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A LOST OPPORTUNITY? OMISSION OF THE ILLUSORY TRUST DOCTRINE FROM THE TRUSTS BILL 2017

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Abstract

This paper considers the role of the illusory trust doctrine in New Zealand. It argues that the illusory trust doctrine should be incorporated into the Trusts Bill 2017 (290-1). Incorporating the illusory trust will enhance clarity in New Zealand's law of trusts, by providing the courts with a conceptually coherent method to assess the permissible boundaries of the trust. This paper explores the differing views of illusory trust in the context of the Trusts Bill and in light of policy concerns. The "no meaningful accountability" view of illusory trust is identified as the best formulation of the doctrine, for incorporation into the Trusts Bill. Importantly, the no meaningful accountability view does not jeopardise discretionary family trusts, which have social and economic significance. The author goes further by drafting a tentative provision, for incorporation in the Trusts Bill. The provision is then applied to the nefarious, Clayton v Clayton *[2016] NZSC 29 trust and a typical, discretionary family trust. This application demonstrates that the provision will only catch the most nefarious* Clayton-*type trusts, thus preserving discretionary family trusts.*

Key words: *"Illusory trust", "Trusts Bill 2017", "Clayton v Clayton", "family trust", "fiduciary relationship", "trustee accountability".*

CONTENTS

I Introduction

The Trusts Bill 2017 (the Bill) is intended to implement a trusts law regime that articulates fundamental trusts concepts, thus providing clarity and accessibility in the law of trusts.[1] Regrettably, the Bill does not provide the clarity it seeks to achieve.[2] The Bill sets out the laws on express trusts, but crucially, does not specify the implications of non-compliance with such laws.

Of course, it was contemplated that the courts continue to refer to the depth of the common law in this regard.[3] When a specific characteristic, right, power or obligation is breached or omitted from the trust deed, the ordinary consequences at law will follow. For example, a trustee exclusion of liability clause for dishonest breaches of trust is amendable.[4] This creates few issues. However, what happens if there are two, three, four, or more problematic clauses in the trust deed? Such clauses may jeopardise the fiduciary relationship, in which the trustee holds the property for the benefit of the beneficiaries, or may hinder trustee accountability. In those circumstances, can we genuinely say that a trust has been created? Under the law espoused in the Bill, there is no clear answer. Without a conceptually coherent method for courts to undertake such analysis, lack of clarity in the law of trusts will subsist.

The illusory trust doctrine should be incorporated into the Bill, to remedy the lacuna. An illusory trust is an arrangement that is not a trust, due to the rights and obligations contained in the trust deed.[5] The doctrine provides a tool by which the court can test trusts that come up for scrutiny. The court can consider the terms of the trust deed as a whole and come to a determination as to whether a trust is really a trust at all. However, there are a number of views of the illusory trust doctrine.[6] This paper assesses each view in light of the scheme of the Bill and broader policy considerations. From a policy perspective, special care must be taken to ensure the discretionary family trust is not jeopardised by the illusory trust doctrine. The paper identifies the "no meaningful accountability" view of the illusory trust doctrine as being best-suited for incorporation

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1 Trusts Bill 2017 (290-1); (6 December 2017) 726 NZPD 707.

2 Tobias Barkley (La Trobe University) "Submission to the Justice Committee on the Trusts Bill (2017)" at 1.

3 (6 December 2017) 726 NZPD 707.

4 *Armitage v Nurse* [1998] Ch 241 (CA).

5 Mark Bennett "Competing Views on Illusory Trusts: the Clayton v Clayton litigation in its wider context" (2017) 11 Journal of Equity 48 at 49.

6 Bennet, above n 5, at 61–73.

into the Bill. The no meaningful accountability view forms the basis for a draft "illusory trust" provision proposed in this paper, for incorporation into the Bill.

II The Case for an Illusory Trust Doctrine

A Contemporary Trusts Usage

Trusts have a well-established legal core.[7] This core can be broken down into two, fundamental tenets of the trust.[8] The first tenet is a fiduciary relationship, in which the trustee holds the trust property for the benefit of the beneficiaries.[9] The second tenet can be described as "trustee accountability".[10] Under this tenet, the trustee owes enforceable fiduciary obligations to the beneficiary.[11] These tenets will be explored in greater detail in Part-III, sub-Part A of this paper, but should be borne in mind from the outset. An illusory trust kicks sand in the face of the two fundamental tenets.

Many of the rules surrounding the creation and use of trusts stem from ancient principles of equity and centuries-old English cases.[12] In some instances, New Zealand courts have taken these rules and given them their own domestic flavour.[13] In other cases, the rules and principles have changed little from their origins.[14] Crucially, trusts have always been a flexible legal arrangement that allowed a person to deliberately structure legal ownership and beneficial rights to property in ways that achieved purposes that could not be achieved at common law.[15] Despite its critics, the trust is accepted as a socially useful institution.[16] Facets of the trust have been revised to meet varying social and economic conditions throughout history.[17] Such revision is an essential character of the law of trusts.[18] Courts have recognised this characteristic and are thus slow to strike down

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7 Andres Knobel "Trusts: Weapons of Mass Injustice?" (2017) *Tax Justice Network*, <www.taxjustice.net>, accessed 25 July 2018, at 9.

8 James Penner *The Law of Trusts* (10th ed, Oxford University Press, Oxford, 2016) at 21.

9 Penner (2016), above n 8, at 21.

10 Graham Virgo *The Principles of Equity and Trusts* (Oxford University Press, Oxford, 2012) at 48.

11 Roderick Meagher, John Heydon and Michael Leeming *Meagher, Gummow and Lehane's Equity: Doctrines and Remedies* (4th ed, Butterworths Lexis Nexis, Chatswood (NSW), 2002) at 157.

12 Law Commission "Review of Trust Law in New Zealand: Introductory Issues Paper" (NZLC IP19, 2010) at 3.

13 Law Commission (IP19, 2010), above n 12, at 6.

14 Law Commission (IP19, 2010), above n 12, at 3.

15 Bennett, above n 5, at 54.

16 Knobel, above n 7, at 9.

17 Law Commission (IP19, 2010), above n 12, at 3.

18 Donovan Waters "The Trust in a Changed Yet Changing World" (2008) 15 JTCP 205 at 242.

contemporary trusts on the basis that their deeds enable greater settlor control over trust property, or relax trustee accountability. This is not problematic, insofar as the fundamental tenets of the trust are retained in the trust structure.

However, issues arise when practitioners, seeking to meet the exacting demands of private and commercial settlors, push the boundaries of the trust to the extent the two fundamental tenets are jeopardised.[19] The New Zealand trusts regime has become infamous because of its use by businesspeople to shelter assets from creditors.[20] All sources of the settlor's wealth; land, money, shares, or chattels can be protected by the use of a trust.[21] Peart comments that property owners now have the ability to reserve to themselves extensive powers of control over the trust.[22] Practically, nothing changes for the settlor who vests their property on trust; they retain effective control over the property. However, they are safe in the knowledge that their assets are protected should personal or financial difficulties arise.[23] In this sense, with careful planning, settlors have nothing to lose and everything to gain from placing their assets on trust.[24] If this usage is paired with the tendency of the courts to dance around discussion of core trust principles and exacerbated by pervasive external regimes such as relationship property, there may be a movement from an appreciation of the flexibility of the trust, to a much more dangerous flexibility in our characterisations of what the trust's essential features are.[25] This movement is the strongest argument for the incorporation of the illusory trust doctrine into the Bill.

Additionally, if courts continue to push core trust concepts to the periphery in their decision making, we may be approaching something of an offshore trust jurisdiction. Offshore trusts are renowned for the cherry picking of trust advantages in a manner that is unsound theoretically.[26] Although it is probably a stretch to say we are already there, the

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19 James Webb "An ever-reducing core? Challenging the legal validity of offshore trusts" (2015) 21(5) Trusts & Trustees 476 at 486.

20 Sue Tappenden "The role of equity in a changing society: from ancient Greece to present day New Zealand" (2015) 21(4) Trusts & Trustees 389 at 396.

21 Tappenden, above n 20, at 396.

22 Nicola Peart "Intervention to Prevent the Abuse of Trust Structures" (2010) NZLR 567 at 568.

23 Peart, above n 22, at 568.

24 Peart, above n 22, at 568, explains that changes in legislation in the past few decades have made trusts increasingly attractive as a mechanism for securing tax benefits, protecting assets from creditors and other unwanted claims, and avoiding means testing for state subsidies.

25 James Penner "Exemptions", in Peter Birks and Arianna Pretto *Breach of Trust* (Hart Publishing, Oxford, 2002) 241 at 254.

26 Webb, above n 19, at 486.

practical implications of such a finding would be significant.[27] Webb argues that offshore developments have turned the whole axis of the trust, to create extra advantages for the settlor.[28] These advantages are said to have concurrent disadvantages for wider society. Waters has identified that while offshore trusts serve "an immediate end" for practitioners and their clients, they simultaneously violate the trust concept and harm others in society.[29]

B Clayton v Clayton

The *Clayton v Clayton* litigation is the raison d'être of problematic, contemporary trust usage.[30] Mr Clayton held substantial business and personal assets on a trust, the "Vaughn Road Property Trust" (VRPT).[31] Mr Clayton was the sole trustee, a discretionary beneficiary and the "Principal Family Member" of the VRPT.[32] On an objective analysis, the VRPT deed can be said to omit both fundamental tenets of trust law. In his capacity as sole trustee, Mr Clayton was able to:

> (a) pay or apply all of the income of VRPT to himself (as a discretionary beneficiary);[33]
>
> (b) exercise all powers and discretions of the trustee, regardless of whether or not the interests of all beneficiaries had been considered, or whether the exercise of those powers or discretions would be contrary to the interests of any beneficiary;[34]
>
> (c) exercise any power or discretion vested in the trustees in his own favour;[35]
>
> (d) exercise all powers and discretions of the trustee notwithstanding that the interests or duty of the trustee may conflict with the duty of the trustee to VRPT or any beneficiary;[36] and

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27 Webb, above n 19, at 486.

28 Webb, above n 19, at 487.

29 Waters, above n 18, at 249.

30 *MAC v MAC* FC Rotorua FAM-2007-063-652, 2 December 2011 (*Clayton* (FC)); *Clayton v Clayton* [2013] NZHC 301 (*Clayton* (HC)); *Clayton v Clayton* [2015] NZCA 30 (*Clayton* (CA)); and *Clayton v Clayton* [2016] NZSC 29 (*Clayton* (SC)).

31 *Clayton* (SC), above n 30, at [11].

32 *Clayton* (SC), above n 30, at [10].

33 VRPT Deed, cl 4.1(a). *Clayton* (SC), above n 30, at appendix.

34 VRPT Deed, cl 11.1(a) and (b). *Clayton* (SC), above n 30, at appendix.

35 VRPT Deed, cl 14.1. *Clayton* (SC), above n 30, at appendix.

36 VRPT Deed, cl 19.1(c). *Clayton* (SC), above n 30, at appendix.

> (e) vary, revoke or enlarge any terms of the VRPT deed (with the prior written consent of the Principal Family Member, which was also Mr Clayton).[37]

As trustee, Mr Clayton could not be liable for any breach of trust except in the case of a dishonest or wilful breach.[38] Mr Clayton had additional powers in his role as Principal Family Member of VRPT. Such powers included to add or remove any beneficiary,[39] to add or remove any trustee,[40] and to withhold consent to any variation of the VRPT deed.[41]

In proceedings between Mr and Mrs Clayton, the Family Court and High Court both held (albeit for different reasons) the VRPT was illusory.[42] In the High Court, Rodney Hansen J formulated the illusory trust inquiry as whether, on the terms of the trust deed, Mr Clayton had retained such control that he did not give up or part with control over the property.[43] Throughout his analysis, Hansen J tacitly referred to the two core elements of the trust; a fiduciary relationship in which the trustee holds the property for the beneficiary and trustee accountability. His Honour was concerned that Mr Clayton was empowered to use and invest the property in any way he wished.[44] Mr Clayton could exercise any of his broad powers or discretions for his own benefit, without regard for the other beneficiaries' interests and notwithstanding any conflict of interest.[45] This meant there was no effective delineation of property interests from the settlor, to the trustee (legal interest) and beneficiaries (beneficial interest). If there is no delineation of property interests between the trustee and beneficiary, there is no fiduciary relationship and the trust loses an essential character.[46]

The Court of Appeal and Supreme Court appeared unwilling to engage in robust discussion on the conceptual boundaries of trusts.[47] The Court of Appeal overruled the

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37 VRPT Deed, cl 23.1. *Clayton* (SC), above n 30, at appendix.

38 VRPT Deed, cl 21.1. *Clayton* (SC), above n 30, at appendix. However, due to the extraordinarily wide powers afforded to Mr Clayton under the trust deed it was unlikely that a breach of trust would ever occur.

39 VRPT Deed, cl 7.1. *Clayton* (SC), above n 30, at appendix.

40 VRPT Deed, cl 17.1. *Clayton* (SC), above n 30, at appendix.

41 VRPT Deed, cl 23. *Clayton* (SC), above n 30, at appendix.

42 Jessica Palmer and Nicola Peart "Clayton v Clayton: a step too far?" (2015) NZFLJ 114 at 114.

43 *Clayton* (SC), above n 30, at [119].

44 *Clayton* (HC), above n 30, at [90].

45 *Clayton* (HC), above n 30, at [81].

46 Penner (2016), above n 8, at 16.

47 See generally Bennett, above n 5; Tobias Barkley (La Trobe University) "Clayton v Clayton: The Court of Appeal on the Concepts of Property and Trusts" (2015) NZLJ 164; Joel Nitikman "Sham,

Family Court and High Court on the illusory trust point.[48] Bennett explains the illusory label is a proxy for the fundamental concepts of settlor control and trustee accountability.[49] As the Family Court and High Court established, the VRPT clearly frustrated these concepts to the point of their non-existence. It is concerning that in those circumstances the Court of Appeal was not prepared to make a finding that no trust had been created. Such a finding should have been made regardless of whether the "illusory" label was applied. The VRPT in *Clayton* has been described as an "offshore trust" in a recent, yet eminent treatise on trusts and modern wealth management.[50] Despite this, the Court of Appeal preferred to classify Mr Clayton's powers under the trust deed as property, for the purposes of the Property (Relationships) Act 1976 (PRA).[51]

The Supreme Court disagreed with the Court of Appeal's outright disregard for the illusory trust argument.[52] However, it did not make a ruling on the doctrine.[53] It considered the illusory analysis as a matter of some complexity that did not need to be decided.[54] The Supreme Court also said that in cases where the trust deed gives the trustee the power to defeat the trust, courts would not need to make a finding on the status of the trust prior to the trustee's powers actually being exercised.[55] This is problematic, as if the trust deed gives the trustee such powers, there is effectively no fiduciary relationship, nor trustee accountability. In those circumstances the irresistible conclusion is that no trust has been created. Instead, the Court was content to hold that Mr Clayton's VRPT powers were relationship property.[56] This demonstrates the Supreme Court's unwillingness to deal with the more fundamental question of, "what is a trust?". The acquiescence of the Court of Appeal and Supreme Court in *Clayton* to the VRPT as a "trust" seems to jeopardise the very nature of the trust. As Palmer and Peart note, *Clayton* may have been "a step too far".[57]

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illusion and all that jazz: a case comment on Clayton v Clayton" (2016) 22(2) Trusts & Trustees 180; and Palmer and Peart, above n 42.

48 Palmer and Peart, above n 42, at 114.

49 Bennett, above n 5, at 54.

50 Lusina Ho "Breaking Bad", in Richard Nolan, Kelvin Low and Tang Hang Wu *Trusts and Modern Wealth Management* (Cambridge University Press, Cambridge, 2018) 34 at 48.

51 *Clayton* (CA), above n 30, at [116].

52 At [122]–[124].

53 At [133].

54 At [127].

55 At [125].

56 At [131].

57 Palmer and Peart, above n 42, at 114.

The Supreme Court delivered its judgment in *Clayton*, despite the parties having already settled the dispute.[58] This was said to be appropriate given the importance of the legal issues raised.[59] That is well-intentioned, but what legal issues have been resolved? We know that extreme levels of settlor-trustee control will be treated as property, for the purposes of the PRA. However, as Bennett reflected post-*Clayton*, this does not solve any of the "big questions" about the nature of trust law.[60] Practitioners and scholars are no nearer to knowing what arrangements will be tolerated as a "trust", and those in which the boundaries are pushed so far as to erode the fundamental character of the trust.

In this context, the Bill could (and should) have been a saving grace for the conceptual boundaries of the trust. It could have proffered guidance on the interplay of troublesome trust deed provisions with those conceptual boundaries, manifested in the two fundamental tenets of the trust. As it stands, the Bill does not achieve this.

C The Trusts Bill is Unsatisfactory in its Current Form

1 Context of the Trusts Bill

The Law Commission's (the Commission's) lengthy Review of the Law of Trusts (the Review) culminated in a finding that the current legislation underpinning trusts is unsatisfactory and in need of reform.[61] The Review spanned from 2009 to 2013.[62] It produced six issues papers,[63] and one report.[64] The Review ultimately resulted in the drafting of the Trusts Bill.[65] The Bill is intended to make trust law easy to find and

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58 At [3].

59 At [3].

60 Bennett, above n 5, at 48.

61 Law Commission "Review of the Law of Trusts: A Trusts Act for New Zealand" (NZLC R130, 2013) at IV.

62 Law Commission "Law of Trusts: Project Overview" <www.lawcom.govt.nz>, accessed 26 July 2018.

63 The papers are: Law Commission (IP19, 2010), above n 12; Law Commission "Some Issues with the Law of Trusts in New Zealand: Review of the Law of Trusts Second Paper" (NZLC IP20, 2010); Law Commission "Perpetuities and the Revocation and Variation of Trusts" (NZLC IP22, 2011); Law Commission "The Duties, Office and Powers of a Trustee: Review of the Law of Trusts Fourth Issues Paper" (NZLC IP26, 2011); Law Commission "Court Jurisdiction, Trading Trusts and Other Issues: Review of the Law of Trusts Fifth Issues Paper" (NZLC IP28, 2011); and Law Commission "Review of the Law of Trusts Preferred Approach Paper" (NZLC IP31, 2012).

64 Law Commission (R130, 2013), above n 61.

65 At the time of writing, the Bill is before the Justice Committee. The Justice Committee's report on the Bill is due 31 October 2018. It is not anticipated that the report will make any substantive comment on the illusory trust doctrine.

understand.[66] It aims to situate the fundamental common law tenets of trusts in one place.[67]

Hayton acknowledges that due to the facilitative nature of trust law, statute has to intervene from time to time to set limits on what the trust can do.[68] The current iteration of the Trusts Bill accurately incorporates trust law as it currently exists in New Zealand.[69] As Barkley notes, this has been advertised as the Bill's strength, but is its weakness.[70] The Bill offers nothing in a practical sense. We are none the wiser as to when a putative trust has exceeded the permissible boundaries of the trust and will be struck down as such.

2 Failure to Consider Illusory Trust

The illusory trust doctrine was not included in the Commission's terms of reference for the Review.[71] There is no reference to the doctrine in the Commission's issues papers or report, nor in the Bill itself. This paper suggests three reasons as to why this omission may have occurred. These reasons are unsatisfactory.

First, there is an argument that through its articulation of fundamental characteristics of the trust and scheme of mandatory and default duties, the Bill implicitly encapsulates the illusory trust doctrine. However, it has already been explained that it is insufficient to simply espouse legal rules, without specifying the implications that follow from non-compliance with such rules. This is especially important in the context of a trust deed with a conglomerate of provisions which, added together, may jeopardise a fundamental tenet or tenets, of the trust.

Second, the Commission was undertaking their Review at the same time the Courts in the *Clayton* litigation were assessing the merits of the illusory trust doctrine. Therefore, it was arguably better to wait for a complete judicial exposition of the doctrine before coming to a view. This is specious. The paucity of trusts cases at appellate level has severely limited the ability of our courts to reason according to basic principles of trust

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66 (6 December 2017) 726 NZPD 707.

67 Trusts Bill 2017 (explanatory note).

68 David Hayton *The Law of Trusts* (4th ed, Sweet & Maxwell, London, 2003) at 42, in Bennett, above n 5, at 55.

69 Barkley (2017), above n 2, at 1.

70 Barkley (2017), above n 2, at 1.

71 Law Commission (Law of Trusts: Project Overview), above n 62.

law. The *Clayton* decisions have left trusts lawyers and scholars scratching their heads.[72] Importantly, courts routinely defer to Parliament on issues of complex socio-political importance, not the other way around.[73]

Third, there is an inference the illusory trust doctrine is not sufficiently enshrined in trusts law to warrant any detailed assessment in the Review, nor incorporation in the Bill. However, the illusory trust doctrine is simply the application of the idea that a trust is a particular kind of legal arrangement that has core features, and an arrangement that lacks them is not a trust despite using the vocabulary of trusts.[74] The core features are plainly the fiduciary relationship in which the trustee holds property for the benefit of the beneficiary and trustee accountability that this paper has identified, and that are incorporated in cl 13 of the Bill.[75] The illusory trust doctrine does not introduce any new constitutive elements of the trust. Rather, it reinforces existing ones. It gives the court a practical tool through which it can consider the trust deed and come to a determination on whether that trust deed in fact creates a trust.

III Theory of Illusory Trust

A Conceptual Underpinnings

An illusory trust is an arrangement that is not a trust, due to the rights and obligations contained in the trust deed.[76] The putative settlor wanted to create a trust and intended to comply with the terms of the trust deed, but was mistaken in thinking that the deed created a trust.[77]

As noted above, there are two fundamental tenets of trust law.[78] The illusory trust doctrine essentially evaluates a trust deed to see if these tenets are present. The first tenet is a fiduciary relationship, in which the trustee holds the trust property for the benefit of the beneficiaries.[79] In order to establish a trust, the settlor transfers her property to the

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72 Palmer and Peart, above n 42, at 114.

73 See generally Richard Clayton "Principles for Judicial Deference" (2006) 11(2) JR 109.

74 Bennett, above n 5, at 48.

75 Set out in detail, in Part IV, sub-Part A of this paper.

76 Bennett, above n 5, at 49.

77 Palmer and Peart, above n 42, at 116.

78 Penner (2016), above n 8, at 21.

79 Penner (2016), above n 8, at 21.

trustee, who holds that property on trust for the benefit of the beneficiary.[80] The trustee has legal ownership of the property and the beneficiary has beneficial ownership.[81] Correlatively, the trustee is not entitled to use the property for her own benefit.[82] Herein lies a fiduciary relationship between the trustee and beneficiary.[83] At a fundamental level, fiduciaries are persons who take decisions in the interests of their principals.[84] The trustee has legal powers to affect the legal position of her principal, the beneficiary.[85] In exercising those powers, the trustee must only act in the interests of the beneficiary and must not allow her own interests,[86] or the interests of third parties, to affect her judgment.[87] If the terms of the trust deed reserve such control to the settlor or trustee that they are able to use the property for their own benefit, there is no fiduciary relationship. It cannot be said that the deed created a trust. A finding of illusory trust may follow.

The second tenet can be described as "trustee accountability".[88] The trustee owes fiduciary obligations to the beneficiary.[89] Millet LJ referred to this tenet as the "irreducible core" in *Armitage v Nurse*.[90] He stated:[91]

> There is an irreducible core of obligations owed by the trustee to the beneficiaries and enforceable by them which is fundamental to the concept of a trust. If the beneficiaries have no rights enforceable against the trustees, there are no trusts.

The fiduciary obligation to benefit others is a fundamental, constituent element of the trust.[92] The corollary is that the duty of the trustees to perform the trusts honestly and in good faith for the benefit of the beneficiaries is the minimum standard necessary to give

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80 Virgo (2012), above n 10, at 48. See also Ho, above n 50, at 46. In her discussion of the illusory trust, Ho explains it is an axiomatic principle in Anglo-common law that the trust involves the settlor's transfer of ownership to the trustee, subject to duties to deal with the property for the benefit of the beneficiaries.

81 Virgo (2012), above n 10, at 48.

82 Penner (2016), above n 8, at 21.

83 Penner (2016), above n 8, at 23.

84 Penner (2016), above n 8, at 23.

85 Penner (2016), above n 8, at 23

86 Unless she is also a beneficiary.

87 Penner (2016), above n 8, at 23.

88 Virgo (2012), above n 10, at 48.

89 Meagher, Heydon and Leeming, above n 11, at 157.

90 *Armitage v Nurse*, above n 4, at 254.

91 *Armitage v Nurse*, above n 4, at 254.

92 Tobias Barkley (La Trobe University) "The Content of the Trust: What Must a Trustee be Obliged to Do With the Property?" (2013) 19 Trusts & Trustees 452 at 453.

effect to a trust.[93] If the trust deed renders the beneficiary unable to hold the trustee accountable, a finding of illusory trust may follow.

These two tenets sit along-side the three certainties needed to constitute a trust; certainty of intention, certainty of object and certainty of subject.[94] Cases of illusory trust tend not to hinge on the three certainties; the settlor always intended to create a trust. She invariably specifies the subjects and identifies the putative objects of the trust.

B Illusory Trusts are not Shams

The illusory trust is distinct from the sham trust. The doctrines can be distinguished on two bases. First, a sham occurs when the settlor and trustee share a common,[95] dishonest intention to create the appearance of a trust, but agree to be bound in reality by a contrary legal relationship.[96] As Birss J noted in the English and Welsh High Court case *JSC Mezhdunarodniy Promyshlenniy Bank & Ors v Pugachev & Ors (Pugachev)*, the illusory analysis is not concerned with the subjective intentions of the parties to create a pretence to mislead.[97] The settlor of an illusory trust intended to create a trust.

Second, reservation of powers to the settlor, no matter how extensive, will not render the trust a sham.[98] A sham will arise if the pattern of conduct subsequent to the establishment of the trust contradicts with the settlor's pretence in the trust deed to part with the property and set up a trust.[99] The subsequent conduct essentially colours the dishonest intention of the settlor. In contrast, the conduct of the parties to the trust is not relevant to a finding of illusory trust. The illusory trust doctrine focuses solely on the trust deed.[100]

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93 *Armitage v Nurse*, above n 4, at 254. The concept is largely attributable to David Hayton, who identified the concept of an irreducible core; David Hayton "The Irreducible Core Content of Trusteeship", in AJ Oakley *Trends in Contemporary Trust Law* (3rd ed, Sweet & Maxwell, London, 1996) 65 at 65.

94 The "three certainties" requirement originates from *Knight v Knight* (1840) 49 ER 58. See also Penner (2002), above n 25, at 190.

95 *Clayton* (SC), above n 30, at [114]. The requirement of common intention applies except if the settlor and the trustee is the same person.

96 Ho, above n 50, at 39–40.

97 *JSC Mezhdunarodniy Promyshlenniy Bank & Ors v Pugachev & Ors (Pugachev)* [2017] EWHC 2426 at [168].

98 Ho, above n 50, at 40.

99 Ho, above n 50, at 40

100 *Pugachev*, above n 97, at [168]. See also *ND v SD* [2017] EWHC (Fam) 1507 (21 June 2017) at 176ff.

This paper does not consider the sham doctrine. The Commission analysed the law on sham in their Review.[101] The Commission weighed the competing arguments for[102] and against[103] including a provision on sham trusts.[104] It concluded that future trusts legislation should not contain any provisions relating to finding that a trust is a sham trust.[105] This is ultimately reflected in the sham doctrine's omission from the Bill.

Illusory trusts are also conceptually distinct from "alter-ego trusts". The alter-ego concept involves viewing the trust as the alter ego of an external controller such as the settlor.[106] It is similar to a finding of a sham, in that the level of control relinquished by the trustee, to the controller, indicates that the trust structure is a façade that can be disregarded.[107] Alter-ego is not considered in this paper.

C Illusory Trust in Jurisprudence and Literature

The illusory trust is not a recent phenomenon. The doctrine has its origins in mid-20th century cases from the United States.[108] In such cases, the courts were trying to protect a widow's distributive share in relationship property.[109] The husband would implement drafting devices which retained the benefit of his property for himself during his lifetime, whilst also depriving his widow of her interest, at his death.[110] The court inquired as to whether the husband had in good faith divested himself of ownership of his property.[111]

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101 Law Commission (IP20, 2011), above n 63, at 39–43.

102 Arguments for included: to provide guidance and education to settlors and trustees; to clarify the law and provide more guidance about considerations for whether a trust is a sham; to prevent the undermining of public policy objectives in terms of people avoiding the responsibilities associated with a trust; to provide an effective mechanism to respond when a trust is not operating as a genuine trust; and to better preserve the integrity of the trust concept.

103 Arguments against included: inflexibility compared with a judicial response; constraining judges from making appropriate findings in some cases; and, that existing law is adequate and courts are better placed to respond since issues are likely to be fact-specific.

104 Law Commission (IP20, 2011), above n 63, at 39–40.

105 Law Commission (IP31, 2012), above n 63, at 38.

106 Law Commission (IP20, 2011), above n 63, at 44.

107 *Official Assignee v Wilson* [2007] NZCA 122 at [64].

108 See generally *Newman v Dore* 9 NE 2d 966 (NYS 1937); *President and Directors of Manhattan Co. v Janowitz* 14 NE 2d 375 (NYS 1939); *Burns v Turnbull* 37 NE 2d 380 (NYS 1942); *Smith v Northern Trust Co.* 54 NE 2d 75 (ILL 1944); *Bolles v Toledo Trust Co* 58 NE 2d 381 (Ohio 1944); and *Merz v Tower Grove Bank & Trust Co.* 130 SW 2d 611 (MO 1939).

109 Edward Smith "The Present Status of "Illusory" Trusts: The Doctrine on *Newman v Dore* Brought Down to Date" (1945) 44(1) Michigan L Rev 151 at 151.

110 Edward Smith, above n 109, at 152-153.

111 *Newman v Dore*, above n 108, at 379.

Without a good faith divestment of ownership, the transfer was held to be illusory.[112]

O'Hagan suggests the principal desire amongst settlors is to retain the ability to reverse what has been put in place and get the trust assets back if circumstances warrant it.[113] This desire manifests in a settlor retaining dispositive powers such as powers of appointment, or administrative or investment powers. If the settlor can call for the capital of the trust without formality, then purported beneficial interests are illusory.[114] Therefore, one can determine from the terms of the trust deed whether the trust is illusory.

The illusory trust doctrine has been considered in other commonwealth jurisdictions. It was argued extensively in *Pugachev*.[115] In that case, Mr Pugachev was the settlor and protector of five New Zealand trusts with near-identical trust deeds.[116] The deeds enabled Mr Pugachev to appoint beneficiaries, appoint and remove trustees, and direct the trustees to sell trust property.[117] Significantly, Mr Pugachev's consent was required in order for a trustee to exercise any power or discretion to distribute or invest trust income and capital, remove beneficiaries, vary the trust deed, revoke any power of the trustee or change the date of distribution.[118] Birss J found, in substance, that the trusts in question were illusory.[119] However, his Honour found the term "illusory" to be unhelpful; rather, he considered the issue from a "true effect of the trusts" perspective.[120]

A more straightforward illustration of the illusory trust doctrine is *BQ v DQ (Re the AQ Revocable Trust)*.[121] The Supreme Court of Bermuda set aside two trusts on the basis that their form rendered them illusory.[122] Ground CJ held that the concatenation of rights and powers in the settlor, when coupled with the fact that he was the sole trustee at the time of

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112 *Newman v Dore*, above n 108, at 379.

113 Patrick O'Hagan "The reluctant settlor – property, powers and pretences" (2011) 17(10) Trusts & Trustees 905 at 905.

114 O'Hagan, above n 113, at 906.

115 *Pugachev*, above n 97, at [155]–[172].

116 At [142].

117 At [115].

118 At [115].

119 Graeme Young "Sham and Illusory Trusts – Lessons from *Clayton v Clayton*" (2018) 24(2) Trusts & Trustees 194 at 200.

120 Young, above n 119, at 200.

121 *BQ v DQ (Re the AQ Revocable Trust)* [2010] SC (Bda) 40 Civ (16 April 2010).

122 At [29].

the constitution of the Trusts, rendered the trusts illusory during his lifetime.[123]

However, Palmer opines that Ground CJ's finding could only be correct if one of the powers retained by the settlor had the effect of vitiating any of the obligations owed by the trustee to the beneficiaries so that there was *no* accountability.[124] Article VIII(H) of the trust deed has this effect:[125]

> The written approval of the Donor [the settlor] of any trust transaction during his lifetime shall be a complete release of the Trustee (including the Donor) of any liability or responsibility of the Trustee to any person with respect to this transaction.

Article VIII (H) enables the settlor to render the beneficiary's right to hold the trustee to account meaningless.[126] For Palmer, it is the fact of no accountability, as opposed to the lack of delineation of property interests identified by Ground CJ, that provides justification for a finding of illusory trust.

IV Formulating the Illusory Trust Doctrine for the Trusts Bill

A survey of jurisprudence and literature has demonstrated there are differences in the formulation of the illusory trust doctrine. These differences are well-articulated by Bennett, who sets out a taxonomy of "narrow views" and "wide views", of the illusory trust.[127]

Narrow views of the illusory trust focus on the formal existence of trust obligations.[128] There are two species of narrow view. These are the "no accountability" and "trustee usurpation" views.[129] Wide views, on the other hand, doubt the flexibility of the trust concept to accommodate the more extreme settlor-controlled or trustee benefitting arrangements.[130] There are three species of wide view. These are the "unlimited benefit", "no meaningful accountability", and "reality of control" views.[131] At a general level, all views follow the concept that a trust is only legitimate when the two fundamental tenets

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123 At [29].

124 Jessica Palmer "Controlling the Trust" (2011) 12(3) Otago L Rev 473 at 485.

125 *Re the AQ Irrevocable Trust*, above n 121, at [7], in Palmer, above n 124, at 485.

126 Palmer, above n 124, at 485.

127 Bennett, above n 5, at 61–73.

128 Bennett, above n 5, at 60.

129 Bennett, above n 5, at 61–65.

130 Bennett, above n 5, at 64.

131 Bennett, above n 5, at 65–73.

outlined above are adhered to. The difference lies in the extent to which the views consider that adherence to be meaningful.

It is necessary to subscribe to one of the above views of the illusory trust doctrine, for incorporation into the Bill. However, this view must reflect the scheme of the Bill. Additionally, as a matter of policy, special care must be taken to ensure the discretionary family trust is not jeopardised by the illusory trust doctrine.[132] This paper will briefly survey the provisions of the Bill relevant to the illusory trust doctrine. The different views of the illusory trust doctrine are then set out in more detail and evaluated with the scheme of the Bill and policy considerations in mind. The evaluation will inform a "preferred view" of illusory trust, for incorporation into the Bill.

A Relevant Provisions of the Trusts Bill

Clause 13 sets out two characteristics of the express trust. First, cl 13(a) explains that a trust is a fiduciary relationship in which a trustee holds or deals with trust property for the benefit of the beneficiaries. The clause reflects the "delineation of property interests" tenet of the trust at common law.[133] Second, cl 13(b) states the trustee must be accountable for the way the trustee carries out the duties imposed on the trustee by law. This reflects the "trustee accountability" tenet of the trust.

The trustee accountability tenet is not contained solely in cl 13(b). The clause interacts with the Bill's clauses on mandatory and default trustee duties, rules on trustee exemption and indemnity for breach of trust, and the requirement to provide trust information. Clause 20(1) explains that the trustee duties set out in cls 22 to 26 are mandatory duties that must be performed by the trustee and may not be excluded or modified by the terms of the trust.[134] Clause 20(2) provides that the duties in cls 27 to 36 are default duties that must be performed by the trustee unless modified or excluded by the terms of the trust, expressly or by implication.[135]

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132 See the discussion of this issue in Part-IV, sub-Part C, sections 1 and 2.

133 It is complemented by cl 14, which provides that a sole trustee must not also be the sole beneficiary of the trust.

134 The mandatory duties are: to know the terms of the trust (cl 22); to act in accordance with terms of the trust (cl 23); to act honestly and in good faith (cl 24); to deal with trust property, or otherwise act, for the benefit of the beneficiaries (or further a permitted purpose) (cl 25); and to exercise powers for a proper purpose (cl 26).

135 The default duties are: general duty of care (cl 27); to invest prudently (cl 28); to not exercise power for own benefit (cl 29); to consider exercise of power (cl 30); not to bind or commit trustees to future exercise of discretion (cl 31); to avoid conflict of interest (cl 32); to act impartially (cl 33); not to

Clauses 37 and 38 of the Bill help to ensure trustee accountability. Clause 37 prohibits the limitation or exclusion of the trustee's liability for any breach of trust arising from the trustee's dishonesty, wilful misconduct, or gross negligence. Clause 38 prohibits the use of indemnity clauses against the trust property for liability for any breach of trust arising from the trustee's dishonesty, wilful misconduct, or gross negligence.

Clause 47(1) creates a presumption that a trustee must make available to every beneficiary or representative of a beneficiary, basic trust information.[136] However, before giving the information, the trustee must consider factors set out in cl 49, and may conclude the presumption does not apply in light of those factors.[137] Clause 47 reflects the Law Commission's desire to further accountability in the law of trusts.[138] Therefore, any formulation of the illusory trust doctrine should consider availability of trust information to the beneficiaries, under the banner of trustee accountability. The rebuttable presumption, however, must also be borne in mind. It reflects that there may be legitimate reasons for withholding trust information.[139]

Clauses 13(a) and 13(b) of the Bill (along with their supplementary provisions) reflect the fundamental tenets of the trust. The requirements of a fiduciary relationship and trustee accountability is essentially *the* Bill. It makes sense that the illusory trust doctrine is applied to test these requirements. A consistent, practical application of the Bill is what will create certainty in the law of trusts.

The Bill continues to allow the courts to refer to common law when interpreting and applying its provisions.[140] Clause 5(5) states that the Bill is not an exhaustive code of the laws of express trusts, and the Bill is intended to be supplemented by the rules of common law and equity relating to trusts. Chief Justice Elias has commented that she expects much of the development of the law of trusts will continue to occur substantially

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profit from the trust (cl 34); to act for no reward (cl 35); and to act unanimously (when there is more than one trustee) (cl 36).

136 The basic trust information is: the fact that a person is a beneficiary of the trust (cl 47(3)(a)); the name and contact details of the trustee (cl 47(3)(b)); the occurrence of, and details of, each appointment, removal, and retirement of a trustee as it occurs (cl 47(3)(c)); and the right of the beneficiary to request a copy of the terms of the trust or trust information (cl 47(3)(d)).

137 Trusts Bill 2017, cl 47(2)(a)(ii).

138 Law Commission (IP31, 2012), above n 63, at 68.

139 Law Commission (IP31, 2012), above n 63, at 69–70.

140 (6 December 2017) 726 NZPD 707.

in cases decided by the courts.[141] In keeping with the scheme of the Bill, the formation of the illusory trust doctrine will provide a framework for the courts to decide cases, while case law continues to perform an auxiliary function.

B Narrow views

1 No accountability

Under the no accountability view, the trust is illusory when *no* obligations on the trustees are enforceable by the beneficiaries. This view is grounded in the concept of the irreducible core and reflected in cl 13(b) of the Bill. As outlined above, cl 13(b) identifies a characteristic of the express trust as the trustee being accountable for the way the trustee carries out the duties imposed on the trustee by law. If the trust deed contains no enforceable obligations on the trustee at all, there is plainly no accountability and there is no trust. While the no accountability view provides a starting point for illusory trust, we need to go further. The doctrine should apply not only to trusts where lack of accountability is manifest in a single provision in trust the deed, but also where a combination of provisions operates to prevent trustee accountability in practice.

2 Trustee usurpation

Under the trustee usurpation view, the trust is illusory when the trustee's discretions can be *completely* overborne by the decisions of another.[142] The "other" is invariably the settlor of the trust, so the trustee usurpation view could equally be termed the "settlor control" view. This view reflects that there must be a delineation of property interests from the settlor, to the trustee and beneficiary. If the trustee's discretion can be completely overborne, there is no true division of legal and beneficial interest in the trust property. This compromises the fiduciary relationship between the trustee and beneficiary. In such a case, the trust would be contrary to the Bill. Clause 13(a) states that a trust is a fiduciary relationship in which the trustee holds or deals with trust property for the benefit of the beneficiaries. Therefore, the trustee usurpation view is a useful conceptual starting point. However, it cannot form the basis of the illusory trust doctrine in its entirety. It is principally concerned with the powers of the settlor in relation to the trust, as opposed to a more holistic consideration of the practical effect of the obligations imposed on the trustee.

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141 Chief Justice Sian Elias "Submission to the Justice Committee on the Trusts Bill (2017)" at 2. Elias CJ was speaking in the context of relationship property.

142 Bennett, above n 5, at 60. See also David Hayton, above n 68, at 65.

C Wide views

1 Unlimited benefit

According to the unlimited benefit view, the trust is illusory if the trustee can take the benefit of the trust property, to the detriment of the beneficiary.[143] A clause in a trust deed permitting the trustee to self-benefit may jeopardise the delineation of legal and beneficial ownership between trustee and beneficiary. Correlatively, it will also conflict with the trustee's fiduciary obligation to hold trust property for the beneficiaries.[144] As Bennett cogently notes:[145]

> The idea that the trustee should not be able to distribute all the trust property to themselves is implicit in the axiomatic trusts law idea of the trustee being a fiduciary steward of property they hold for the benefit of others.

The key fiduciary obligation to hold trust property for the beneficiaries is excluded, because the trustee is expressly given the power to benefit herself over another.[146] If the provisions have this effect, the trust is illusory. This appears to have been Hansen J's approach in the High Court, in *Clayton*.[147] Thus, the unlimited benefit view looks at the impugned provisions of the trust deed as a whole, to see whether the trustee is empowered to use and invest the property in any way they wish.[148] If they can, there is no delineation of property interests, nor fiduciary relationship.

Trustee accountability is also implicitly captured by the unlimited benefit view. A hallmark of trustee accountability is whether a trustee, in practice, holds their power in a fiduciary capacity to the object of the trust.[149] As this paper has explained, unlimited trustee self-benefit means there is no delineation of property interests and the fiduciary character of the relationship is denied. In such trusts, the trustee does not have to exercise her power for the benefit of the beneficiary. By the very nature of the arrangement, it will be difficult to call the trustee to account for an exercise of the trust. This is contrary to the core tenet of the trust identified in cl 13(b) of the Bill, that the trustee is accountable for the way the trustee carries out the duties imposed on the trustee by law.

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143 Bennett, above n 5, at 64.

144 Bennett, above n 5, at 66.

145 Bennett, above n 5, at 66.

146 Bennett, above n 5, at 20.

147 Bennett, above n 5, at 66.

148 *Clayton* (HC), above n 30, at [90].

149 Penner (2016), above n 8, at 74.

However, the Bill has locked in "massively discretionary trusts", which may be jeopardised under the unlimited benefit view.[150] Discretionary trusts are trust structures in which the trustee holds some or many dispositive discretions.[151] In some cases, the trustees' dispositive discretions effectively govern the whole trust, such that the beneficial interests under the trust are not only qualified, but potentially displaced.[152] The distinction between discretionary and final beneficiaries becomes false, because the final beneficiaries will only benefit if the trustee chooses to let them benefit.[153] The Commission declined to engage with discretionary trusts as a substantive matter for reform, and this is reflected in the lack of distinction between fixed and discretionary trusts, in the Bill.[154] Problematically, if a trustee-beneficiary has discretionary powers to appoint any or all of the trustee property to any beneficiary, they may have powers of unlimited self-benefit. There is a risk the trust would be illusory on the unlimited benefit view. This is contrary to the clear legislative and policy intention to allow such trusts to subsist. In order to justify the unlimited benefit view of the illusory trust doctrine, this paper would have to demonstrate why it is sound in law and policy to capture massively discretionary trusts as illusory. That is a separate issue and not within the purview of this paper.[155]

It follows that the illusory trust doctrine must strike a balance between catching nefarious uses of the trust, as in *Clayton*, on one hand, and preserving discretionary family trusts, on the other. The 2013 Census suggested that 215,280 dwellings, or 14.8 per cent of all occupied private dwellings, were held in a family trust by the usual residents of the dwelling.[156] This is significant. It suggests a wide-cross section of the community is using a discretionary family trust to protect the family home. Such usage is of great utility; it provides asset protection benefits, enables succession planning and enhances flexibility in

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150 Barkley (2017), above n 2, at 1.

151 See generally Lionel Smith "Massively Discretionary Trusts", in Nolan, Law and Wu, above n 50.

152 Lionel Smith, above n 151, at 131–132.

153 Barkley (2017), above n 2, at 1–4.

154 Lucie Greenwood "Discretionary Trusts – what happened to "practical intelligence" in the law?" (LLB(Hons) Dissertation, University of Otago, 2012) at 1.

155 Barkley (2017), above n 2, presents a strong argument as to why massively discretionary trusts should be treated differently from fixed trusts. This paper does not express a view on the normative desirability of making a distinction between fixed and discretionary trusts in the legislation. However, this issue surely warrants further consideration from the Law Commission.

156 Statistics New Zealand "2013 Census Quick Stats About Housing" <www.stats.govt.nz>, accessed 01 September 2018. See generally Phil Briggs "Family trusts: ownership, size, and their impact on measures of wealth and home ownership" (Reserve Bank of New Zealand, Discussion Paper 2006/06, 2006).

the family home.[157] Discretionary family trusts are thus socially and economically important. To disturb them would be contrary to the interests of "mum and dad" home owners and investors.[158] This is in contrast to the *Clayton* trust, for example, which was used to shield personal and business assets from a relationship property claim. Only the *Clayton*-type trust should be rendered illusory.[159]

Discretionary family trusts by their very nature give the trustee broad discretionary powers. The trustee is typically also a discretionary beneficiary and will be able to appoint some or all of the trust income or capital to themselves, as beneficiary.[160] This risks a finding of illusory trust on the unlimited benefit view. Therefore, the appropriate balance cannot be struck using the unlimited benefit view.

2 No meaningful accountability

Under the no meaningful accountability view, the trust deed should not provide for simply any accountability of the trustee to the beneficiaries, but meaningful accountability.[161] It is wide view because it looks at whether there is trustee accountability *in substance*.[162] Despite using the terminology of "accountability", this view encompasses the two fundamental tenets of the trust described in this paper, and reflected in cl 13(a) and (b) of the Bill.

First, as with the unlimited benefit view, an indicia of meaningful accountability is whether a trustee, in practice, holds their power in a fiduciary capacity to the object of the trust.[163] Therefore, the no meaningful accountability view reflects cl 13(a) of the Bill, that a trust is a fiduciary relationship in which the trustee holds or deals with trust property for the benefit of the beneficiaries. This paper has explained that unlimited self-benefit will usually omit a fiduciary relationship. However, the no meaningful accountability view

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157 Law Commission (IP19, 2010), above n 12, at 6.

158 Law Commission (IP20, 2010) above n 63, at 4.

159 But see Sue Tappenden "The family trust in New Zealand and the claims of 'unwelcome beneficiaries'" (2009) 2 Journal of Politics and Law 17. Tappenden suggests while there is nothing illegal in setting up a family trust, the law pertaining to family trusts in New Zealand has become so far removed from the accepted principles of equity as to demand investigation.

160 New Zealand Law Society "The Family Trust" <www.lawsociety.org.nz>, accessed 03 September 2018.

161 Bennett, above n 5, at 64.

162 Bennett, above n 5, at 73.

163 Penner (2016), above n 8, at 74.

requires more than the ability of the trustee to take an unlimited benefit from the trust.[164] As Palmer and Peart have explained in relation to *Clayton*:[165]

> Because the powers Mr Clayton conferred upon himself were so wide-ranging, he was the sole trustee and important fiduciary duties were excluded, arguably there was little evidence of any meaningful accountability. Such accountability is central to the existence of a trust and might suggest a lack of trust intention.

Bennett elaborates on the point. He explains that even if a sole trustee can appoint trust property to themselves, that power is a fiduciary power and is subject to fiduciary duties in its exercise.[166]

Palmer and Peart's view is reflected in the well-established rule that the trustee is permitted to take some benefit from the trust.[167] The no meaningful accountability view does not capture all situations of trustee self-benefit. The trust deed may authorise the trustee to benefit from the exercise of a trust power, but the nature of the power is limited so that the trustee cannot completely disregard all others' interests.[168] This includes the discretionary family trust. Discretionary family trusts are thus consistent with the core of the trust, as fiduciary obligations still exist.[169] Traditional mechanisms used to control the exercise of fiduciary powers will still apply, when those powers are exercised.[170] These include excessive execution of, or fraud on a power, conflict of interest, relevant and irrelevant considerations, and irrationality.[171]

Contrastingly, the trust deed in *Clayton* excluded not only fiduciary constraints, but conferred significant other powers on Mr Clayton such that the intention to create a trust would be in doubt.[172] These powers included the ability to appoint all the income and capital to Mr Clayton without having the duty to act impartially or consider all beneficiaries' interests, to act in a conflict of interest situation and to remove all other beneficiaries from the trust.[173] No meaningful accountability requires extreme levels of

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164 Bennett, above n 5, at 72.

165 Palmer at Peart, above n 42, at 124, in Bennett, above n 5, at 64.

166 Bennett, above n 5, at 64.

167 Barkley (2013), above n 92, at 3.

168 Barkley (2013), above n 92, at 3.

169 Penner (2016), above n 8, at 70

170 Richard Nolan "Controlling Fiduciary Power" (2009) 68(2) Cambridge Law Journal 293 at 293.

171 Nolan, above n 170, at 293.

172 Bennett, above n 5, at 64.

173 Palmer and Peart, above n 42, at 118.

trustee control, such as the ability to act without considering the interests of the beneficiaries, or to act in a conflict of interest situation.[174] Such levels of control tend not to occur in discretionary family trusts and so those trusts will not be caught. The no meaningful accountability view is therefore more suitable to upholding the distinction between *Clayton*-type trusts and socially acceptable discretionary family trusts.

In permitting some trustee self-benefit, the no meaningful accountability view reflects the scheme of the Bill. Clause 25 imposes a mandatory duty on the trustee to hold or deal with the trust property for the benefit of the beneficiary. This is a clear exposition of the fiduciary nature of the trust relationship, between the trustee and beneficiary. However, cl 29 creates a default rule that the trustee cannot benefit from the trust. As this rule can be overridden by the trust deed, it must be possible for the trustee to take *some* benefit from the trust property.

Second, the no meaningful accountability view plainly contemplates trustee accountability as it is formulated in cl 13(b) of the Bill. Part of the accountability analysis is whether, as explained above, the trustee holds their powers in a fiduciary capacity. However, accountability also encompasses trustee exclusion of liability and indemnity provisions for breach of trust. Incorporation of such provisions in the trust deed may significantly hinder the accountability of the trustee, to the beneficiary. These concepts are embedded in the Bill. Clauses 37 and 38 prohibit the exclusion of liability or indemnification for a breach of trust that is grossly negligent, dishonest, or a wilful breach. Additionally, knowledge of the basic terms of the trust by the beneficiary is crucial to holding the trustee to account.[175] Clause 47 creates a rebuttable presumption in favour of disclosing basic trust information to the beneficiaries. Therefore, the scope and extent of any bar on the provision of trust information to the beneficiaries will form part of the illusory trust inquiry, under the no meaningful accountability view.

3 Reality of control

Reality of control looks beyond the strict legal form of the arrangement. It examines whether, in substance or reality, the powers provided in the trust deed to the settlor or trustee mean that they, rather than the specified beneficiaries, have the benefit of the property.[176] Issues of extensive trustee (or settlor-trustee) control are captured by the no meaningful accountability view, making the reality of control view redundant in this

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174 Bennett, above n 5, at 72–73.

175 Law Commission (IP31, 2012), above n 63, at 65–71.

176 Bennett, above n 5, at 69.

respect. However, the no meaningful accountability view looks solely at the position of the trustee. The reality of control view is essential for demarcating the role of the settlor, when the settlor is not a trustee or beneficiary.

A reality of control is likely to exist where the settlor is not a trustee, but retains powers to control how the trust property is used. For example, the settlor may reserve powers under the trust deed to give binding directions for investment, to give or withhold consent for the exercise of the trustee's powers, to replace trustees, to direct the distribution of trust assets contrary to the terms of the trust deed, or to act as a director of a company whose shares are owned by the trust.[177] If these powers exist in the trust deed, they obfuscate the delineation of property interests between trustee and beneficiary upon transfer. If the settlor is exercising control over the trustee, they essentially have a legal interest in the property. If the settlor is exercising that control to take a benefit from the property, they have a beneficial interest.

Excessive settlor control is contrary to cl 13(a) of the Bill. Clause 13(a) explains that the trust is a fiduciary relationship in which the trustee holds or deals with the trust property for the benefit of the beneficiaries. It could be said that if control of the trust lies with the settlor, the trustee is not holding the property for the benefit of the beneficiaries, thus abandoning the requisite delineation of property interests. It may follow that the trustee does not hold their power in a fiduciary capacity to the object of the trust. This is repugnant to the concept of the trust, both at common law and under the Bill. Therefore, it would be favourable to incorporate reality of control of the settlor into an analysis of whether the trust is illusory.

D Preferred View

The value of the illusory trust doctrine, in relation to the Bill, lies in the adaption of the wide views. The narrow views provide the conceptual basis of the doctrine, per the two fundamental tenets of the trust. A trust deed that provides for absolutely no trustee accountability, or complete trustee usurpation by the settlor, is evidently not a trust. However, courts must be able to look to the substance of the trust deed, to see whether the fundamental tenets of the trust are jeopardised.

The no meaningful accountability view should form the basis of the illusory trust doctrine for the Bill. The trust will be illusory if there is no meaningful accountability on the part of the trustee, to the beneficiaries. If there is no meaningful accountability, the trustee

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177 Bennett, above n 5, at 69.

does not hold their powers under the trust in a fiduciary capacity. It follows that the trustee is not accountable for the way the trustee carries out the duties imposed on the trustee by law. In this way, the no meaningful accountability view accounts for the two fundamental tenets of the trust.

As the no meaningful accountability view is more demanding than unlimited benefit, discretionary family trusts will be protected from a finding of illusory trust. The interaction of the doctrine with a typical family trust, compared to the nefarious *Clayton* trust, is set out below. The ability to strike a balance between *Clayton*-type trusts and discretionary family trusts is the determinative reason why the no meaningful accountability view should be preferred.

The trade-off is that some massively discretionary trusts will remain permissible. However, the alternative is untenable in light of the social and economic importance of discretionary family trusts in New Zealand. It is worth bearing in mind there is always a risk of people using trust structures inappropriately. However, so long as the two fundamental tenets of the trusts are present, inappropriate use will run contrary to the terms of the trust deed, giving rise to a cause of action on the part of the beneficiaries. It has been shown that the discretionary family trust incorporates these two tenets. Additionally, external regimes will still be able to look through discretionary trusts in the usual circumstances. In this light, the no meaningful accountability view is most consonant with the Bill and policy concerns.

The no meaningful accountability view needs to be built upon in one respect, for incorporation into the Bill. A reality of control inquiry must be added. However, this will be restricted to *settlor* control, where the settlor is not a trustee. A reality of control may exist where the settlor retains control of how the trust property is used. This obscures the fiduciary relationship between the trustee and beneficiary, jeopardising a fundamental tenet the trust.

V Draft Provision

The following draft provision (hereafter "s 132A") is proposed. Section 132A enables the court to make a finding of illusory trust, in accordance with the no meaningful accountability view. It will be situated at the bottom of Part 7 of the Bill, which mandates court powers and dispute resolution.

132A Court may declare trust illusory

(1) The court may declare the trust illusory, if it is satisfied that in substance, the terms of the trust deed provide no meaningful accountability on the part of the trustee, to the beneficiaries.
(2) In determining whether the terms of the trust deed provide no meaningful accountability, the court must have regard to-
    (a) whether the trust deed in substance omits a fiduciary relationship in which the trustee holds or deals with trust property for the benefit of the beneficiaries, within the meaning of section 13(a); and
    (b) whether the trust deed in substance prevents the trustee from being accountable for the way the trustee carries out the duties imposed on the trustee by law, within the meaning of section 13(b).
(3) Subsection (2) does not limit the matters the court may have regard to.
(4) If the settlor is not a trustee, the court may make a declaration that the trust is illusory if it is satisfied that the terms of the trust deed give the settlor real control of the trust property.
(5) Where the court makes a declaration that the trust is illusory, the trust is a resulting trust for the settlor.
(6) The court may decline to make a declaration of illusory trust if it considers that to do so would unfairly prejudice the interests of the other parties to the trust, or the interests of third parties.

VI Analysis of s 132A

A Section 132A is a Substantive Reform

Implementing the preferred, no meaningful accountability view through s 132A will not substantively alter the requisite core of the trust. Further, in framing the no meaningful accountability inquiry around two mandatory considerations, per s 132A(2), the doctrine is squarely focused on the two fundamental tenets of the trust outlined in this paper. These tenets are affirmed in cl 13 of the Bill.

The ss 132A(2)(a) and 132A(2)(b) inquiries will draw on existing factors identified in the jurisprudence and literature. For example, the omission of a fiduciary relationship per s 132A(2)(a) may be evinced by the ability of the trustee to exercise broad powers or discretions for her own benefit, whether the trustee is compelled to consider the interests of the other beneficiaries' interests, and whether the trustee can act in a conflict of

interest.[178] Additionally, the inhibition of trustee accountability per s 132A(2)(b) may be evinced by the absence of fiduciary constraints, trustee exclusion of liability or indemnity clauses and whether the beneficiary is able to know the terms of the trust within the meaning of cl 47 of the Bill.[179]

The alternative, settlor control inquiry under s 132A(4) will also be based on factors identified in the jurisprudence and literature. For example, real settlor control may exist where the settlor has powers to give binding directions on investment, to replace trustees, to distribute assets contrary to the terms of the trust deed or to act as a director of a company whose shares are owned by the trust.[180]

However, s 132A can be considered a substantive reform in three respects. First, it alters the approach of the courts in coming to a determination on whether the trust deed in fact creates a trust. Section 132A(1) incorporates the concept of illusory trust into the Bill. This is important. It pre-empts courts to resolve trusts disputes using principles of trusts law. The current approach is to dance around the issue of the boundaries of the trust, and resolve disputes principally by reference to external regimes such as relationship property. Second, s 132A(5) provides that where the trust is illusory, the trust is a resulting trust.[181] A resulting trust will require the recipient of the legal title (the "trustee"), to retain the property for the transferor (the "settlor").[182] The property is legally and beneficially the transferors', and can be accessed by creditors. This is a substantive change, as a resulting trust has different consequences to merely looking through the trust for the purposes of an external regime. A resulting trust causes the purported trust to be set aside. Contrastingly, external regimes enable access to the trust property for a limited purpose, but the trust otherwise subsists. Third, s 132A(6) confers broad discretion on the courts as to whether to declare the trust illusory. Under s 132A(6), the court may decline to make a declaration if to do so would prejudicially affect the interests of other parties. This is because a declaration will necessitate a resulting trust. Applying the external regime may therefore create a more just result, where a beneficial

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178 *Clayton* (HC), above n 30, at [81]. The presence of these factors were integral to a finding of illusory trust in that case.

179 Bennett, above n 5, at 70. See also Palmer and Peart, above n 42, at 118.

180 Bennett, above n 5, at 69. See also *Kain v Hutton* [2008] NZSC 61; *Walker v Walker* [2007] NZCA 30.

181 The resulting trust is referred to in cl 5 of the Bill, but is not defined. It must be taken to have its ordinary, common law meaning.

182 Jessica Palmer "Resulting Trusts" in Andrew Butler *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 307 at 308.

or other interest needs to be maintained. For these reasons, s 132A is a substantive reform of New Zealand's trust law. It needs to be justified as such.

Scholars have argued we ought to be slow to reform the common law on the mere basis it appears to be untidy and unduly complex.[183] Further, it is hard to point to any recent trusts case in which injustice appears to have been done simply because the court has found itself constrained by unsatisfactory doctrine. While the reasoning of the appellate Courts in *Clayton* was messy, the result was a just one, in that Mrs Clayton was able to access her share of the property. Scholars have fiercely advocated that the legislature should only intervene in the common law where courts, shackled by the doctrine of precedent, have lost the required flexibility to reach the appropriate results.[184] Additionally, many scholars have faith in the ability of common law judges to affect realistic doctrinal reforms where reason or fairness demands.[185] One has argued that the common law should be trusted to "clean its own house".[186] Due to a lack of substantive injustice in the law of trusts, one might consider a substantive reform to be unnecessary.

However, s 132A does not seek correct injustice in the law of trusts, nor iron out its complexities. Rather, it recognises fundamental trust concepts and gives them practical effect. As has already been explained, courts are upholding structures that cannot objectively be considered as trusts. Paired with the tendency of the courts to dance around discussion of core trust principles, and exacerbated by pervasive external regimes, there may be a movement from an appreciation of the flexibility of the trust, to a much more dangerous flexibility in our characterisations of what the trust's essential features are.[187] Section 132A gives the courts a practical tool by which they can manage these essential features, and preserve the core of the trust.

B Conferring Discretion

Section 132A will enable the court to decline to make a declaration of illusory trust, if it considers the interests of other parties will be prejudicially affected. This confers an element of judicial discretion. Some practitioners and scholars will be opposed to this

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183 David McLauchlan "Contract and Commercial Law Reform in New Zealand" (1984) 11 NZULR 36 at 42.

184 Stephen Waddams "Legislation and Contract Law" (1978-1979) 17 UWO L Rev 185 at 186.

185 Waddams, above n 184, at 186–190.

186 Edward Belobaba "The Resolution of Common Law Doctrinal Problems Through Legislative and Administrative Intervention" in Barry Reiter and John Swan *Studies in Contract Law* (Butterworths, Toronto, 1980) 423 at 423.

187 Penner (2002), above n 25, at 254.

discretion, because of an ostensible lack of certainty and predictability it gives to the illusory trust inquiry.[188] As Virgo explains, the language of judicial discretion appears to allow for the judge to secure what he or she considers to be the just result with reference to the particular facts of the case.[189] Indeed, this author contemplates that many declarations of illusory trust will hinge on whether the interests of other parties would be prejudicially affected, in the opinion of the court.

Importantly, the New Zealand judiciary and legal commentators appear generally content about the legitimacy of the exercise of judicial discretion.[190] Judicial discretion is guided by rational principles, so that a decision which is not susceptible to principled justification is not an exercise of discretion, but a mere arbitrary choice.[191] Certainly, it is contemplated that the courts will build up their own principles for the exercise of discretion. As Burrows notes, our courts have never been slow to state what considerations judges may and may not take into account when exercising discretion.[192] As such, precedents inevitably arise.[193] It is unlikely those precedents will be departed from in later cases where the facts are the same.[194] Additionally, courts are guided in their exercise of discretion by the purpose, context and scheme of the statute concerned.[195] This will provide an amount of flexibility (especially considering the equitable origins of trusts law), but will also provide guidance. Further, appeal courts can contribute much to the consistency of decisions if they are prepared to reverse idiosyncratic exercises of discretion by lower courts, and by pointing out how those courts erred.[196] Finally, in light of the scheme of the Bill, s 132A should not be overly prescriptive; conferring an element of discretion through which the courts can develop the doctrine is consonant with the scheme of the Bill.

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188 Graham Virgo "Judicial Discretion in Private Law" (2016) 14(2) Otago L Rev 257.

189 Virgo (2016), above n 188, at 259.

190 Virgo (2016), above n 188, at 257.

191 HLA Hart "Discretion" (2013) 127(2) Harv L Rev 652 at 665.

192 John Burrows "Contract Statutes: The New Zealand Experience" (1983) Statute L Rev 76 at 86. Burrows was writing in the context of New Zealand's discretion-enhancing contract law reforms of the 1970s and 1980s.

193 Burrows, above n 192, at 86.

194 Burrows, above n 192, at 88.

195 *Broadlands Rentals Ltd v R D Ltd* CA71/74, 22 July 1974 at 600. In the case of illusory trusts, one is concerned with the Trust Bill 2017, as enacted.

196 Burrows, above n 192, at 88.

C External Regimes are a Secondary Consideration

There is an argument that s 132A is superfluous, due to the ability of external regimes to look through the trust. Trusts enable settlors and beneficiaries to access government benefits as well as to avoid obligations.[197] The use of trusts in this regard has been met with a variety of legislative responses that look through the trust, so that trust assets can be considered to be the settlor's or beneficiaries' own assets for certain purposes.[198] External legislative responses can be categorised as either responding to private interests, or government interests.[199] Private interests pertain to the claims of creditors[200] and relationship property.[201] Government interests principally relate to income tax[202] and means-tested social support.[203]

The Commission states that look through provisions reflect a common policy objective that trusts ought not to be permitted to frustrate the fundamental policy objectives of particular legislation.[204] The ability to look through the trust in each external regime is a tailored response to the use of trusts contrary to the policy objectives of that regime. Individual policy areas require different approaches to the use of trusts because they involve different problems, objectives and priorities.[205] Therefore, the Commission was opposed to a general look through provision in the Bill.

At first glance, this appears to preclude the implementation of the illusory trust doctrine, in the Bill. However, look through provisions are of an entirely different nature to s 132A. Look through provisions do not challenge the validity of the trust itself. They recognise that a settlor has used a trust structure to avoid a particular regime, so will treat

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197 Law Commission (IP20, 2011), above n 63, at 17.

198 Law Commission (IP20, 2011), above n 63, at 17.

199 Law Commission (IP20, 2011), above n 63, at 17.

200 Sections 344 to 350 of the Property Law Act 2007 enable the court to set aside certain dispositions of property that "prejudice" creditors. This includes certain transfers of property to a trust.

201 Section 44 of the PRA provides that dispositions of property may be set aside if they were made "in order to defeat the claim or rights of any person" under the Act. "Disposition" includes the settlement of assets on a trust.

202 The Income Tax Act 2007 contains a number of provisions that can make the settlor or beneficiary liable to income tax on income from the trust fund. However, there is no express look through provision empowering Inland Revenue to disregard a trust and access its assets.

203 See generally Law Commission (IP20, 2011), above n 63, at 31–35. Several statutory provisions allow the Government to take account of an interest in a trust for the purposes of assessing a person's assets or income.

204 Law Commission (IP31, 2012), above n 63, at 276–277.

205 Law Commission (IP31, 2012), above n 63, at 278.

the trust property as the settlor's for the purposes of that regime. In contrast, s 132A simply says what you created cannot be a trust; the trust deed has particular provisions which omit the fundamental tenets of the trust. Section 132A is not intended to affect the applicability of look through provisions. The applicability of external regimes to the trust will be a matter for the court to consider, in determining whether making a declaration of illusory trust would prejudicially affect the interests of other parties.

Additionally, s 132A is a more doctrinally sound mechanism to manage the permissible boundaries of the trust. If an external regime such as relationship property is the sole means by which the courts regulate trust disputes,[206] we are implicitly allowing the external regime to regulate the boundaries of the trust. This especially true in New Zealand, where relationship property disputes involving trusts are pervasive. In *Clayton*, for example, the Court of Appeal and Supreme Court decisions had the effect of upholding a structure as a trust, that on further analysis, could not objectively be considered a trust.[207]

Management of core trust principles through external regimes is also undesirable, as external regimes are not developed with the conceptual boundaries of the trust in mind. For example, at the time of writing, the relationship property regime is undergoing a reform process, guided by the Commission.[208] One of the Commission's terms of reference is to assess how the Relationships (Property) Act deals with property held by a company or trust and the powers of the courts in this area, and whether that is satisfactory. This assessment will be conducted in light of the policy objectives of the relationship property regime, not by reference to contemporary social and political circumstances indicating what a trust should be.

VII Section 132A in Practice

Crucially, s 132A strikes the appropriate balance between structures which go beyond the permissible conceptual boundaries of the trust, as in *Clayton*, and structures which, although flexible and discretionary, remain within those boundaries. This includes the discretionary family trust. To show that discretionary family trusts are not at risk of being found illusory, this paper will analyse the VRPT trust deed in *Clayton* and a typical family trust deed under the proposed s 132A. The relevant provisions of the VRPT trust

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206 Putting to the side a finding that the trust is a sham.

207 See Part II, sub-Part B.

208 Law Commission "Review of Property (Relationships) Act 1976" <www.lawcom.govt.nz>, accessed 28 August 2018.

deed in *Clayton* have been set out in Part II, sub-Part B of this paper. The family trust deed is based upon a deed of which the author is aware, and in accordance with the common features of a discretionary family trust, per the New Zealand Law Society's guidelines on family trusts.[209] Its relevant provisions are set out below.

A Clayton Trust

First, one must consider whether the VRPT deed in substance omits a fiduciary relationship in which the trustee holds or deals with trust property for the benefit of the beneficiaries, under s 132A(2)(a). As Hansen J established in the High Court, the deed empowered Mr Clayton to use and invest the property in any way he wished.[210] Mr Clayton could exercise any of his broad powers or discretions for his own benefit.[211] The trust is not illusory on this basis alone. If Mr Clayton appointed property to himself as beneficiary, he would be exercising a fiduciary power and would be subject to the traditional mechanisms used to control the exercise of that power.[212] However, the VRPT deed provided that Mr Clayton could exercise any of his broad powers or discretions for his own benefit, without regard for the other beneficiaries' interests, and notwithstanding any conflict of interest with the VRPT or other beneficiaries.[213] At this point, the trust deed in substance omits a fiduciary relationship in which the trustee holds or deals with trust property for the benefit of the beneficiaries. Mr Clayton can *completely disregard* all other interests in relation to the trust. This is directly on point with s 132A(2)(a) and goes toward a finding of illusory trust.

It should be noted that powers to appoint and remove trustees and beneficiaries will not ordinarily jeopardise the fiduciary nature of the relationship. Indeed, powers of appointment are fiduciary powers, and are subject to the traditional mechanisms of control of a fiduciary power. The difference here is that cl 11 of the VRPT deed purports to exclude the fiduciary nature of the power, by providing that such powers may be exercised notwithstanding that the interests of all beneficiaries are not considered, the exercise would be contrary to the interests of any beneficiary, or the trustee is in a conflict of interest. In this sense, the powers of appointment under the VRPT trust deed could be seen as jeopardising the fiduciary nature of the relationship between the trustee and beneficiaries.

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209 New Zealand Law Society, above n 160.

210 *Clayton* (HC), above n 30, at [90].

211 *Clayton* (HC), above n 30, at [81].

212 See Part IV, sub-part C, section 2.

213 *Clayton* (HC), above n 30, at [81].

Second, trustee accountability needs to be considered under s 132A(2)(b). If the fiduciary nature of the relationship is excluded, the trust deed will likely prevent the trustee from being accountable for the way the trustee carries out the duties imposed on the trustee by law. In other words, s 132A(2)(b) will usually be satisfied as a consequence, although other provisions of the trust deed may be relevant. The VRPT deed excludes trustee liability for breach of trust except in the case of dishonesty or wilful breach.[214] This is a factor going against meaningful accountability. However, some exclusion of liability is consistent with cl 37 of the Bill.[215] Another factor is Mr Clayton's ability to appoint and remove discretionary beneficiaries.[216] Mr Clayton has this power in his capacity as Principal Family Member of the VRPT, but the power is properly considered under trustee accountability, as an exercise of the power will affect the way in which the trustee is accountable to the beneficiary. A beneficiary is less likely to call the trustee, Mr Clayton, to account if they are removable at the will of the Principal Family Member, who is also Mr Clayton. These factors, in addition to the exclusion of a fiduciary relationship, mean s 132A(2)(b) is satisfied. Therefore, in considering ss 132A(2)(a) and 132A(2)(b), it can be said that in substance, the terms of the VRPT deed provide no meaningful accountability on the part of the trustee, to the beneficiaries. A declaration of illusory trust follows.

Under s 132A(5), the illusory trust is a resulting trust for the settlor, Mr Clayton. The VRPT property is simply Mr Clayton's property, and becomes subject to the equal sharing regime under the PRA. Practically, nothing changes for Mrs Clayton. She has recourse to the assets of the trust to the same extent as if Mr Clayton's powers under the VRPT were treated as "property". The benefit, however, lies in the condemnation of the "trust" structure that was established, thus affirming the boundaries of the trust. If for some reason Mrs Clayton's interests were unfairly prejudiced due to the property being placed on resulting trust, the court could exercise its discretion and refrain from making a declaration of illusory trust. The court would instead use the external, relationship property regime to give effect to Mrs Clayton's interests.

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214 VRPT Deed, cl 21.1. *Clayton* (SC), above n 30, at appendix.

215 Notwithstanding the issue of gross negligence. The VRPT deed would be in breach of cl 37, as it purports to exclude liability for gross negligence. However, cl 37 was not (and is still not) in effect at the time the VRPT deed was constituted, so this cannot be considered in the analysis.

216 VRPT Deed, cl 7.1. *Clayton* (SC), above n 30, at appendix.

B Family Trust

Andrea, the settlor, constitutes the Family Trust (FT) trust deed. Andrea is a co-trustee along with her solicitor, Ben. The discretionary beneficiaries are Andrea and her children, Charlie and Devon. The final beneficiaries are Charlie and Devon. The relevant provisions of the FT trust deed are as follows:

> **10 – Income distribution**
>
> 10.1 The Trustees may pay or apply all or any part of the income of the Trust Fund to or for such one or more of the Discretionary Beneficiaries.
>
> **11 – Distribution of capital before vesting day**
>
> 11.1 The Trustees may pay, apply or appropriate any part or all of the capital of the Trust Fund to or for such one or more of the Discretionary Beneficiaries.
>
> **12 – Powers of appointment**
>
> 12.1 The Trustees have the power to appoint and remove Trustees.
>
> 12.2 The Trustees have the power to appoint and remove Discretionary Beneficiaries.
>
> **13 – Liability of Trustees**
>
> 13.1 No Trustee shall be liable for any loss incurred by the Trust Fund or by an any beneficiary not attributable to that Trustee's own dishonesty, wilful breach or gross negligence.
>
> **14 – Amendment of trust deed**
>
> 14.1 The Trustees may vary, revoke or enlarge all or any of the provisions of this deed concerning the management or administration of the Trust.

First, the applicability of s 132A(2)(a) is considered. Under the FT deed, Andrea is given broad discretionary powers as co-trustee. With the consent of her co-trustee, Andrea can exercise her powers under cls 10 and 11, to receive all the income and capital of the trust respectively. These powers do not render the trust illusory. If Andrea appointed property to herself as beneficiary, she would be exercising a fiduciary power. In contrast to Mr Clayton, Andrea would still have to consider the interests of the beneficiaries and not act in a conflict of interest situation. This is crucial for the validity of the trust. It was the absence of these obligations in the VRPT deed that tipped the trust over the edge. In Andrea's case, however, any exercise of her power would be subject to the traditional mechanisms of control of trustee discretion.

As noted above, Andrea's power as trustee to appoint and remove trustees and beneficiaries (with Ben's consent) does not jeopardise the fiduciary nature of the trust. Nor does her power to amend the trust deed; it only enables a variation of the deed on matters of management or administration of the trust, not on matters of beneficial or fixed interests under the trust. Therefore, the FT deed does not omit a fiduciary relationship in which the trustee holds or deals with trust property for the benefit of the beneficiaries.

Second, the applicability of s 132A(2)(b) is assessed. As the FT deed maintains a fiduciary relationship, it is likely that the trustees will be accountable for the way the trustees carries out their duties imposed on the trustees by law. The FT deed will not reach the threshold contemplated in s 132A(2)(b). The exclusion of liability for breaches of trust that are not dishonest, a wilful breach or grossly negligent appears to go against trustee accountability, but this is only one factor. Importantly, exclusion of liability is permitted under cl 37 of the Bill. The FT deed is consonant with cl 37. Therefore, the FT deed does not prevent trustee accountability.

The FT deed provides meaningful accountability on the part of the trustees, to the beneficiaries. This conclusion has been arrived at after considering the factors required by s 132A(2). It has been shown that the s 132A formulation of the illusory trust doctrine will not catch discretionary family trusts. The author has stressed that striking this balance is integral to s 132A.

VIII Conclusion

The illusory trust doctrine is a necessary addition to the Trusts Bill. It enables the court to consider the terms of the trust deed as a whole, and come to a determination as to whether a trust is really a trust at all. Without this ability, the courts will continue to dance around the issue of the conceptual boundaries of the trust. The current approach reflects a movement from an appreciation of the flexibility of the trust, to a much more dangerous flexibility in our characterisation of the essential characteristics of trusts.

The no meaningful accountability view articulated in s 132A is entirely consonant with the scheme of the Bill, and broader policy considerations. It is consistent with the two tenets of the trust recognised in law, and now identified in cl 13 of the Bill. These features are a fiduciary relationship in which the trustee holds the property for the benefit of the beneficiaries, and trustee accountability. If these features are absent, there is no meaningful accountability, and the trust is illusory. Crucially, s 132A strikes a balance

between egregious uses of the "trust", as in *Clayton*, and socially acceptable discretionary family trusts. Discretionary family trusts are an integral part of how New Zealanders structure their property, and should not be disturbed. Additionally, as a declaration of illusory trust may not be made if the interests of other parties are prejudicially affected, the application of the view will not interfere with the applicability of external regimes if a more just result would occur under that regime. Therefore, the illusory trust doctrine as reflected in s 132A is a necessary and acceptable addition to the Bill. It sets out the framework for a finding that a structure cannot properly be considered a trust. Without the doctrine, the current lack of clarity in the law of trusts will subsist.

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X Appendix

132A Court may declare trust illusory

(1) The court may declare the trust illusory, if it is satisfied that in substance, the terms of the trust deed provide no meaningful accountability on the part of the trustee, to the beneficiaries.

(2) In determining whether the terms of the trust deed provide no meaningful accountability, the court must have regard to-

(a) whether the trust deed in substance omits a fiduciary relationship in which the trustee holds or deals with trust property for the benefit of the beneficiaries, within the meaning of section 13(a); and

(b) whether the trust deed in substance prevents the trustee from being accountable for the way the trustee carries out the duties imposed on the trustee by law, within the meaning of section 13(b).

(3) Subsection (2) does not limit the matters the court may have regard to.

(4) If the settlor is not a trustee, the court may make a declaration that the trust is illusory if it is satisfied that the terms of the trust deed give the settlor real control of the trust property.

(5) Where the court makes a declaration that the trust is illusory, the trust is a resulting trust for the settlor.

(6) The court may decline to declare the trust illusory if it considers that to do so would unfairly prejudice the interests of the other parties to the trust, or the interests of third parties.