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CONTROLLING THE SETTLOR: DISINCENTIVISING SETTLOR CONTROL OVER TRUSTS THROUGH THE PROPERTY (RELATIONSHIPS) ACT 1976

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I Introduction

A recent discretionary trust trend is the tendency of settlors to retain extensive control over, and ability to benefit from, trusts settled. This control-benefit nexus allows the settlor to avoid the application of various legal regimes (such as relationship property and insolvency law) while continuing to deal with and enjoy the trust property as if they were its legal owner. In these cases, the trust externalises the settlor's legal obligations onto those outside the trust, and the settlor is afforded an unjustifiable benefit. Whether, and in which cases, New Zealand trust law deems settlor-controlled trusts to be invalid is unsettled, but it is unlikely the courts will interfere with the validity of trusts in any but the most extreme cases of settlor control. Existing non-trust legal regimes in New Zealand provide minimal disincentive to settlors who wish to retain control over their trusts. The law as it stands therefore effectively permits settlors to establish trusts for subversive purposes while neglecting to provide a remedy to claimants against the settlor. This paper argues that statutory reform is required to prevent the injustices caused by settlor control.

Part II of this paper conceptualises settlor control by providing an overview of the features of express trusts, categorising the different forms of settlor control that may exist, and identifying the conditions likely to enable the settlor control trend to flourish. Part III conducts a normative analysis of settlor control and concludes that settlor control over trusts for subversive purposes cannot be justified. Part IV assesses the extent to which New Zealand trust law responds to the issue of settlor control, and concludes that existing trust law is insufficient to address settlor control. Part V evaluates the extent to which existing non-trust legal regimes disincentivise settlor control, and concludes that any disincentive is negligible. Finally, Part VI proposes statutory reform targeting settlor-controlled trusts. Focusing on the PRA as one suitable regime, Part VI assesses provisions in relationship property legislation of comparable jurisdictions, suggests the possible wording of a new provision in the PRA, and tests the provision against examples of trusts with varying degrees of settlor control.

II Conceptualising Settlor Control

A The Trust: An Ever-Evolving Institution

Trusts have several key identifying features. To settle a trust, the absolute owner of property (the settlor) passes the legal title in property to another (the trustee), subject to fiduciary duties to deal with the property for the benefit of a third (the beneficiary).[1] To successfully create this trust relationship,[2] the settlor must indicate with sufficient certainty: intention to settle a trust,

[1] Alastair Hudson *Equity and Trusts* (9th ed, Taylor & Francis Group, London, 2016) at 43.

[2] The trust is a relationship, rather than an entity: Greg Kelly and Chris Kelly *Garrow and Kelly Law of Trusts and Trustees* (7th ed, LexisNexis NZ, Wellington, 2013) at 7.

the objects of the trust, and the subject matter of the trust.[3] The trust relationship is characterised by two fundamental tenets, described as the "irreducible core" by Millet J in *Armitage v Nurse*:[4] the trustees must owe the beneficiaries fiduciary obligations, and those obligations must be enforceable by the beneficiaries against the trustees.[5]

Besides the three certainties and the irreducible core, there are no universally agreed necessary characteristics of a valid trust.[6] It follows that, so long as these features are present, a trust arrangement can take practically any form, limited only by the settlor's creativity.[7] This flexibility gives rise to a range of legitimate uses of trusts, including estate planning, holding family assets, managing property for someone unable to manage their affairs, putting aside property for a specific purpose,[8] and commercial enterprises.[9] This flexibility also gives rise to some opportunistic uses, including shielding assets from claimants, minimising taxable income, and accessing government benefits.[10]

The flexibility of the trust institution has facilitated the evolution of common trust characteristics.[11] In response to their clients' needs, lawyers have pushed the drafting of trust

[3] Andrew Butler and Tim Clarke *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) at 74; Hudson, above n 1, at 73; and Kelly and Kelly, above n 2, at 53. See also Trusts Act 2019, s 15(1)(b).

[4] [1998] Ch 241, [1997] 2 All ER 705 at 253.

[5] Thomas Probert "A Lost Opportunity: Omission of the Illusory Trust Doctrine from the Trusts Act 2019" (2019) 50 VUWLR 681 at 682-683; and Kelly and Kelly, above n 2, at 9.

[6] James Webb "An ever reducing core? Challenging the legal validity of offshore trusts" (2015) 21 Trusts Trustees 476 at 477 and 480; and Jessica Palmer "Equity and Trusts" (2019) New Zealand Law Review 365 at 367.

[7] Hanoch Dagan and Irit Samet "Express Trust: The Dark Horse of the Liberal Property Regime" in Simone Degeling (ed) *Philosophical Foundations of the Law of Trusts* (2022) (forthcoming) at 29.

[8] Such as children's education.

[9] Katy Barnett "Offshore Trusts in the South Pacific: How Far can the Concept of the Trust be Stretched before it Breaks?" in Ying Khai Liew and Matthew Harding (eds) *Asia-Pacific Trusts Law: Volume 1: Theory and Practice in Context* (Hart Publishing, Oxford, 2021) at 372; Hudson, above n 1, at 53-54; Webb, above n 6, at 480; and Law Commission *Dividing relationship property – time for change? / Te mātatoha rawa tokorau – Kua eke te wā?* (NZLC IP41, 2017) at [20.23].

[10] Hudson, above n 1, at 53-54; Webb, above n 6, at 480; Barnett, above n 9, at 372; and Law Commission, above n 9, at [20.23].

[11] A classic example is *McPhail v Doulton* [1971] AC 424 (HL), wherein the House of Lords significantly developed the certainty of objects requirement. It held that all is required is that it is possible for the trustees to determine, according to the terms of the trust, whether any person is or is not part of the class of beneficiaries, thus overturning the pre-existing complete list test. See Jessica Palmer and Charles Rickett "The Revolution and Legacy of the Discretionary Trust" (2017) 11 J of Eq 157 at 157; and Hudson, above n 1, at 132.

instruments to the limits of what they believe the courts will enforce as a valid trust.[12] The development of trust law is therefore:[13]

> … a product of the interplay of on the one hand the ingenuity of lawyers to create an arrangement favourable to their client's interests… and on the other hand the ability of the courts to enforce the arrangement.

After the settlor has settled a trust, they do not necessarily have ongoing involvement with it. Thus, the settlor "effectively drops out of the picture" once they have declared a valid trust and vested the trust property in the trustee.[14] This separation has long been uncommon, as settlors frequently desire continued involvement with the trust as a trustee or beneficiary.[15] However, a recently emerging trend is that of settlors retaining excessive control over trusts which they have settled.[16] Molloy and Graham describe settlor control as "[o]ne of the most acute tensions that pervades modern trust practice".[17] Extreme settlor control is characterised by the ability of the settlor to treat trust property as if it were their own, notwithstanding that it is supposedly settled on the trust.

B A Classification of Settlor Control

Settlor control can be classified as "authorised", where the trust deed enshrines the settlor's control through their various positions, rights, and powers in relation to the trust, or as "unauthorised" or "de facto", where the settlor exerts control over the trust beyond that which is permitted by the trust deed.[18]

One form of authorised settlor control may exist in cases where the settlor is the sole trustee and a discretionary beneficiary. For example, in *Clayton and Clayton [Vaughan Road Property Trust]* (*Clayton*) and *Webb v Webb* (*Webb*) both settlors were the sole trustee and a

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[12] Donovan Waters "Trusts: Settlor Reserved Powers" (2006) 25 Est Tr and Pensions J 234 at 246.

[13] Mark Bennett "Competing Views on Illusory Trusts: the Clayton v Clayton litigation in its wider context" (2017) 11 J Eq 48 at 77.

[14] Tsun Hang Tey "Reservation of Settlor's Powers" (2009) 21(2) SAcLJ 517 at 524.

[15] Hudson, above n 1, at 74.

[16] Jessica Palmer "A Lament for Trust Principles in New Zealand" in Ying Khai Liew and Matthew Harding (eds) *Asia-Pacific Trusts Law: Volume 1: Theory and Practice in Context* (Hart Publishing, Oxford, 2021) 39 and 41; Waters, above n 12, at 234; Nicholas Jacob and Lawrence Graham "The legal realities of reserved powers trusts" 12 (2006) Trusts Trustees 25 at 27; Law Commission, above n 9, at [20.19]; Butler and Clarke, above n 3, at 62; Bennett, above n 13, at 49; and Mark Bennett "The Illusory Trust Doctrine: Formal or Substantive?" (2020) 51 VUWLR 193 at 226.

[17] Tony Molloy and Toby Graham "Trustees duties to creditors; trustee exoneration clauses; settlor control and settlor mistake" (2011) 17 Trusts Trustees 897 at 898.

[18] Jessica Palmer "Controlling the Trust" (2011) 12 Otago Law Review 473 at 474.

discretionary beneficiary, with broad powers which meant they could distribute the entire trust fund to themselves if they wished.[19]

There may be elements of both authorised and unauthorised settlor control where the settlor is a discretionary beneficiary and one of two or more trustees. For example, in *Murrell v Hamilton* and *Vervoort v Forrest* both settlors were one of two trustees at the relevant time but were the only trustee involved in the active management of the trust, enabling the settlors to control and benefit from the trust property as if it were their own.[20] Alternatively, unauthorised settlor control may exist where the settlor is not a trustee, but effectively controls the actions of the trustees.

Authorised control may alternatively exist where the settlor reserves to themselves powers in the trust deed in a capacity other than as trustee, for example as the settlor, protector, enforcer or other moniker.[21] Reserved powers can be either administrative or distributive,[22] and may be held in various combinations. Powers held by non-trustees are not necessarily constrained by fiduciary duty, and when they are not they may be exercised selfishly.[23]

In some cases, the combination of powers reserved might appear to give the settlor the ability to control the trust, even where the settlor is not a trustee.[24] For example, in *JSC Mezhdunarodniy Promyshlenniy Bank and another v Pugachev and ors* (*Pugachev*), the powers reserved to the settlor were so numerous and far-reaching that the Court considered he could effectively divert the whole of the trust property to himself if he chose to do so.[25]

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[19] *Clayton v Clayton [Vaughan Road Property Trust]* [2016] NZSC 29; *Webb v Webb* [2020] UKPC 22.

[20] *Murrell v Hamilton* [2014] NZCA 377; *Vervoort v Forrest* [2016] NZCA 375.

[21] Palmer, above n 18, at 478.

[22] Examples of administrative powers include powers to vary the provisions of the trust deed, to appoint or remove trustees, or to add or exclude beneficiaries, while examples of distributive powers include powers to veto or direct distributions of trust income or capital: Jacob and Graham, above n 16, at 27; and Palmer, above n 16, at 41.

[23] *JSC Mezhdunarodniy Promyshlenniy Bank and another v Pugachev and ors* [2017] EWHC 2426 (Ch) at [181].

[24] In moderation, reserved powers do not connote a high degree of settlor control – for example, some settlors reserve the power over investment of trust capital to apply their business skill or knowledge for the benefit of the trust fund: see Waters, above n 12, at 234; Lusina Ho "'Breaking Bad' – Settlors' Reserved Powers" in Richard Nolan, Kelvin Low and Tanghang Wu (eds) *Trusts and Modern Wealth Management* (Cambridge University Press, Cambridge, 2018) at 37.

[25] At [243] and [244].

C Factors Enabling the Settlor Control Trend

Literature on the factors enabling the emerging trend of settlor control is light, likely because it is difficult to establish a causal relationship between any given factor and general trust drafting. Nonetheless, some likely enabling factors are briefly discussed below.

1 Abolition of estate duty

Current New Zealand law provides minimal legal consequence for a settlor retaining authorised control over their trust.[26] In the past, provisions in the Estate and Gift Duty Act 1986 provided that, where the settlor reserved certain rights or powers over trust property which could be taken to mean the settlor derived a benefit from the trust, the property in question was dutiable.[27] Since the repeal of estate duty,[28] settlors have been able to reserve extensive powers over trusts with no tax consequence.[29]

In contrast to New Zealand, other high tax jurisdictions tend to have provisions in tax statutes which cause a trust to be taxed as a bare trust for the settlor where the settlor reserves powers involving active trustee duties.[30] Settlors are thus discouraged from retaining excessive trust powers to avoid being personally liable for the trust's income tax.

2 Offshore jurisdiction reserved powers legislation

Although most "offshore" trust jurisdictions have their roots in English trust law, they have "taken the basic structure of a traditional trust and stretched it"[31] through legislation permitting features and uses of trusts which arguably would not fit the definition of a trust at common law.[32] Jurisdictions such as the Bahamas,[33] the British Virgin Islands,[34] the Cayman Islands,[35] the Cook Islands,[36] and Nevis[37] have introduced statutory provisions that, to varying degrees, permit the reservation of certain powers by the settlor without threatening the validity of the

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[26] See Part V.

[27] For example Estate and Gift Duties Act 1968, s 8; Palmer and Rickett, above 11, at 178; and Palmer, above n 18, at 478.

[28] Estate Duty Abolition Act 1993, s 3.

[29] Nicola Peart "Intervention to Prevent the Abuse of Trust Structures" [2010] NZLR 567 at 568.

[30] Waters, above n 12, at 235-236.

[31] Barnett, above n 9, at 353.

[32] Webb, above n 6, 476; and Chris Duncan and Henry Brandts-Giesen "The potential vulnerability of reserved powers trusts" (2021) 27 Trusts Trustees 194 at 199.

[33] Trustee Act 1998 (BAMA), ss 3(2) and 81.

[34] Trustee Ordinance 1961 (BVI), s 86.

[35] Trusts Law (2020 Revision) (KY), s 14.

[36] International Trusts Act 1984 (COK), s 13C.

[37] International Exempt Trust Ordinance 1994 (KN), s 47.

trust.[38] These statutory developments facilitate the use of the trust as a financial tool aimed at enhancing the value of financial assets, which is equally beneficial to the offshore jurisdiction as it is to the settlor as it encourages foreign investment.[39] Some New Zealand trusts are likely at least partially modelled on offshore trusts, which afford settlors non-trustee powers over the trust. This reflects the general trend of trust drafting, with certain features becoming more common, and therefore permissible, over time.[40]

3 Avoiding sham claims

The sham transaction doctrine is not specific to trust law,[41] but was accepted as applicable to trust law in New Zealand in *Official Assignee v Wilson,*[42] and more recently by the New Zealand Supreme Court in *Clayton v Clayton*.[43] A sham transaction is defined as:[44]

> … acts done or documents executed by the parties to the "sham" which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create.

The Court of Appeal in *Official Assignee v Wilson* held that, for a bilateral trust to be a sham, the settlor and the trustee must have a common "shamming" intention.[45] Despite this being a high threshold which is hard for claimants to establish,[46] settlors are advised to afford themselves powers within a trust deed, rather than exercising de facto control, to avoid claims of sham.[47] This is likely to have contributed to the trend of reserving powers.

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[38] Waters, above n 12, at 245; and Barnett, above n 9, at 361-364.

[39] Hang Tey, above n 14, at 520. Waters argues that such statutory provisions "tacitly admit" that, at common law, such reserved powers could threaten the validity of a trust: Waters, above n 12, at 245.

[40] See Waters, above n 12, at 246; and Bennett, above n 13, at 77.

[41] Law Commission *Some Issues with the Use of Trusts in New Zealand: Review of the Law of Trusts: Second Issues Paper* (NZLC IP20, 2010) at [4.6].

[42] *Official Assignee v Wilson* [2008] NZCA 122, [2008] 3 NZLR.

[43] At [113].

[44] *Snook v London & West Riding Investments Ltd* [1967] 1 All ER 518 at 528.

[45] At [40]-[41]; and Law Commission, above n 41, at [4.15].

[46] Palmer, above n 18, at 476; and Jeremy Kosky, Maxine Mossman and Nicole Buncher "Sham Trusts and Reserved Powers" in Steven Kempster, Morven McMillan and Alison Meek *International Trust Disputes* (2nd ed, Oxford University Press, Oxford, 2020) at 68.

[47] Patrick O'Hagan "The reluctant settlor – property, powers and pretences" (2011) 17 Trusts Trustees 905 at 915-916; Webb, above n 6, at 476; and Bennett, above n 13, at 57.

III A Normative Analysis of Settlor Control

A The Trust as an Externalising Tool

A claimant against a beneficiary of a discretionary trust will not have recourse to property owned by the trust to satisfy their claims. This is a result of the "magic triangle" – the settlor passes legal title to the trustees, who are subject to fiduciary obligations to hold the property for the beneficiaries – and the unique feature of the discretionary trust that property can be held on behalf of multiple beneficiaries, without any one of them having a proprietary right to the property.[48] Discretionary beneficiaries instead have a mere hope or expectancy of benefitting from distributions, because the trustees are afforded wide discretion as to when and to whom to make distributions of trust income and capital.[49] Thus, in a discretionary trust, no person can be identified as the beneficial owner of trust property.

For this reason, Schenkel describes the trust as an elective externalisation tool.[50] Although to the parties to the trust the trust appears to perform a "magic trick" by causing potential claims against the trust property to disappear, this "turns out to be a chimera, as the costs do not really disappear; they merely resurface elsewhere, falling on those outside the trust relationship".[51] This is a social cost the trust externalises on those outside the trust. Although a beneficiary of the trust might have benefited from distributions of trust income or capital in the past, a claimant with a claim against a discretionary beneficiary will, in most cases, have no recourse to the trust property.

Despite its well-known externalising feature, the trust is accepted as a legitimate property holding device. Theorists have attempted to normatively justify the trust and its continued existence.[52] Dorfman argues that the trust is justified by its ability to provide "access to ownership to those who could not, or otherwise would not, invoke it to pursue their own or others' ends", such as infants, mentally impaired adults, or those whose vocations prevent them from owning property which would result in a conflict of interest.[53] Others justify the trust through an economic lens, arguing it reduces agency costs,[54] provides an alternate vehicle for

[48] Hudson, above n 1, at 43.

[49] *Hunt v Muollo* [2003] 2 NZLR 322 (CA) at [11]; Palmer and Rickett, above n 11, at 160; Law Commission, above n 9, at [20.32].

[50] Kent D Schenkel "Exposing the Hocus Pocus of Trusts" (2012) 45 Akron Law Rev 63 at 67.

[51] At 64.

[52] See Mark Bennett and Adam Hofri-Winogradow "The Use of Trusts to Subvert the Law: An Analysis and Critique" (2021) 41 Oxford Journal of Legal Studies 692 at 703-708 for a comprehensive discussion.

[53] Avihay Dorfman "On Trust and Transubstantiation: Mitigating the Excesses of Ownership" in Andrew S Gold and Paul B Miller (eds) *The Philosophical Foundations of Fiduciary Law* (Oxford University Press, Oxford, 2014) 339 at 352-354.

[54] Robert H Sitkoff "An Agency Costs Theory of Trust Law" (2004) 89 Cornell L Rev 621.

asset partitioning to the company,[55] or simultaneously incentivises production and provides a low-cost structure for "highly-customized ownership arrangements" that cannot be achieved in contract.[56] Further others suggest the raison d'être of the trust arises from its flexibility, conferring autonomy-enhancing features on settlors that are not available at common law, and thus that the trust exists to advance settlor autonomy.[57]

Which, if any, of the normative theories justifying the trust is most convincing is unimportant for present purposes. The important conclusion is that trust is accepted as a legitimate vehicle for property holding *despite* its externalising features. In other words, the externalising nature of the trust is deemed to be an acceptable incident of the use of trusts.[58]

B The Subversive Use of Trusts

This paper seeks to make a distinction between the externalising feature of the trust and the subversive use of the trust. Whereas the externalising feature of the trust is an incidental, but acceptable, result of the discretionary trust, the subversive use of the trust is an intentional exploitation of the externalising feature of the trust to avoid legal obligations. Bennett and Hofri-Winogradow define the subversive use of the trust as:[59]

> … the planned use of the private law of trusts to frustrate the substantive purposes of non-trust property liability regimes, by *formally* removing property from the ownership of the settlor and/or avoiding the creation of rights to that property in the beneficiaries, while *functionally* allowing the settlor or the beneficiaries, who may be identical to the settlor, to control the property, and/or benefit from it, now or at a later time.

Thus, settlor control over a trust is subversive where the trust is established to externalise claims against the property in question, while the settlor continues to control, and benefit from, the property.

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[55] Henry Hansmann and Ugo Mattei "The Functions of Trust Law: A Comparative Legal and Economic Analysis" (1998) 73 NYU L Rev 434.

[56] Ming-Wai Lau *The Economic Structure of Trusts Law* (Oxford University Press, Oxford, 2011) at ch 3 and ch 8.

[57] See Hanoch Dagan "Inside Property" (2013) 63 UTLJ 4; Hanoch Dagan "Property's Structural Pluralism: On Autonomy, the Rule of Law, and the Role of Blackstonian Ownership" (2014) 3 Brigham-Kanner Property Rights Conference Journal 27 at 32; Hanoch Dagan and Michael Heller *The Choice Theory of Contracts* (Cambridge University Press, Cambridge, 2017) ch 4; Dagan and Samet, above n 7; and Jesse Wall "Taking the Bundle of Rights Seriously" (2019) 50 VUWLR 733.

[58] Made clear by the sheer scale of trust use in New Zealand – in 2020 it was estimated that there were between 300,000 and 500,000 trusts in New Zealand, or around 1 trust for every 13 New Zealanders: Ministry of Justice "Trust Law Reform" (7 December 2020) <www.justice.govt.nz>.

[59] Bennett and Hofri-Winogradow, above n 52, at 699.

The distinction between an incidental effect and the purpose of a legal arrangement is employed in existing statutory provisions. For example, under the Income Tax Act 2007 the Commissioner of Inland Revenue is permitted to offset a tax advantage obtained under a tax avoidance arrangement,[60] which is defined as an "arrangement that directly or indirectly has tax avoidance as its purpose or effect, or has tax avoidance as one of its purposes or effects, whether or not any other purpose or effect is referable to ordinary business or family dealings, *if the tax avoidance purpose or effect is not merely incidental*".[61] This clearly distinguishes between the purpose or incident of a certain arrangement, and imposes a legal penalty where the *purpose* of an arrangement is deemed unacceptable.

C Subversive Settlor Control is Unjustifiable

Subversive settlor control over a trust creates an unfair benefit for the settlor at the expense of those external to the trust. James Webb's following statement, made about offshore statutory provisions expressly permitting settlor reserved powers, applies to settlor-controlled trusts more generally:[62]

> First, trust advantages naturally have correlative disadvantages for others in society, which become devoid of conceptual justification and therefore unjust. Secondly, allowing the blatant 'cherry-picking' of trust advantages introduces artificiality and undermines the institution as a whole.

Webb's first statement refers to the odd outcome arising where a settlor is permitted to dispose of property to a discretionary trust while being able to continue to deal with the trust property as if it were their own. At law the settlor does not beneficially own the trust property, so claimants against them will not have recourse to it, yet the settlor controls and enjoys the property as if they own it. This is inconsistent with the objectives of numerous legal regimes providing claimants with recourse to a defendant's property to answer their claims.

Webb's second statement, that the blatant "cherry-picking" of trust advantages introduces artificiality into the trust institution as a whole, rings especially true for New Zealand where trusts are disproportionately common.[63] If society's perception of the trust is that it is a method of structuring one's affairs to retain control over property while making it invincible to legal claims, the legitimacy of the trust as an institution will be threatened.

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[60] Section BG 1.

[61] Section YA 1.

[62] Webb, above n 6, at 477.

[63] To illustrate, 13.3% of occupied dwellinghouses in New Zealand are owned by trusts: Statistics New Zealand "2018 Census place summaries: New Zealand" <www.stats.govt.nz>.

The author's conclusion is that settlor control over a trust becomes normatively unjustified when it can be described as subversive, that is, an intentional exploitation of the externalising feature of the trust. This subversive use of the trust causes unjustified detriment to those outside the trust. As with any abuse of the law causing undesirable detriment, the law must provide a mechanism by which subversive instances of settlor-controlled trusts are either outright invalidated as a matter of internal trust law, or disincentivised through external non-trust regimes.

IV Trust Law and Settlor Control

Part IV assesses the extent to which trust law in New Zealand disincentivises, or provides a remedy for claimants against, settlor-controlled trusts.

A The Trusts Act 2019

The Trusts Act 2019 was enacted relatively recently, following the Law Commission's comprehensive review of the law of trusts. Despite initially opining that it would be unrealistic to ignore the problem of settlor control,[64] its final recommendation was to leave the issue of determining whether or not a valid trust has been formed to the courts.[65] Thus, the Trusts Act makes no mention of settlor control or the invalidity of trusts.

The Trusts Act does, however, set out the necessary characteristics of an express trust, being that (a) it is a fiduciary relationship wherein the trustee holds or deals with trust property for the benefit of beneficiaries or for a permitted purpose; and (b) the trustee will be accountable for the way the trustee carries out the duties imposed on them by trust law. While the Trusts Act does not set out the consequences for failure to comply with the Act's provisions, the presumption is that where the Act is silent on existing law, common law or equity continues as it did previously.[66] This means that, although the requirements of s 13 must be met for the Act to apply,[67] a court would be free to recognise a trust so long as the trust could have been recognised in equity (though the provisions of the Trusts Act would not apply to it).[68] Therefore, as McLay suggests, a court might hold that a trust deed which fails to meet the requirements of s 13 would not result in the formation of a valid trust.[69] Equally, however, a

[64] Law Commission, above n 41, at [5.39].

[65] Law Commission *Review of the Law of Trusts: A Trusts Act for New Zealand* (NZLC R130, 2013) at [4.14].

[66] Geoff McLay "How to read New Zealand's new Trusts Act 2019" (2020) 13 J of Eq 325 at 332.

[67] Section 12.

[68] McLay, above n 66, at 336.

[69] At 336.

court could hold that a failure to establish a fiduciary relationship was not intended to frustrate s 13, and deem the trust to be valid.[70]

Although the Trusts Act is not intended to clarify the circumstances in which a trust will be invalid, it does not limit the courts' power to invalidate a trust due to excessive settlor control.

B The Sham Trust

Although the sham doctrine is not specific to trust law, the sham trust claim can appropriately be considered in this Part. As earlier discussed, a court may hold that a trust is a sham where it is proven that the parties to the trust (the settlor and any trustees) intended to create some other arrangement under the pretence of creating a trust.[71] A sham claim may be relevant where the settlor's control over the trust is unauthorised, though such a claim is notoriously difficult to establish due to practical issues in establishing the subjective intention of both the settlor and the trustee(s) to create something other than a trust.[72] Thus, the usefulness of the sham doctrine in disincentivising unauthorised settlor control is significantly limited.

C The Constructive Trust Upon an Express Trust

The constructive trust upon an express trust may also provide a claimant against a settlor-controlled trust the opportunity for relief. A constructive trust is a remedy arising by operation of law, rather than by the intention of the parties.[73] A *Lankow v Rose* constructive trust may be established where the claimant establishes: contributions, direct or indirect, to the property in question; the expectation of an interest in the property; that such an expectation is reasonable; and that the defendant should reasonably expect to yield to the claimant an interest in the property.[74] In *Murrell v Hamilton*, it was held that a constructive trust may be imposed over property held on an express trust where the *Lankow v Rose* criteria are satisfied.[75] In *Murrell v Hamilton* the settlor was one of two trustees but was the only trustee actively involved in the management of the trust.[76] This de facto settlor control enabled the final limb of the *Lankow v Rose* test to be satisfied despite the property being held on trust, because allowing the trustees to deny the claimant's claim in circumstances where the settlor-trustee gave the claimant a reasonable expectation of an interest in the trust property would have been unconscionable.[77]

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[70] At 336.

[71] *Clayton v Clayton*, above n 19, at [113] citing *Ben Nevis Forestry Ventures Ltd v Commission of Inland Revenue* [2008] NZSC 115, [2009] NZLR 289 at [33].

[72] Palmer, above n 18, at 476; and Kosky, Mossman and Buncher, above n 46, at 68.

[73] Butler and Clarke, above n 3, at 335.

[74] *Lankow v Rose* [1995] 1 NZLR 277 (CA) at 294.

[75] At [22].

[76] At [27] and [28].

[77] At [29].

The constructive trust upon an express trust only provides a remedy to claimants against a trust over which the settlor retains de facto control where extraneous factors are satisfied, most significantly that the claimant made contributions, direct or indirect, to the property in question. For example, in *Vervoort v Forrest* the claimant's contributions to the trust property were found to be merely cosmetic,[78] barring her claim despite the settlor's extensive de facto control over the trust.[79] As such, the constructive trust upon an express trust is only available to claimants in circumstances substantially similar to those in *Murrell v Hamilton*, thus significantly limiting the usefulness of the remedy to most claimants against settlor-controlled trusts.

D The Illusory Trust Doctrine

As previously discussed, the minimum requirements to settle a valid trust are that the three certainties are identifiable, and the irreducible core of the trust is present. It follows that a purported trust which does not satisfy these minimum requirements cannot be deemed a valid trust at law. This concept can be helpfully referred to as an *illusory trust*: on its face certain documentation appears to create a trust, but this appearance is an illusion and no trust in fact exists.[80] Mark Bennett defines an illusory trust as:[81]

> … an arrangement that is not a trust due to the rights and obligations contained in the deed, because either the beneficiaries are unable to hold the trustee accountable, or the settlor or trustee has such control that they are able to use the property for their own benefit.

In three recent cases, the issue of whether a trust is invalid due to the settlor retaining excessive control was considered. The reasoning of each court varied, reflecting the contention among legal scholars as to when a settlor retains too much control for a valid trust to have been formed.[82] The various decisions align with some of the narrow and wide views of the illusory trust doctrine identified by Bennett.[83]

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[78] At [75].

[79] At [32]-[35].

[80] The judicially preferred label is simply that the trust is invalid, rather than illusory. See *Clayton v Clayton*, above n 19, at [123]; and *JSC v Pugachev*, above n 23, at [169]. The Court in *Webb v Webb*, above n 19, did not refer to the term "illusory trust" at all.

[81] Bennett, above n 13, at 48.

[82] Jack Davies "New Developments in Settlor Reserved Powers" (2019) The Conveyancer and Property Lawyer 175 at 179.

[83] Bennett, above n 13.

1 Clayton

Clayton involved a relationship property claim against property held on the Vaughan Road Property Trust (VRPT).[84] Mrs Clayton argued that the powers retained by the settlor, Mr Clayton, over the trust were so wide as to render the trust invalid.[85] As well as being the settlor of the VRPT, Mr Clayton was the sole trustee, a discretionary beneficiary, and the Principal Family Member (PFM).[86] As trustee, Mr Clayton had powers to pay or apply the whole of the trust income or capital to any discretionary beneficiary,[87] resettle the trust fund on another trust with one or more of the same discretionary beneficiaries,[88] exercise any power without considering the interests of all beneficiaries and despite it being contrary to the interests of any beneficiary,[89] act in self-benefit,[90] and to amend the trust deed with the consent of the PFM.[91] As PFM, Mr Clayton could appoint and remove discretionary beneficiaries and trustees.[92]

The Family Court held the VRPT to be invalid, finding that several clauses in the trust deed cumulatively meant that the beneficiaries were not able to call the trustees to account.[93] This is in line with the narrow "no accountability" view of the illusory trust doctrine, that where the trustees owe no enforceable obligations to beneficiaries, no trust will be formed. This view can be interpreted as an expression of the *Armitage v Nurse* irreducible core of obligations: "if the beneficiaries have no rights enforceable against the trustees there are no trusts",[94] the minimum enforceable rights being the trustees' duties to "perform the trusts honestly and in good faith for the benefit of the beneficiaries".[95] Thus, a settlor who attempts to retain control over a trust by absolving the trustees of liability for breaches of their duties towards beneficiaries in the trust deed will not form a valid trust.[96]

The High Court upheld the Family Court's finding but disagreed with its reasoning, instead holding that the effect of several clauses in the trust deed was to give Mr Clayton unfettered power to distribute trust assets to himself.[97] This is consistent with the wide "unlimited benefit"

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[84] At [4].
[85] At [108].
[86] At [10].
[87] At 586.
[88] At 586.
[89] At 587.
[90] At 588.
[91] At 589.
[92] At 588.
[93] *MAC v MAC* FC Rotorua FAM-2007-063-652, 2 December 2011 at [78]; *Clayton v Clayton* [2013] NZHC 301 at [80], citing *Armitage v Nurse* [1998] Ch 241, [1997] 2 All ER 705 (CA) at 713.
[94] At 713.
[95] At 713.
[96] *Re the AQ Revocable Trusts* [2010] SC(B)(da) 40 CIV; Bennett, above n 13, at 63.
[97] At [90].

view of the illusory trust, that where the settlor-trustee can take the benefit of the trust to the detriment of the other beneficiaries, the trust will be invalid.[98] Proponents of this view draw on the fiduciary obligation to benefit others, arguing that a trustee acting in self-benefit beyond a limited extent goes against the fundamental nature of the trust as a fiduciary relationship.[99]

The Court of Appeal overturned the lower courts' findings that the VRPT was invalid,[100] holding that the concepts of sham and illusory trusts were effectively the same, as the question in both cases pertains to the intention of the settlor.[101]

The Supreme Court declined to make a finding on the validity of the trust, instead deciding the case by holding that Mr Clayton's powers fell within the definition of property in the PRA.[102] It nevertheless made obiter comments on the issue of whether Mr Clayton's broad powers invalidated the VRPT, suggesting there were two possible lines of analysis. On the one hand, the VRPT may have been invalid because there was no sufficient disposition of trust property (arguably aligning with the wide "unlimited benefit" view of the illusory trust preferred by the High Court), or, equally, because the irreducible core of obligations owed by trustees to beneficiaries was not present (the narrow "no accountability" view adopted by the Family Court).[103] The alternative line of analysis was that there would be no reason in principle to regard the trust as invalid until Mr Clayton's broad powers were actually exercised.[104] *Clayton v Clayton* left the law in New Zealand on the illusory trust unsettled, and it has yet to be revisited by the appellate courts.

2 Pugachev

The decision of the High Court of Justice in *Pugachev* concerned trusts settled by Mr Pugachev, who had misappropriated significant sums of money from a Russian bank.[105] The liquidator argued that property held on the trusts should be brought into the pool available to creditors, as the trust deeds did not effectively divest Mr Pugachev of ownership of the trust property. Mr Pugachev was not a trustee, but was the settlor, a discretionary beneficiary and the

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[98] At 65.

[99] At 65-66.

[100] *Clayton v Clayton* [2015] NZCA 30, [2015] 3 NZLR 293 at [85].

[101] At [78].

[102] See Part V.

[103] The fact that the Supreme Court conflated the no accountability and trustee usurpation views of the illusory trust has been criticised in academia. See: Joel Nikitman "*Clayton v Clayton* in the New Zealand Supreme Court: it's hard to keep a good court down" (2016) 22 Trusts Trustees 1049 at 1054; and Grahame Young "Sham and illusory trusts–lessons from *Clayton v Clayton* (2018) 24 Trusts Trustees 194 at 200.

[104] At [124]-[125].

[105] At [35].

protector.[106] As the protector, Mr Pugachev had various rights and powers, including the power to veto all major trustee decisions, the power to appoint new discretionary beneficiaries, the power to appoint a successor, and when "under a disability" (which included coercion by operation of law) Mr Pugachev's son Victor would become the protector, and the powers to remove trustees "with or without cause" and to appoint trustees.[107] The trustees' powers included the power to transfer all trust property to any discretionary beneficiary,[108] and the power to remove discretionary beneficiaries,[109] both subject to protector veto.[110]

Birss J held the trusts were invalid because they did not "divest Mr Pugachev of the beneficial ownership he had of assets transferred into them".[111] Birss J first held that, although Mr Pugachev was not a trustee, the combination of his powers as protector alongside the fact that he was a discretionary beneficiary meant he would be able to vest all of the trust assets in himself if the protector's powers were personal (rather than fiduciary).[112] The judge reasoned that, although the trustees were subject to fiduciary duties, it was "hard to see" how transferring all of the trust property to Mr Pugachev would be open to "realistic challenge". Even if it was, Mr Pugachev's powers to replace trustees meant that, if the protector's powers were personal, Mr Pugachev could remove trustees who didn't act in accordance with his wishes and replace them with trustees who would.[113] Subsequently, Birss J held the protector's powers were indeed personal, due to their extensive nature, the fact that the protector was also the settlor and a discretionary beneficiary, and because the protector was permitted to remove trustees "with or without cause".[114]

The finding was effectively that Mr Pugachev could divert the trust funds to himself if he desired. This appears to endorse the wide "reality of control" view of the illusory trust, which looks beyond the formal legal arrangement to determine whether, in substance or reality, the powers in the trust deed provide the settlor with control over and benefit from the trust property.[115]

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[106] At [15]-[16].
[107] At [115], [125] and [127].
[108] At [119]-[124].
[109] At [137].
[110] At [115].
[111] At [278].
[112] At [244] and [272].
[113] At [243] and [244].
[114] At [268] and [278].
[115] At 70.

3 Webb

Webb concerned divorce proceedings in the Cook Islands.[116] Mr Webb had settled a significant amount of property on two trusts, of which he was a trustee, a discretionary beneficiary, and the consultant.[117] Mrs Webb argued the trusts lacked the irreducible core of obligations owed by beneficiaries to trustees, or alternatively that the settlors never intended to relinquish the beneficial interest in the trust assets, rendering the trusts illusory.[118] Key provisions in the trust deeds included that Mr Webb was the sole trustee, Mr Webb was one of two discretionary beneficiaries, the consultant could remove and appoint trustees, the consultant could consent to variation of the trust deed by the trustee, and the trustee could exercise all powers and discretions despite conflict with duties as a trustee or with the interests of other beneficiaries.[119]

The Privy Council held the trusts were invalid for lack of effective alienation by Mr Webb of the trust property,[120] stating that there were "various ways in which it is said Mr Webb can exercise these powers to secure the benefit of trust property to himself".[121] The Board suggested that, in assessing the validity of the trusts, there were two possible analyses: first, either Mr Webb had not sufficiently disposed of the trust property or the irreducible core of enforceable obligations owed by trustees to beneficiaries was not present; or secondly, the powers reserved to Mr Webb were so extensive that equity would regard him as having rights which were tantamount to ownership.[122] The parties agreed either of the analyses would have the same result, so the Board stated confined itself to the second.[123] The Privy Council's reasoning in finding the trust to be invalid was that:[124]

> Mr Webb had the power at any time to secure the benefit of all the trust property to himself and to do so regardless of the interests of the other beneficiaries.

This appears to follow the wide "unlimited benefit" view of the illusory trust, although the Privy Council's reasoning in invalidating the trusts was brief, and has been fairly described as "opaque".[125]

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[116] At [1].

[117] *Webb v Webb*, above n 19, at [4].

[118] At [69].

[119] At [80], [81], and [82].

[120] At [89].

[121] Including by nominating himself the sole beneficiary, exercising his discretion as trustee to apply the entire trust capital or income to himself (in a way consistent with his fiduciary duties), resettling the assets on another trust of which he was a beneficiary, or varying the terms of the trust deed to vest all assets in himself: at [80]-[82].

[122] At [89].

[123] At [89]

[124] At [89]

[125] Sinéad Agnew "The Reservation of Powers by Settlors: Intention and Illusion" (2021) 80 CLJ 18 at 20.

E Conclusion – Trust Law Provides an Unsatisfactory Solution

While the beneficiaries of a trust have a claim against the trustees for breach of fiduciary duty in circumstances where the settlor has unauthorised control, those external to the trust must rely on a claim that the trust is a sham, or attempt to establish a constructive trust over property held upon the express trust. The latter claims provide a remedy to claimants against trusts under the de facto control of the settlor only in very limited circumstances. Thus, trust law does not provide an effective remedy for claimants against trusts over which the settlor retains de facto control.

The three cases discussed in the preceding section can be interpreted as the courts' response to instances of extreme authorised settlor control over trusts.[126] Although the doctrine may permit the courts in some extreme cases to invalidate trusts due to the settlor's retention of control over the trust, it provides an unsatisfactory solution to the widespread issue of settlor control.

The illusory trust doctrine is yet to be accepted by the appellate courts into New Zealand law. Whether it will be implemented, and in what circumstances it will be applied, is still unclear. The New Zealand courts appear to be reluctant to interfere with the validity of trusts – evidenced by the Court of Appeal's refusal to accept that a trust could be invalid for any reason other than for being a sham,[127] and the Supreme Court's decision not to invalidate the VRPT despite the strong argument that the irreducible core of the trust was not present.[128]

If the New Zealand appellate courts were to accept that a trust may be rendered invalid due to the settlor retaining excessive control, it is unlikely the wider views of the illusory trust doctrine will be accepted. The prevalence of trust use in New Zealand, and therefore the possibility that a huge number of New Zealand trusts would be invalidated, is likely to be perceived by the courts as a reason to limit the circumstances in which a trust may be deemed invalid. Academic critique of *Pugachev* and *Webb*, both of which applied wide views of the illusory trust doctrine, is likely to further steer the New Zealand courts away from applying the doctrine in anything but its narrowest form.[129]

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[126] Tim Akkouh and Christopher Lloyd "'Trust Busting' after *JSC Mezdunarodniy Promyshlenniy Bank v Pugachev & ors* [2017 EWHC 246 (Ch)" (2018) 24 Trusts Trustees 151 at 15; and Jack Davies "New Developments in Settlor Reserved Powers" (2019) The Conveyancer and Property Lawyer 175 at 183.

[127] At [78].

[128] See Jack Davies "Are the Floodgates Open – A Brief Analysis of the Supreme Court's Decision in *Clayton v Clayton [Vaughan Road Property Trust]* (2016) 22 Auckland U L Rev 383 at 391; Palmer, above n 6, at 367; and Kate Davenport and Stephanie Thompson "Piercing the trust structure at a relationship's end: interesting developments in trust law from the New Zealand Supreme Court" (2016) 22 Trusts Trustees 864 at 872.

[129] See for example James Brightwell and Luke Richardson "*Mezhprom v Pugachev*: bold new approach or illusory development?" (2018) 24 Trusts Trustees 398; Raymond Davern and Alex Way "An offshore

On this basis, if the illusory trust doctrine is implemented into New Zealand law it is difficult to imagine anything but the most flagrant displays of settlor control being caught by the doctrine. Given that settlors may use trusts to subvert their legal obligations without having such extreme levels of control over their trusts, reliance on the illusory trust doctrine to disincentivise authorised settlor control is ill-advised.

V New Zealand Non-Trust Legal Regimes and Settlor Control

Legal regimes external to trust law itself are a useful method of influencing trust use. On that premise, Part V will assess the extent to which existing New Zealand legal regimes external to trust law may provide a remedy to claimants against, and disincentivise instances of, subversive settlor-controlled trusts

A Property (Relationships) Act 1976

Despite the prevalence of family trusts in New Zealand,[130] the equal sharing presumption under s 11 of the PRA does not apply to discretionary interests in trust property.[131] In relationship property disputes, claimant partners frequently attempt to make claims against property owned by a trust, of which their ex-partner is often the settlor. The settlor's control over the trust may be relevant in determining whether their ex-partner has a claim over the trust property.

1 Section 44

Under s 44(1) of the PRA, the court may set aside dispositions of property, including to trusts, made "in order to defeat the claim or rights of any person".[132] This threshold does not require the transfer to be made to defeat a particular person's claim or rights – the High Court in *Ryan v Unkovich* held "an intention to defeat future claims is capable of constituting an operative intention to defeat".[133] A claimant against a settlor-controlled trust could argue that dispositions by the settlor to the trust were made in an attempt to avoid future relationship

perspective on the 'True Effect' of Mr Pugachev's trusts" (2018) 24 Trusts Trustees 406; Joel Nitikman "More about illusory trusts: is 'tantamount' to ownership the same as 'ownership'? The Privy Council takes a step too far" (2021) 27 Trusts Trustees 69; and Davies, above n 126, at 183.

[130] Law Commission, above n 41, at [2.8].

[131] Law Commission *Review of the Property (Relationships) Act 1976: Preferred Approach / Te Arotake i te Property (Relationships) Act 1976: He Aronga i Mariu ai* (NZLC IP44, 2018) at [6.1].

[132] Law Commission, above n 41, at [3.23].

[133] *Ryan v Unkovich* [2010] 1 NZLR 434 (HC) at [42], following *Regal Castings Ltd v Lightbody* [2008] NZSC 87, [2009] 2 NZLR 433.

property claims.[134] If the s 44(1) claim is successful, the court is empowered to set aside the disposition to the trust.[135]

A settlor's control over a trust may be a relevant consideration to the court in determining whether the disposition was made to defeat the claim or rights of any person, though s 44 does not expressly state as such. Therefore the usefulness of s 44 in disincentivising settlors from retaining control over trusts is limited. Additionally, the Law Commission notes s 44 "rarely applies" because the threshold for subjective intention that must be proven by the claimant is difficult to meet, despite the *Ryan v Unkovich* qualification.[136] Section 44 thus does not provide an effective form of redress for claimants against settlor-controlled trusts.[137]

2 Powers in trust deed can be property

Section 2 of the PRA defines property as including real property, personal property, any estate or interest in any real or personal property, any debt or thing in action, and *any other right or interest*. Anything falling within this definition of property is susceptible to be included within the s 8 definition of relationship property, which is subject to the equal sharing presumption of the PRA.[138]

Although at common law there is a general, but not invariable, rule that powers are distinct from property,[139] the Supreme Court in *Clayton* considered the PRA definition of property should be interpreted "as broadening traditional concepts of property and as potentially inclusive of rights and interests that may not, in other contexts, be regarded as property rights or property interests".[140] Taking into account the statutory context, the Supreme Court held the settlor-trustee's broad powers in the trust deed to appoint property to himself without considering the interests of any other beneficiaries could be considered "property" within the meaning of the PRA.[141] Thus, in determining whether powers in a trust deed are property for the purpose of the PRA, settlor control is the "touchstone".[142]

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[134] Palmer, above n 16, at 42.

[135] Section 44(2).

[136] Law Commission, above n 131, at [6.22].

[137] Although an unsuccessful claimant under s 44 may have a claim under s 44C of the Property (Relationships) Act.

[138] Section 11.

[139] *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust* [2011] UKPC 17, [2011] All ER 704 at [31]. In this case trust powers were held to be "tantamount to ownership" at [59].

[140] At [38].

[141] At [80]. This is similar to the "unlimited benefit" view of the illusory trust.

[142] Davenport and Thompson, above n 128, at 871.

The *Clayton* ruling may provide a basis for some claimants against settlor-controlled trusts to argue the settlor's ability to benefit from property should be included in the pool of relationship property,[143] and it has been relied on in subsequent cases in the lower courts with mixed success.[144] However, the Law Commission noted that more recent cases suggest powers will only be held to constitute property within the meaning of the PRA where the settlor has unfettered control over the trust property, without being constrained by fiduciary duties.[145] Such powers are likely to be highly unusual, limiting the usefulness of *Clayton* to future claimants.

B Insolvency

Ordinarily, property held in a trust settled by an insolvent settlor does not form part of the pool of assets available to satisfy their creditors' claims. However, provisions in the Property Law Act 2007 (PLA) and the Insolvency Act 2006 may, in some cases, make assets settled on a settlor-controlled trust available to creditors.

1 Part 6 subpart 6 Property Law Act 2007

Part 6, subpart of the PLA protects creditors against dispositions of property, including to trusts, made by a debtor with intent to prejudice a creditor.[146] To establish intent to prejudice it must be shown the debtor knew or ought to have known when disposing of the property that there was a risk their creditors would not be able to recover their debts.[147] A creditor may apply for an order requiring the debtor to either transfer to the creditor the property disposed to the trust, or to pay the creditor compensation to satisfy their claim.[148]

Where the debtor's disposition is to a trust which they have settled, it is conceivable the court would consider their level of control over the relevant trust in determining whether the disposition was made with the requisite intent to prejudice a creditor. It may arguably also create a moderate level of disincentive to settlors from retaining excessive control over trusts, though the fact that settlor control is not expressly stated as a relevant factor suggests this is unlikely. Further, the subpart is significantly limited in its application by the fact that it only applies to dispositions made by a debtor who is insolvent or approaching insolvency.[149] A

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[143] See Nick Grant "Up to 100,000 trusts at risk, thanks to Clayton decision" *The National Business Review* (New Zealand, 24 June 2016); and Davies, above n 128, at 390.

[144] Law Commission, above n 131, at [6.4].

[145] At [6.4].

[146] Law Commission, above n 41, at [3.4]; and Section 346(1)(b).

[147] Palmer, above n 16, at 42; based on the *Regal Castings v Lightbody* decision, above n 133, on a similar provision in the Property Law Act 1952.

[148] Section 348.

[149] Section 346(2).

claimant against a settlor-controlled trust could not rely on the subpart where the settlor disposed of property to the trust while financially stable. Additionally, the burden of establishing that the debtor intended to prejudice the creditor will be a significant hurdle for most claimants.[150]

2 Section 194 Insolvency Act 2006

Part 3, subpart 7 of the Insolvency Act allows the Official Assignee to set aside certain transactions and gifts,[151] including dispositions to trusts, made by a bankrupt shortly before being adjudicated bankrupt.[152] Section 194(2) allows the Official Assignee to cancel transactions made within 2 years (rather than the usual 6 months) when made with a related party.[153] A related party includes a trustee of a trust of which the bankrupt is a beneficiary of if the bankrupt is in a position to control the trustee.[154] In a settlor-controlled trust, the argument could be made that the settlor is in a position to control the trustee (whether they are a trustee or they exercise de facto control over the trustee), therefore meaning any disposition to the trust within 2 years could be clawed-back into the pool of resources available to creditors. The time limitations in the subpart generally limit its usefulness to claimants where the settlor's disposition to a trust under their control was made outside the specified time periods.

C Income Tax Act 2007

The earlier mentioned s BG 1 of the Income Tax Act permits the Commissioner of Inland Revenue to offset a tax advantage obtained under a tax avoidance arrangement, defined as an arrangement that directly or indirectly has tax avoidance as its purpose or effect, or has tax avoidance as one of its purposes or effects, whether or not any other purpose or effect is referable to ordinary business or family dealings, if the tax avoidance purpose or effect is not merely incidental.[155]

Section BG 1 was applied to trusts in *Penny v Commissioner of Inland Revenue*, where the Supreme Court held that trusts used to artificially lower the incomes, and therefore income tax rates, of two surgeons were tax avoidance arrangements.[156] The question was not one of the settlors' control over the trusts, but rather the continued benefit the defendants and their families derived from the income of the trusts while paying substantially less income tax in

[150] Palmer, above n 16, at 42.
[151] Sections 194, 204, 205, 211 and 212.
[152] Law Commission, above n 41, at [3.15].
[153] Insolvency Act 2006.
[154] Section 193A(1)(j).
[155] Section YA 1.
[156] *Penny v Commissioner of Inland Revenue* [2011] NZSC 95, [2012] NZLR 433.

total.[157] In a case involving a trust with a high degree of settlor control, that control would undoubtedly be a relevant factor to the Court when determining whether tax avoidance is the purpose or effect of the arrangement. This is supported by the Supreme Court's reliance on the fact that each settlor "could naturally expect that the trustees whom they had chosen would act as they in fact did",[158] that is, the trustees would make distributions to the settlors. A settlor themselves having significant control over the trust property would provide an even stronger inference of their likelihood of benefitting from the trust property.

D Government Benefits

Several government benefit regimes permit the authority in question to assess an applicant's interest in a trust in determining their eligibility for government assistance.[159] For example, reg 8(4) of the Legal Services Regulations 2011 permits the Ministry of Justice to assess an applicant's interest in a trust, whether vested or contingent, or any benefit the applicant might receive in connection with any trust, when determining their disposable capital for the purpose of assessing their eligibility for legal aid. The assessment must consider how the trust arose or was created, the terms and conditions of the trust, the persons who have the power to appoint and remove trustees and beneficiaries, the history of the trust's transactions (including distributions), changes in membership of the trustees, changes in the class of beneficiaries, and the source of income or capital the trust receives.

Regulation 8(4), in particular the ability to look at the terms and conditions of the trust and the powers to appoint and remove trustees and beneficiaries, gives the Ministry of Justice the ability to look through a trust at the extent of the settlor's control over the trust.[160] Presumably, a trust with a high degree of settlor control coupled with an ability to benefit from the trust would be assessed as forming part of the settlor's disposable capital.

E Conclusion – Non-Trust Law Provides an Unsatisfactory Solution

Although existing non-trust legal regimes in New Zealand provide some limited scope for the courts or other authorities to assess a settlor's level of authorised or de facto control over a trust, the provisions are unlikely to deter settlors from retaining control over trusts to subvert their legal obligations. Additionally, while provisions in the PRA and insolvency law provide some recourse for ex-partners and creditors against settlor-controlled trusts, those provisions

[157] At [53].

[158] At [53].

[159] Social Security Act 2018, ss 16; Residential Care and Disability Support Services Act 2018, Part 6; and Legal Services Regulations 2011, reg 8(4).

[160] Law Commission, above n 41, at [3.73].

are not specifically aimed at the issue of settlor control and many claims will go unanswered. This is a significant lacuna in New Zealand law for claimants against settlor-controlled trusts.

VI Legislative Reform to Disincentivise Settlor Control

Parts IV and V establish that settlor control over trusts is presently not effectively disincentivised in New Zealand by either trust law or external legal regimes. This is unacceptable considering that subversive settlor-controlled trusts are normatively unjustifiable. Part VI therefore explores the implementation of a statutory provision intended to serve the dual purposes of disincentivising subversive instances of settlor control over trusts and providing claimants against said trusts with an effective remedy.

A Approach to Reform

1 Provision "internal" or "external" to trust law

Reform designed to disincentivise and provide a remedy for settlor control could take one of two alternative forms. Firstly, it could take the form of a general anti-settlor-control provision in the Trusts Act, invalidating trusts with a specified level of settlor control. Probert proposes as such, arguing for a s 140A to be enacted into the Trusts Act to implement the illusory trust doctrine into the Trusts Act.[161] Secondly, it could take the form of provisions in one or more non-trust legal regimes which, for the purposes of those regimes, set out legal consequences for a settlor retaining specified levels of control over a trust. The author considers the latter alternative is preferable for several reasons.

First, the Law Commission's review of trust law in New Zealand invited submissions on whether greater constraints on settlor control over trusts within the Trusts Act would be necessary or desirable.[162] The overwhelming response was that such a provision in the Trusts Act would be detrimental to the flexibility of the trust institution, and therefore that such an approach would be unjustified.[163] This reflects a view commonly held in the literature: where there is a way to do justice without invalidating a trust, the integrity of the trust structure should be upheld.[164]

[161] Probert, above n 5, at 702.

[162] Law Commission, above n 41, at [5.49].

[163] Law Commission *Review of the Law of Trusts: Preferred Approach* (NZLC IP31, 2012) at [16.29]. Note that most submitters were legal practitioners, suggesting that submissions may not necessarily reflect the views of wider society on the matter.

[164] Brightwell and Richardson, above n 129, at 400; and Peart, above n 29, at 584.

Similarly, there is an argument that trust law itself should not be used to serve interests external to trusts. Jesse Wall argues that laws "internal" to property regimes should be construed strictly according to the formal rights conferred by the property regime, while laws "external" to the property regime may curtail property rights for specific social objectives.[165] This preserves the flexibility of trusts, as the particular form a trust may validly take is not limited, while social legislation may be used to effectively remedy injustices caused by the operation of trust law. It also mitigates against the risk of unforeseen consequences of limiting the forms trusts may take. New Zealand has no trusts register, so the terms of all trusts cannot be known. There may be some trusts which, for legitimate reasons, have terms causing the trust to be unwittingly caught, and therefore invalidated, by a general Trusts Act provision.

Further, the author is aware of no legislation in any comparable jurisdiction specifically limiting the extent of control a settlor may exercise over a trust, though "offshore" jurisdictions specifically expand on the limits of settlor control.[166] This suggests that other jurisdictions also take the view that "internal" trust law should exclusively deal with the formal rights conferred, rather than rights curtailed.

2 The appropriate legal regime

To achieve the optimal disincentivising effect on settlor control, anti-settlor-control provisions should be enacted in multiple non-trust legal regimes. The scope of this paper is limited to considering a single legal regime, namely the PRA, though the author considers that insolvency law and tax law are also appropriate. There are several key reasons the PRA has been selected as the focus of this paper.

There is a strong case for intervening in trusts to protect the relationship property rights of spouses and partners, as "they accumulate assets through their joint efforts and expect to share those assets equally when their relationship ends".[167] When Parliament adopted the PRA Amendment Act in 2001, it decided against permitting trust property to be used to satisfy relationship property claims, as trusts were "created for legitimate reasons and so should be permitted to fulfil that purpose".[168] The Law Commission's subsequent review of the PRA found the PRA does not ensure the just division of property held on trust, and noted the injustice caused where "only one partner controls the trust, which means that in reality they may be able to treat the trust property as their own".[169] This is compounded by the fact that a significant amount of what would otherwise be relationship property is believed to be held on trust, and

[165] Jesse Wall "The functional-formal impasse in (trust) property" (2018) 14(3) Int J Law Context 437.

[166] See Part II(C)(2).

[167] Peart, above n 29, at 587.

[168] Matrimonial Property Amendment Bill 1989 (109–2) (select committee report) at xii.

[169] Law Commission, above n 131, at [6.17]; see also Law Commission, above n 9, at [21.6].

therefore not subject to the PRA's equal sharing regime.[170] Thus, as suggested by Palmer and Peart, the policy relating to the PRA and trusts must be amended.[171]

The PRA specifically provides for a contracting out regime in Part 6 of the Act.[172] Parties may contract out of the PRA so long as the agreement is in writing and signed by both parties, both parties have independent legal advice before signing the agreement, the signature of each party is witnessed by a lawyer, and the lawyer certifies that they explained to the party the effect and implications of the agreement.[173] One party unilaterally settling a trust to avoid the application of the PRA is inconsistent with the PRA's existing contracting out regime, and is therefore subversive. Relatedly, because many settlors are motivated to settle trusts by the desire to avoid relationship property claims,[174] an anti-settlor control provision in the PRA is likely to make a significant impact in disincentivising instances of settlor control over trusts.

An amendment to the PRA which makes the reality of a spouse or partner's control over trust property a relevant factor in the distribution of relationship property would bring New Zealand more closely in line with Australian relationship property law. In Australia, control over trust assets is:[175]

> "…the effective determinant of the question of whether, in private family law proceedings, the assets of a discretionary trust can be treated as an asset of a party or parties, such that they are the de facto property of the parties".

On a pragmatic note, reform of the PRA is likely impending. The Government's response to the Law Commission's review of the PRA was not to give effect to the Law Commission's recommendations at the time, due to the Law Commission's ongoing review of succession law.[176] Given the Law Commission's review of the law of succession is complete, reform of the PRA is impending and the timing is right to implement a provision targeting settlor control in the PRA.[177]

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[170] Law Commission, above n 9, at [21.5].

[171] Jessica Palmer and Nicola Peart "Clayton v Clayton: a step too far?" (2015) 8 NZFLJ 114 at 118.

[172] Sections 21-21T.

[173] Section 21F.

[174] Law Commission, above n 41, at [2.11].

[175] Diana Bryant "Heterodox is the new orthodox – discretionary trusts and family law: a general comparison" (2014) 20 Trusts Trustees 654 at 657.

[176] New Zealand Government *Government Response to the Law Commission report: Review of the Property (Relationships) Act 1976 / Te Arotake i te Property (Relationships) Act 1976* (presented to House of Representatives 27 November 2019) at 3.

[177] Law Commission "Review of Succession Law" <www.lawcom.govt.nz>.

B Comparative Analysis

Statutory provisions in the relationship property regimes of two comparable jurisdictions, the United Kingdom and Australia, require the courts to consider each spouse's access to "financial resources" in making maintenance orders under the respective enactments.[178] The term "financial resources" has been interpreted to include an interest in a discretionary trust in certain circumstances.[179] Each provision, as it applies to an interest in a discretionary trust, is summarised below, followed by an analysis of the usefulness of the "financial resources" test in disencentivising, and providing claimants with a cause of action against, settlor-controlled trusts.

1 Matrimonial Causes Act 1973 (UK)

Section 25(2) of the Matrimonial Causes Act 1973 (UK) sets out a list of eight factors the court must consider in determining whether to make an order for financial provision or property adjustments upon divorce or separation.[180] Section 25(2)(a) requires the court to have regard to "the income, earning capacity, property and *other financial resources* which each of the parties to the marriage has or is likely to have in the foreseeable future…". While the court is not empowered to award the claimant spouse a share of the actual financial resource, it may adjust financial or property orders benefitting the claimant spouse upon consideration of the other party's access to those financial resources.[181]

In *Charman v Charman* (*Charman*), Wilson LJ held the central question for determining whether the husband's interest in a discretionary trust was a financial resource was whether "if the husband were to request it to advance the whole (or part) of the capital of the trust to him, the trustee would be likely to do so",[182] either immediately or in the foreseeable future.[183]

Moylan LJ, Head of International Family Justice for England and Wales,[184] stated extra-judicially that, in determining whether a party's interest in a discretionary trust is a financial resources, the court will consider all relevant factors.[185] Such factors include the terms of the trust, the history of the trust (including its administration, particularly past distributions, and the source of its assets), letters of wishes, evidence provided by the trustees as to their likely

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[178] Matrimonial Causes Act 1973 (UK), s 25(2)(a); and Family Law Act 1975 (Cth), s 75(2)(b).

[179] *Charman v Charman* [2007] EWCA Civ 503, [2006] 2 FLR 422 at [12] and [13]; and *In the Marriage of Kelly (No 2)* (1981) 7 Fam LR 762 at 769.

[180] The orders for financial provision and property adjustments are under ss 23 and 24 respectively.

[181] Section 25.

[182] At [12].

[183] At [13]

[184] United Kingdom Judiciary "Biographies of the Court of Appeal judges" <www.judiciary.uk>

[185] John Moylan "Trusts in the family courts – through the looking glass or the reality of the situation" (2013) 19(3) Trusts Trustees 322 at 331.

response to requests for financial assistance, and the effect on the interests of other beneficiaries if the trustees did exercise their power in the proposed manner.[186]

2 Family Law Act 1975 (Cth)

Section 75(2) of the Australian Family Law Act 1975 (Cth) sets out a list of factors which the court must consider in making an order for spousal maintenance.[187] Section 75(2)(b) requires the court to consider "the income, property and *financial resources* of each of the parties and the physical and mental capacity of each of them for appropriate gainful employment".

The term "financial resource" was interpreted in *In the Marriage of Kelly* (No 2) to refer to "a source of financial support which a party can reasonably expect will be available to him or her to supply a financial need or deficiency".[188] A beneficiary's interest in a discretionary trust may be a financial resource where that beneficiary has "a reasonable expectation that the trustee's discretion will be exercised in his or her favour", whether or not that beneficiary has control over the trustee.[189]

3 "Financial resources" wording

The words "financial resources" are broad, and extend to more than an interest in a discretionary trust. For example, s 25(2)(a) of the Matrimonial Causes Act (UK) has been applied to include access to companies' assets in the defendant's ownership and control,[190] and to pension payments.[191] Although this would carry some benefits in the context of the PRA,[192] the term "financial resources" is too broad for the particular purpose of disincentivising subversive settlor control over trusts. The New Zealand provision should employ wording more directly addressing the issue.

4 Test for whether interest in discretionary trust is a "financial resource"

An interest in a discretionary trust has been interpreted to be a "financial resource" where the trustee of the trust would be likely to transfer whole or part of the trust capital to the interested

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[186] At 331.

[187] Orders for spousal maintenance are made under s 74.

[188] At 769.

[189] *Hall v Hall* (2016) 332 ALR 1 at [54]; and Sayward McKeown, Gary Patterson and Stipe Vuleta "Legal update: Trust busters" (2020) 32(1) ARITA J 34 at 37.

[190] *Prest v Petrodel Resources Ltd & Ors* [2013] UKSC 34, [2013] 2 FLR 732, at [40].

[191] *Martin-Dye v Martin-Dye* [2006] EWCA Civ 681, [2006] All ER 779.

[192] The Law Commission noted concerns that, if trusts were no longer believed to be an effective means of shielding assets from relationship property claims, alternative avoidance mechanisms such as company structures would become more popular: Law Commission, above n 131, at [6.45].

party were they to request it,[193] or where the interested party can "reasonably expect" it will be made available to them to supply a financial need or deficiency.[194] This interpretation means financial resources are not limited to a settlor's authorised control over trust property, but rather that they extend to de facto control over the trust where the trustee is likely to accede to the interested party's request. Thus, in a case where the settlor is not a trustee, the "financial resources" test may still be met.

Further, this interpretation of "financial resources" in relation to an interest in a discretionary trust requires the court to assess all relevant factors, including the history of the trust.[195] Thus, in *Charman* (where the husband was not a trustee), the husband's letters of wishes to the corporate trustees,[196] and the fact the trustee had only ever made distributions to the husband and no other discretionary beneficiaries, were important factors in determining the trust assets were the husband's financial resource.[197] This assessment of the actual use of the trust permits the courts to undertake a realistic assessment of the settlor's treatment of the trust property.

5 "Financial resources" not relationship property

Both the United Kingdom and the Australian enactments use the "financial resources" test for the limited purpose of determining the level of maintenance payments to be made by one ex-partner to the other. This means the "financial resource" is not included in the pool of relationship property to be divided between the parties, although in effect an increased maintenance order gives the claimant spouse a greater percentage of the relationship property.[198]

Arguably, this has the benefit of non-interference with other beneficiaries' interests in the trust property. However, in *Thomas v Thomas* Waite LJ noted that, although courts should exercise "judicial self-restraint" in exercising their powers under s 25 of the Matrimonial Causes Act (UK), where a party enjoys "access to wealth but no absolute entitlement to it" there may be some occasions where a judge would be permitted to frame their orders in such a way as to give "judicious encouragement" to the trustees to provide the maintaining spouse with the means to comply with the court's view of the justice of the case.[199] Thus, the argument of non-interference with trust property is fallacious. Further, concerns about the beneficiaries' interests

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[193] *Charman v Charman*, above n 179, at [12].

[194] *In the Marriage of Kelly (No 2)*, above n 179, at 769

[195] Moylan, above n 185, at 331; and see *Charman v Charman,* above n 179.

[196] Such as his wish to have the "fullest possible access to the capital and income of the Settlement including the possibility of investing the entire Fund in business ventures undertaken by me" and to be treated as the "primary beneficiary" during his lifetime: at [6] and [10].

[197] At [7].

[198] McKeown, Patterson and, above n 189, at 37.

[199] *Thomas v Thomas* [1995] 2 FLR 668 at 670-671.

in trust property are likely misplaced where the trust property is deemed to be the settlor's financial resource, as in reality any other beneficiaries would have been unlikely to ever benefit from the property.

Further, where an interest in a trust is deemed a financial resource and spousal maintenance is resultingly increased, this has the effect of increasing the pool of relationship property available for division.[200] However, the "financial resource" available to the beneficiary spouse may not, but for the trust, have been part of the property of the relationship. Taking into account the parties' financial resources in determining maintenance payments may therefore afford the claimant spouse a windfall, by increasing their entitlements resulting from the parties' separation beyond their share of what would, but for the trust, have been relationship property.

A more balanced approach would be to limit the applicability of a New Zealand provision to property which, but for the trust, would have formed part of the property of the relationship (for example, the family home), but to deem that property to be relationship property.[201] This balances the beneficiaries' interests in the other trust property and the interests of the claimant partner in the relationship property.

C Suggested Reform

1 Section 42A Property (Relationships) Act 1976

In the context of the PRA, settlor control is unjustified where it is used to subvert the equal sharing regime of the PRA by formally removing property from the settlor's ownership while functionally allowing the settlor to retain control and enjoyment over the property.[202] Statutory reform must disincentivise this subversive behaviour, and provide claimants with a remedy where it occurs. To achieve these goals, the following provision should be enacted in the PRA,[203] immediately following s 42.[204]

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[200] McKeown, Patterson and Vuleta, above n 189, at 37.

[201] In accordance with s 8 of the Property (Relationships) Act 1976.

[202] See Part III.

[203] The Law Commission considered, but did not recommend, the enactment of a similar provision in its review of the Property (Relationships) Act 1976. The proposition was a revision of the definition of "property" to include all beneficial interests in a trust when it is likely and permissible that the partner will receive distributions from the trust. The property would then be classified as either relationship property or separate property according to the normal procedure. The Law Commission instead recommended a revised s 44C, which would enable the court to grant relief when a trust holds property that was produced, preserved or enhanced by the relationship. Notably, settlor control is irrelevant to this recommendation, and was not the focus of the Law Commission's review. See Law Commission, above n 9, at [22.11]-[22.22]; and Law Commission, above n 131, at [6.47], [6.49], and [6.56].

[204] Within the existing subheading "Protection of spouses' or partners' rights".

42A An interest in a discretionary trust may be relationship property

(1) For the purpose of s 42A, **otherwise relationship property** is defined as property that, if not settled on a trust, would have been relationship property of the marriage, civil union, or de facto partnership in accordance with section 8 of this Act.

(2) Where otherwise relationship property is settled on a trust of which a spouse or partner is a discretionary beneficiary, the otherwise relationship property is deemed to be relationship property to the extent that the spouse or partner is permitted by the terms of the trust to receive distributions of the otherwise relationship property where—

(a) the spouse or partner is the sole trustee of the trust; or

(b) the spouse or partner is one of two or more trustees of the trust, and—

(i) if the spouse or partner were to request it, the court considers that it is more likely than not that the other trustee(s) would distribute all or part of the otherwise relationship property to the spouse or partner; or

(ii) the trustee(s) other than the spouse or partner have not taken an active role in the management of the otherwise relationship property, such that the spouse or partner is effectively in control of the otherwise relationship property; or

(c) the spouse or partner is not a trustee of the trust, and—

(i) if the spouse or partner were to request it, the court considers that it is more likely than not that the trustee(s) would distribute all or part of the otherwise relationship property to the spouse or partner; or

(ii) the spouse or partner has trust powers or rights that, in effect, enable the spouse or partner to compel the trustee(s) to make a distribution of all or part of the otherwise relationship property to the spouse or partner.

(3) In determining whether it is more likely than not that the trustee(s) would distribute all or part of the otherwise relationship property to the spouse or partner for the purposes of subsections (2)(b)(i) and (2)(c)(i), the court must take into account all relevant factors, including—

(a) the terms of the trust; and

(b) the history of distributions of trust income or capital made by the trustee(s) to beneficiaries; and

(c) any letters of wishes, or similar other documents, provided by the settlor of the trust in question to the trustee(s); and

(d) evidence provided by the trustee(s) as to their likely response to requests for distributions of trust income or capital; and

(e) the effect on the interests of other beneficiaries if the trustee(s) were to exercise their powers in the proposed manner.

To allow the terms of trusts which are likely to be caught by the provision to be varied, s 42A should take effect two years after enactment.

2 Wording of s 42A

Section 42A only applies to property which, but for being owned by the trust, would have been relationship property and therefore subject to the equal sharing presumption of the PRA. This strikes a balance between the interests of other discretionary beneficiaries of the trust in the trust property, and the interests of the claimant ex-partner in the relationship property.[205]

Although s 42A is intended primarily to apply to settlor-controlled trusts, it does not make explicit reference to the settlor for three reasons. Firstly, reference to the settlor might unnecessarily limit the application of s 42A, preventing claimants who might otherwise be able to claim under s 42A from doing so due to a mere technicality. Secondly, reference to the settlor might invite attempts by trust parties to obscure the identity of the true settlor of the trust to avoid the application of s 42A. Thirdly, objectionable instances of settlor control will, in virtually all instances, clearly fall within one of the limbs of s 42A(2), implying that use of the word settlor is unnecessary.

The wording of s 42A(2)(a) is extracted from the facts and reasoning in *Clayton* and *Webb*. Both cases are arguably examples of the most extreme instances of settlor control, wherein the settlor is the sole trustee with effectively unlimited entitlement to the trust assets. For the purposes of s 42A(2)(a), otherwise relationship property held on such a trust is deemed to be relationship property, and is subject to the equal sharing presumption of the PRA.

The wording of ss 42A(2)(b)(i) and 42A(2)(c)(i) is derived from the United Kingdom test for determining whether an interest in a discretionary trust is a financial resource – whether, in the court's opinion, the trustee(s) would be "likely to" make a distribution of otherwise relationship property to the settlor.[206] The United Kingdom test emphasises the court's perception taking into account all relevant factors, whereas the Australian test (whether the discretionary beneficiary could "reasonably expect" the trustee(s) to make a distribution of trust property to them if they were to request it) places the emphasis on the discretionary beneficiary's subjective understanding of the trust.[207] While both approaches would likely have the same outcome in most situations, the United Kingdom test is preferable where the discretionary beneficiary is not the settlor of the trust. In such cases, the discretionary beneficiary might not expect the trustee(s) would make such a distribution when in fact they would, unnecessarily defeating the test. The wording of the test has been slightly modified, from "likely to" to "more likely than not".

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[205] See Part IV.

[206] *Charman v Charman*, above n 179, at [12].

[207] *Hall v Hall*, above n 189, at [54]; and McKeown, Patterson and Vuleta, above n 189, at 37.

Section 42A(3) requires the court to consider all relevant factors in determining whether the trustee(s) would be "more likely than not" to make a distribution of all or part of the otherwise relationship property to them for the purposes of ss 42A(2)(b)(i) and 42A(2)(c)(i). The listed factors are derived from *Charman*, and from Moylan LJ's extra-judicial statement of the relevant factors a court may consider.[208]

Section 42A(2)(b)(ii) considers circumstances where the settlor is one of two or more trustees, but the other trustees have abjured their responsibilities regarding the otherwise relationship property, leaving the settlor with de facto control. The wording is drawn from the facts of *Murrell v Hamilton* and *Vervoort v Forrest*.

The wording of s 42A(2)(c)(ii) is drawn from the facts and reasoning in *Pugachev*. In that case the settlor was not a trustee, but the judge nevertheless considered that his broad powers to veto trustee decisions and to replace trustees effectively meant he could compel the trustees to make distributions of property to him.[209]

D Testing s 42A

To establish the functionality of s 42A, it will be applied to several examples of trusts with varying degrees of settlor control.[210]

1 Clayton

In *Clayton*, the settlor of the VRPT was also sole trustee, the PFM, and a discretionary beneficiary.[211] The trust deed permitted the trustee to distribute all of the trust income or capital to any beneficiary without considering the interests of other beneficiaries and to act in self-benefit, and the trustee was excluded of virtually all liability.[212] Thus, the VRPT would be caught by s 42A(2)(a), as the settlor had the power to distribute any trust property to himself without the beneficiaries having a claim against him.

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[208] Moylan, above n 185, at 331. See *Charman v Charman,* above n 179.

[209] At [243], [244] and [272].

[210] All cases will be assessed as if the relevant trust property had been determined to have the character of otherwise relationship property, pursuant to s 42A(1).

[211] At [10].

[212] At 586-588.

2 *Pugachev*

In *Pugachev*,[213] the settlor was not a trustee, but was a discretionary beneficiary and the protector.[214] The protector had wide-reaching powers to appoint and remove trustees and veto trustee decisions.[215] The trusts in that case would be caught by s 42A(2)(c)(ii), as Mr Pugachev's cumulative powers under the trust deeds in effect enabled him to compel the trustees to distribute trust property to himself.[216]

3 *Webb*

In *Webb*, the settlor was the sole trustee, a discretionary beneficiary, and the consultant.[217] Although the beneficiaries did have some rights enforceable against the trustee, there were various ways in which the settlor could, within the terms of the trust deed, exercise his powers to divert all of the trust capital to himself.[218] Thus, the trust in *Webb* would be caught by s 42A(2)(a), as Mr Webb could have distributed all or part of the relationship property to himself without the other beneficiary having a claim against him.

4 *Vervoort v Forrest*

In *Vervoort v Forrest*, Mr Duffy was the settlor, one of two trustees, and a final and discretionary beneficiary.[219] Mr Duffy had the power to appoint new trustees, but could not make himself the sole trustee.[220] The High Court found, and the Court of Appeal accepted, that Mr Duffy exercised de facto control over the trust, making all decisions without consulting the other trustee.[221] The trust owned various properties, including the family home in which Mr Duffy resided with Ms Vervoort for some time.[222] There was evidence that Mr Duffy treated, and sometimes referred to, the trust property as his own.[223] Mr Duffy and Ms Vervoort had entered into two agreements contracting out of the PRA, but they were voidable for reason of duress.[224] Any otherwise relationship property in the *Vervoort v Forrest* trust would therefore

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[213] For the purpose of this exercise, s 42A will be applied to the trusts in *Pugachev* as if the case were a relationship property dispute. In reality it was an insolvency dispute.

[214] At [15]-[16].

[215] At [115], [125] and [127].

[216] At [243] and [244].

[217] *Webb v Webb* [2020] UKPC 22 at [4].

[218] At [83], [84], and [85].

[219] At [27].

[220] At [27].

[221] At [28], [33] and [35].

[222] At [7].

[223] At [32] and [34].

[224] At [19].

be caught by s 42A(2)(b)(ii), as the other trustee abjured all responsibility, leaving Mr Duffy in effective control of the otherwise relationship property.

5 Brkic v White

In *Brkic v White*,[225] Mrs White settled a trust to purchase certain land,[226] and appointed as trustees herself and a corporate trustee, the latter later being replaced by her brother.[227] As settlor, Mrs White had the powers to appoint and remove discretionary beneficiaries and trustees.[228] The trustees had the power to apply all of the capital to any of the discretionary beneficiaries, to resettle the trust fund upon another trust with one or more of the same beneficiaries, to exercise powers without considering the interests of all beneficiaries and in a way that might be contrary to the interests beneficiaries, to exercise any power notwithstanding any conflict of interest, and to vary or revoke any provisions of the deed.[229] No trustee who was also a discretionary beneficiary could exercise powers in their own favour, but the other trustee could exercise powers in their favour.[230]

As there were two trustees at any given time, s 42A(2)(b) is the relevant limb. Mrs White was only permitted to receive distributions of trust property made by the other trustee, so s 42A(2)(b)(ii) cannot apply. Thus, the land could only be deemed relationship property if the court were satisfied the other trustee would be more likely than not to distribute the land to Mrs White was she to request it under s 42A(2)(b)(i). There was no evidence in the case on that point, so it cannot be determined whether or not s 42A(2)(b)(i) would be satisfied.

6 Typical New Zealand family trust

New Zealand has no trusts register, making it difficult to determine what is a "typical" New Zealand family trust. Legal databases provide precedents for family trusts, and it can be assumed many New Zealand family trusts take a substantially similar form to these precedents. A generic family trust precedent from LexisAdvance will be used as a proxy for a typical New Zealand family trust.[231]

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[225] Although the dispute in that case related to a debt owed by Mrs White to the appellant, it will be assessed as if it were a relationship property dispute.

[226] *Brkic (as trustees of the Madeg Trust) v White (as trustees of the Awhitu Trust)* [2021] NZCA 670, [2021] NZFLR840, at [6].

[227] At [5].

[228] At [6].

[229] At [6].

[230] At [6].

[231] LexisAdvance "47.02 Deed creating family trust (longer form)" <http://advance.lexis.com>.

Relevant provisions and advice from the precedent are as follows. Firstly, the settlor should be named as the primary discretionary beneficiary, with their needs to take priority over all other beneficiaries, and their immediate family should be named secondary beneficiaries, with their needs to take priority over all remaining beneficiaries.[232] Secondly, to avoid claims that powers under a trust deed are relationship property,[233] there should be at least two trustees, a company appointed as trustee should not be under the control of the other trustee, two or more trustees should act as appointers at all times, and if self-dealing rules are disapplied there must nevertheless be some independent oversight.[234] Finally, if a settlor wishes to avoid relationship property claims, best practice is to enter a contracting out agreement with their spouse or partner regarding any property that would otherwise be relationship property.[235]

A settlor who heeds all of the above advice in settling a trust will not be caught by s 42A(2)(a), (b)(ii), or (c)(ii). The trust will not be caught by s 42A(2)(b)(i) or (c)(i) so long as all of the relevant circumstances do not suggest to the court that the trustee(s) would distribute all or part of the otherwise relationship property to the settlor were they to request it. If the circumstances suggest that the trustee(s) would agree to distribute only part of the otherwise relationship property to the settlor, only that part of the otherwise relationship property is otherwise relationship property by s 42A(2). If the settlor has contracted out of the PRA in accordance with the scheme provided in the Act,[236] s 42A will not apply.

VII Conclusion

Presently, New Zealand law effectively permits settlors to exploit the externalising feature of the trust for personal gain, at the expense of others in society. This use of the trust is normatively unjustifiable. Though some courts have ruled that extreme levels of settlor control may invalidate a purported trust, cases with such levels of settlor control will likely be rare. As such the usefulness of these authorities is limited. Non-trust legal regimes can provide an effective means by which to influence trust use, but this mechanism is not utilised in current New Zealand law.

This paper has proposed the enactment of a provision, s 42A, in the PRA that has the dual purpose and effect of disincentivising settlor control over trusts and providing ex-partner claimants against settlor-controlled trusts with recourse to certain trust property. The provision deems that property which, if not held on trust, would otherwise be relationship property in accordance with s 8 of the PRA, is relationship property in certain circumstances where it can

[232] At 2 and cl 3.3.

[233] Following *Clayton v Clayton*.

[234] At 3.

[235] At 3.

[236] Part 6.

be said that the settlor is in control of the otherwise relationship property. This paper tested s 42A against trusts with varying levels of settlor control, thus establishing its effectiveness.

VIII Word Count

The text of this paper (excluding cover page, table of contents, footnotes, and bibliography) comprises approximately 12,089 words.

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