act* 1973 (Qld)
- Section 14(1) of the *Trusts Act* 1936 (SA)
- Section 13(1) of the *Trusts Act* 1898 (Tas)
- Section 41(1) of the *Trusts Act* 1958 (Vic)
- Section 7(1) of the *Trusts Act* 1962 (WA)

Personal Liability of Directors of Corporate Trustees

*Directors of a corporate trustee not automatically liable for the trust's debts if trust's assets insufficient. Legislation "corrects" Hanel's case - **Julian Smith and Jacqui Partridge***

The new law
The liability of directors will only extend to where the corporate trustee is not entitled to be fully indemnified out of trust assets solely because of:

- a breach of trust by the corporation; or
- the corporation acting outside the scope of its powers as trustee; or
- a term of the trust denying, or limiting, the trustees right to be indemnified against the liability.

Directors of corporate trustees can now be sure that they will not effectively be deemed to be guarantors for the corporate trustee unless any of the three criteria above exist. (See new Section 197 of the Corporations Act, amended in November 2005.)

Why the legislation was amended
The Section 197(1) of the *Corporations Act* 2001 (the **Act**) states when a director will be liable for the debts and other obligations incurred by a corporate trustee.

A 2003 South Australian case *Hanel v O'Neill* [1] changed the accepted understanding of that provision.

Before the case it was generally believed:
- that a director of a corporate trustee would be protected from liabilities incurred in relation to the administration of the trust provided that an appropriate exclusion clause and indemnity existed in the trust deed; and
- that the trustee's liability would be limited to the assets of the trust; and
- the director of the corporate trustee would not incur personal liability in the course of administering the trust; and
- that directors would not be liable for debts merely because the trust had insufficient assets and therefore was unable to meet its liabilities.

In *Hanel* the Court held that a director was liable to meet the trustee's liabilities if the trust's assets were insufficient to meet those liabilities. The decision in *Hanel* had the effect of making directors of corporate trustees the guarantor of the trust if it did not have sufficient assets to discharge its liabilities.

The changes
The November 2005 amendment replaces section 197 of the Act to ensure that directors will not automatically be personally liable for the liabilities incurred by a trust if the trust's assets are insufficient to discharge its liabilities. The amendment clarifies when a director of a corporate trustee will be personally liable for the debts incurred by the trust and corrects a perceived inconsistency arising from the decision in *Hanel*.

Trust to Trust Distributions … bending the law against perpetuities

*The Federal Court has held that a trust may distribute to another trust even if the vesting date of the receiving trust falls outside the perpetuity period of the distributing trust – **Julian Smith***

The "rule against perpetuities"
The rule against perpetuities says that property held by a trustee must vest in a beneficiary, both legally and beneficially, within a period not exceeding 80 years.

The rule is contained in various state legislation and is a modified version of the common law rule. However, the rule has been abolished in South Australia).

The rule limits the power of members of generations past from tying up property so as to prevent it being freely disposed of in the present or in future[2].

An exception, the "wait and see" rule
In all of the jurisdictions that have the rule, there is an exception known as the "wait and see" rule. Basically, that exception allows a distribution (despite the rule against perpetuities) until it becomes evident that the property held on trust must vest outside the 80 year period. So basically, you wait and see whether the rule against perpetuities will actually be **offended**, before invoking it.

The Commissioner of Taxation's losing argument
In 2005, the Federal Tax Commissioner in the *Nemesis Australia* case[3]:
- argued that if a trust (**distributing trust**) makes a distribution to another trust (**receiving trust**), and the vesting date of the receiving trust is outside the 80 year perpetuity period of the distributing trust, then the distribution is invalid as its offends the rule against perpetuity; and

1 *[2003] SASC 409*
2 *Nemesis Australia Pty Ltd v Commissioner of Taxation at para 24*
3 *Nemesis Australia Pty Ltd v Commissioner of Taxation [2005] FCA 1273*

• that those distributions were not saved by the "wait and see" rule. (The Commissioner had run the same argument in 2004 in *Ramsden v Federal Commissioner of Taxation*[1] but the Court was not required to make a determination at that time.)

The Court accepted the Commissioner's assertion that the trust deeds of the distributing trust and receiving trust should be read together with the effect that the perpetuity period of the distributing trust was extended to the vesting date of the receiving trust. As would often be the case, in this instance this period was in excess of 80 years.

However, the Court rejected the Commissioner's submissions that in these circumstances, a distribution to a receiving trust was not saved by the wait and see rule. (The Commissioner argued that point on the basis that any other approach would have the effect that the perpetuity period stated in the distributing trust's deed would be meaningless. The Commissioner felt that such a distribution would constitute a conscious decision on the part of the settlor that the trust property may possibly vest outside the perpetuity period, and that it was not purpose of the wait and see rule to save trusts where this decision is made consciously.)

The law

The Court determined that each of the requirements for the wait and see rule had been met. The most pertinent of these was that (as would often be the case) it was possible that the trust property **may** vest within the 80 year period. The Court held that it was the whole purpose of the "wait and see" rule that where this possibility exists, the rule against perpetuities will not be deemed to have been infringed.

Following *Ramsden*, some practitioners advocated that trust deeds be amended to the effect that distributions could not be made to trusts with a later vesting date than the distributing trust. However, it now appears that such a measure may be unnecessary particularly as it would create obligations that are difficult for the trustee to meet namely identifying the vesting dates of all receiving trusts.

The useful development

On the strength of this decision, a trust may distribute to another trust even if the vesting date of the receiving trust falls outside the perpetuity period of the distributing trust. No word yet on whether the Commissioner plans to appeal.

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Michael has considerable experience in consulting on tax and stamp duty issues to a wide range of corporate and non-corporate clients. He has advised large multi-national and Australian corporate groups in the manufacturing, property development/investment and gaming/casino industries. He advises on the tax implications arising from various forms of transactions, including acquisitions and divestitures, corporate reorganisations and capital raisings. He has had particular experience with inbound investment for both corporate groups and individuals and regularly advises in relation to Capital Gains Tax, CFC/FIF rules, withholding tax and Australia's tax treaty network.

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[1] *(2004) ATC 4659*