"Effective control" and sham trusts

By Anthony Grant, Trusts & Estates Litigator

Because judges believe they have been given insufficient tools to unsettle trusts in relationship property disputes, they have been fashioning new ones.

For people who were married or who were parties to civil unions, judges can now modify "nuptial settlements" in any way they like. This has been done by giving a new interpretation to section 182 of the *Family Proceedings Act*.

What about co-habitees?

Section 182 did not give any rights to co-habitees since living together outside marriage was "living in sin" in 1867, when section 182's predecessor section was enacted, and it was contrary to the public interest for the Courts to sanction immoral behaviour.

The method that the courts currently favour to modify a co-habitee's trust is to impose a constructive trust over the assets of an express trust.

It does this where a trustee (usually the man) is said to have encouraged the woman to spend time and/or effort to enhance the value of "his" trust's assets.

Trustees must act unanimously and the co-trustee(s) in such a trust will usually know nothing of the man's conduct. But non-compliance with the unanimity rule is not being allowed to stand in the way of the woman's claims.

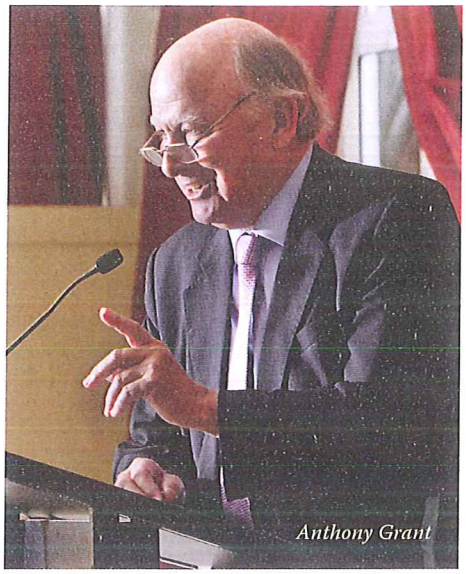
In *Vervoort v Forrest & Others* [2016] NZCA 375, the Court of Appeal explained why the unanimity rule should be circumvented (at paras [70] and [71]):

"It is a ... reality of [the New Zealand trust] landscape that the trustees of family discretionary trusts are more often than not the beneficiaries of those trusts and in control of them ... The effect is that the reality of a trustee's ability to give a third party expectations ... over trust property, which that trustee deals with as if their own, must be recognised."

"A constructive trust over assets held by a trustee, over which he or she has effective control, can be created by the *Lankow v Rose* factors."

It may be that the paradigm New Zealand family trust often contemplates that the man who settles it will expect to be able to deal with its assets as he likes, regardless of any technical constraints that may exist in the trust deed, but the trouble with the court's analysis is that the concept of "effective control" is usually interpreted as a sign of trust *invalidity* rather than of trust validity.

In my last article (see *Law News* Issue 30, 2 September 2016), I referred to some cases from Jersey and Australia where "effective control" was equated with sham.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The evidence that the court can look at to determine the existence of a sham includes subsequent conduct, "the degree of de facto control", whether trust property "has been used for personal benefit" and whether there has been "poor administration of the trust". This will be fertile ground for the investigation of typical New Zealand family trusts and I suspect that many of them, when tested by these criteria, would be found wanting.

With space constraints, I will refer to only one more such judgment – *In the Marriage of Goodwin* [1990] Fam CA 147, 4.12.90 – a decision of the full Family Court of Australia. In that case, Nicholson CJ held (at para [32]):

"[W]e have no doubt that his Honour was entitled to find that the trust property was, in reality, the property of the husband ... The husband had the sole power of appointment of the Trustee, which was a creature under his control and he was a beneficiary to whom the Trustee could make payments exclusively of other beneficiaries as the husband saw fit. If further evidence were needed that the husband controlled both the Trustee and the trust for his own purposes, it is to be found in the fact of the removal of the wife and her son as beneficiaries of the trust following the separation. This evidence confirms both the power of the husband and the fact that the Trustee acted as his creature."

To hold that "effective control" of a trust is a sign of *validity* has serious implications for creditor protection trusts and it is a distortion of a fundamental principle of the law of trusts.

A better way to deal with such "trusts" is to adopt what the Hon Michael Kirby has called a more "robust" approach to the doctrine of sham.

If the Court of Appeal accepts that "it is common in many trusts in New Zealand" for a settlor to exercise "effective control" over its assets, the courts should accept that reality and deal with it head on.

If Mr A is only willing to transfer property to a trust so long as he can control who will receive anything from it, how the assets are to be invested, and on the basis that he can take them back whenever he wants, he did not intend to create a trust and no trust was created. Alternatively, if one was, it was a sham.

A recent decision of the Hon Justice Wylie is helpful in this context. His Honour held in *Rosebud Corporate Trustee Limited v Bublitz & Others* [2014] NZHC 2018 that the trust under consideration in that case was a sham, and he said this of "effective control" (at para [92]):

"[E]vidence of control can be relevant to the question of whether the trust is a sham. It can evidence a lack of true intention to form the trust at the outset. A finding of effective control by another may help establish that a trust is a sham if it indicates that it was not intended that the trust took effect according to its terms, and evidence of effective control of the trust post settlement can be used to infer the requisite intention ... Evidence that a sham was intended from the outset can include looking at why the trust was set up in the first place, the degree of de facto or actual control over the trust, whether trust property has been used for personal benefit, and whether there has been poor administration of the trust."

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