

Discretionary Trusts – what happened to “practical intelligence” in the law?

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*“Equity consists primarily in a judge’s exercise of practical intelligence
to conform universal laws to particular situations”*
– Aristotle, Nicomachean Ethics

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INTRODUCTION

The Trust has long been considered “the greatest and most distinctive achievement of the Englishman in the field of jurisprudence”, by virtue of its ability to mould to the wishes of its creator.¹ Inherent in such flexibility however lies the potential for abuse, and consequently the trust doctrine is the subject of heightened scrutiny in many jurisdictions.²

In New Zealand, the Law Commission has highlighted the issues associated with the use of trusts, drawing attention to the fact that discretionary family trusts have become “a big business in New Zealand”, and are increasingly used in a manner which compromises the integrity of the trust doctrine. Specifically, there has been growing concern over the past decade that trusts can be used as a device to avoid the law and social policy, causing Sue Tappenden to comment that the family trust is now so devoid from the principles of equity from which it was born, “as to demand investigation”.³

The Law Commission’s investigation is certainly comprehensive,⁴ and draws attention to the popularity of structuring a trust so that there is common identity between settlor, trustee and beneficiary. The result of this is a blurring of the distinctions between these roles, and thus it is increasingly apparent that settlors, in divesting themselves of property, continue to treat it as their own while avoiding legal obligations and sometimes attaining government benefits which, without a trust, they would have no right to.⁵ In the author’s opinion, it is these uses of the trust that is the cause of the doctrine’s waning integrity. The Commission Preferred Approach is conservative, and will not solve this aspect of the problem. Rather, they have purported to theoretically improve trust law by clarifying the roles associated with trusts, especially the obligations trustees owe to beneficiaries.⁶

This paper is concerned with pinpointing the cause of the injustices afforded by discretionary trusts. The view of the Law Commission is that the problem is not with trust law, but rather with inefficient legislative restraints on the doctrine.⁷ This is indisputable. If legislation in New Zealand had greater trust busting mechanisms, injustices in the individual case could be avoided. Indeed, this is the approach taken by many overseas jurisdictions.⁸ In contrast to the view of

¹ FW Maitland *Equity* (2nd ed, Cambridge University Press, Cambridge, 1936).

² See generally: The Future of Trusts conference, Kings College London, April 2012; The Law Commissions six issues papers as part of their *Review of Trust Law*. Trusts as a device for individual gain have always been looked upon with suspicion in America: Scott and Austin Wakeman *Scott and Ascher on Trusts* (5th ed, Aspen Publishers, New York, 2006). See generally Ch 15.

³ Sue Tappenden “The Family Trust in New Zealand and the claims of ‘unwelcome beneficiaries’” (2009) 2 JPL at 17.

⁴ The Law Commission has released a total of six issues papers (with one more to come) covering the full extent of the problems associated with the use of trusts in New Zealand, along with suggestions for reform.

⁵ See generally: Law Commission *Review of the Law of Trusts: Some issues with the use of trusts in New Zealand* (NZLC IP20, 2012).

⁶ Law Commission *Review of the Law of Trusts: Preferred Approach* (NZLC IP31, 2012) at 44.

⁷ *Ibid*, at 52

⁸ This is the approach taken by many jurisdictions overseas. For example, in Australia, in the context of relationship property division, s 79 of the Family Law Act 1975 confers a wide discretionary power on the court to vary the legal interest of any property of the parties to a marriage. “Property” in s 4 includes financial resources, which the court has interpreted to include access to trust assets: See *Kennon v Spry* (2008) HCA 56, at [59], [60] and [62]. Here, the property in a discretionary trust fell in the category of “property” because Dr Spry was the sole trustee and the person with the only interest in its assets as well as the holder of a power, *inter alia*, to appoint them entirely to Mrs Spry

commentators and the Law Commission, this paper asserts that that the problem is not Parliaments fault alone, but rather lies within trust law itself.

While once governed by the largely discretionary institution of Chancery, the trust now resides in the domain of the common law – which, in the author’s opinion is ill equipped to deal with flexibility.⁹ The consequence is that trusts today have been able to evolve to a point largely bereft from their equitable roots. Indeed an examination of the origins of the trust, and its development in equity and the common law demonstrates that many modern day uses of the trust would not stand up to equitable examination. Ultimately, this paper concludes that the flexible nature of the trust is incompatible with the rigidity of the common law, and that consequence of this is that New Zealand’s trust law has lost touch with “practical intelligence”.

Chapter one outlines in brief the specific problems precipitated by discretionary trusts and whether these problems reside within, or externally to, trust law. Chapter two looks at the historical origins of the trust. This examination reveals two points. First, the fact that trusts have always been used to avoid legal obligations, and thus are not as ‘equitable’ as the doctrines origin insinuates. Secondly, that the trust developed in the context of a very flexible system, which was able to act to curb abuses of the trust as they arose. The common law, by contrast, is rigid and thus has been unable to respond to abuses of the doctrine. Specifically as rules of general application have emerged, they have subsequently acted as barrier to achieving practical and rational justice on a routine basis. Chapter Three supports the assertion that trusts do not work in a rigid system by comparing the orthodox application of trust law in New Zealand to the more flexible approach of the courts in America, where public policy is relevant in decision-making. Chapter 4 discusses solutions premised on the finding that trusts are incompatible with a rigid application of the law. In short, the law either needs to be more flexible, or the flexibility of the trust needs to be reigned in.

CHAPTER ONE

What is the problem with discretionary trusts?

The problem with discretionary trusts is well known. To reiterate, they enable settlors to retain the enjoyment of property as discretionary beneficiaries (and often as trustees as well), to the point that outwardly they appear to retain the legal ownership of assets. This is troublesome for two reasons: it enables discretionary beneficiaries to avoid creditors and their statutory obligations, and individuals can use these structures as a means to attain government welfare subsidies. Overall, discretionary trusts enable law avoidance due to the legal fiction that discretionary beneficiaries possess no equitable interest in trust property.¹⁰ When this fiction is coupled with the extensive powers of control available to settlors a very effective instrument, by

⁹ See generally Donovan Waters “The Trust in a Changed and Changing World” (2008) JITCP 205, discussing the changing uses of trusts from the 1300s through to the present day.

¹⁰ *Hunt v Muollo* [2003] 2 NZLR at 11: It is generally regarded as settled law that a discretionary beneficiary’s interest in a normal discretionary trust is no more than a mere expectancy. See also *Gartside v Inland Revenue Commissioners* [1968] AC 533 at 607 per Lord Reid: An ordinary discretionary beneficiary has no interest, legal or equitable, in the assets of the trust.

which one can protect their assets while retaining control over them, emerges. It is this use of the trust that this paper is primarily concerned at addressing.

The remainder of this chapter discusses the injustices associated with discretionary trusts across the board in New Zealand. The purpose of this discussion is to introduce the idea that the trust doctrine itself is flawed. First, it examines the use of trusts to restructure one's assets in order to qualify for government assistance. Secondly, it looks at the numerous legal obligation that trusts are able to avoid, and the external implications of this avoidance. In both instances, the response of the legislature to these abuses of the trust is examined and critiqued. Lastly, this chapter raises the contention that if the doctrine of the trust *is alone* capable of facilitating injustice – it must be subject to examination.

The use of trusts to gain government assistance

The Law Commission's Second Issues Paper highlighted that the use of trusts to circumvent asset testing, in order to benefit from government subsidies, poses a threat to the credibility of the doctrine.¹¹ While legislative provisions actively protect the Government from being cheated, case law has illustrated that the trust can, in many instances, be tailored to avoid these restrictions.¹²

Generally, asset-testing legislation grants the relevant agency a broad discretion to take into account an applicant's trust property. The broadest discretion is found in the Social Security Act 1964, testing for social assistance benefits,¹³ and effectively prevents the tailoring of trusts to curtail its aims of benefiting those truly in need. Testing for residential care subsidies also grants broad discretion to look thorough trusts, however this discretion is fettered by the qualification of "deprivation".¹⁴ The effect of this fetter permits individuals the ability to plan their disposition within legislative limits, and thus 'legitimately' hide their assets in trust.¹⁵ Similar fetters allow individuals to reduce their assets in order to receive Working for Families payments.¹⁶

In addition to social assistance, the government also grants aid to those who cannot afford a lawyer. Applications for this purpose can be made under the Legal Services Act 2011, and are determined on the basis of income and disposable capital. The Legal Services Regulations 2006 allow the authority to take into account dispositions to trust,¹⁷ as well as the realities of discretionary trusts,¹⁸ such as settlor control. Despite this apparently broad provision, *BM (legal aid)* has recently held that orthodox trust law restricts the authority's discretion; the existence of

¹¹ *Some issues with the uses of trusts in New Zealand* above n 5, at 27-37.

¹² There are a wide range of cases where people with property in trust apply to have their assets tested for government assistance purposes: *Ibid* at 27

¹³ Social Securities Act 1964, s 74(1)(d): The Ministry of Social Development is granted a broad discretion to reject a claim on the ground that an applicant has directly or indirectly deprived themselves of property. See also s 147A(1): where the chief executive is satisfied that a person who has applied for a means assessment has directly or indirectly deprived themselves of any income or property, they can conduct the assessment as if the deprivation did not occur.

¹⁴ Social Security (Long-term Residential Care) Regulations 2005, reg 9B provides a number of examples to be taken into account for the purposes of s 147A of the Social Securities Act 1964: couples who wish to avoid being caught by the act must not transfer more than \$27,000 per annum.

¹⁵ *Some issues with the uses of trusts in New Zealand* above n 5 at 34: The Ministry of Social Development acknowledges that many trusts are created for this purpose.

¹⁶ Victoria University of Wellington Tax Working Group *A Tax System for New Zealand's Future* (Report of the Victoria University of Wellington Tax Working Group, 2010) at 55-56.

¹⁷ Legal Services Regulations 2006, reg 8(4).

¹⁸ *Some issues with the uses of trusts in New Zealand* above n 5 at 35.

other beneficiaries acts as an obstacle to looking through trust deed to the realities of the applicants financial circumstances.¹⁹

Trusts enabling individuals to ‘bludge’ off the government are by no means uncommon. This is particularly true when it comes to obtaining residential care and Working for Family benefits, which disturbingly are promoted by some trust lawyers as convenient payoffs for those considering whether to gift their assets to trust.²⁰ In the author’s opinion these uses of the trust call into question the integrity of the doctrine for three reasons.

First, families and individuals who are, by virtue of a trust, able to obtain government benefits whereas others without a trust, who are far worse off financially, are unable to do so, is difficult to justify from a moral standpoint. Secondly, the use of the trust to qualify for government assistance stands in stark contrast to one of the doctrines redeeming attributes, its ability to enable individuals to care for those closest to them, which inadvertently serves to lessen the burden on the state. Using the trust for a purpose, opposed to the good the doctrine is capable of perpetuating is fundamentally inconsistent. Lastly, it is arguable that the use of trusts to gain government benefits in New Zealand raises egalitarian concerns. Essentially, the trust has become a device for ‘those in the know’, namely the upper and middle socio-economic brackets of society. The lower socio-economic sectors of New Zealand do not possess the same degree access to lawyers,²¹ or knowledge to create trusts for their benefit. The government has limited welfare assistance – and, in short, the money should be going to those truly in need, not those who, by manipulating the legal fictions within a discretionary trust, succeed in making themselves appear poorer than they actually are.

Avoidance of legal obligations

Creditors

The use of Trusts to protect assets from creditors is by no means new,²² and today is considered a commonplace reason for setting a trust.²³ While the legitimacy of this use is well established in professional partnerships, the rise of the self-settled trust in New Zealand casts increasing doubt over the uses of trusts when agreements are entered into voluntarily, debtors have access to substantial capital and income, and yet are able to deny creditors what is owed to them. This is especially so given that creditors are vulnerable in the absence of a requirement to register trusts, as non-disclosure can mistakenly lead a creditor to believe that the individual they are dealing with is the legal owner of the assets in question.²⁴ It is only when things go wrong that the legal

¹⁹ *BN (legal aid)* [2011] NZLAT at [48].

²⁰ *Preferred Approach* above n 6 at 25: Trusts are actively promoted in New Zealand. This has been described as a “commodification” and “marketing of trusts by the “trust industry”. See for example: Govett Quillam “Guide to Asset Protection and Residential Care” (2012) Govett Quillam Guide <www.thelawyers.co.nz>; Fortune Manning “Residential Care A care for Life Interest Wills” (2012) Fortune Manning Lawyers <www.fortunemanning.co.nz>; Harkness Henry, “Gifting and Entitlements to Residential Care Subsidies” (2012) Harkness Henry Lawyers www.harknesshenry.co.nz>

²¹ *Preferred Approach* above n 6 at 26: trusts are used by the middle and upper class sectors of New Zealand Society.

²² Trusts have been used to avoid creditors since the 1800s: See generally chapter part one of Chapter 2.

²³ This is especially so in the case of partnerships, where individuals are jointly and severally liable for the blunders of their counterparts. It is considered a prudent to protect family assets in trust from loss in the event of liability.

²⁴ Peter Blanchard “Towards a modern law of trusts” (paper presented to New Zealand Law Society Trusts Conference, 2001) at 8. For further discussion on the issue of transparency, see generally The Law Commission *Review of the Law of Trusts: Court, jurisdiction, trading trusts and other issues* (NZLC IP28) at Ch 7.

reality of ownership comes to surface. This absence of transparency is most apparent in trust owned companies, as here the trust is actively involved in carrying out business.²⁵

Where a trust precludes a creditor from obtaining the payment they are entitled to, legislation offers limited redress. The Insolvency Act 2006 invalidates all transfers made two years prior to insolvency,²⁶ and the Property Law Act 2007 empowers the court to set aside disposition made with the intention of defeating a creditor's rights.²⁷ As "intention" is a high bar²⁸ and many disposition of property to trust are planned well in advance of business ventures, these provisions lack teeth, forcing creditors to turn to the common law for redress.

The doctrine of 'sham trusts' had great potential for limiting the ability of individuals and companies to hide their assets in trust, while retaining effective control over them. A sham exists when it is established that the transaction was never intended to affect the rights or obligation of the parties involved.²⁹ Such a finding on behalf of a court does more than simply 'bust' the trust, but results in a declaration that it never existed in the first place.³⁰

Unfortunately, before the sham law was able to make inroads into the problem of effective control, the Court of Appeal watered down its viability.³¹ *Official Assignee v Wilson* established that there must be a common 'sham intention' between the settlor and trustee, despite the fact that only the intention of the settlor is relevant to both the creation and resurrection of a trust.³² In applying orthodox sham law from a contractual context to that of the trust, the court has made it more difficult to look to the substance of a trust and the realities of a situation. The consequence of this judgment for Mr Wilson was that he was able to hide behind the trust, in which he had no legal interest and thus was able to avoid his creditors while in reality he continued to control the trust for the benefit of himself and his family. Thus, the decision in *Wilson* has served to undermine the court's ability to see through the trust for what it really is.

Overall, *Wilson* illustrates a protective attitude towards trusts in the commercial context in order to preserve commercial certainty and the interest of beneficiaries. This view is supported by the Court of Appeal's outright dismissal of the Official Assignee's claim on the ground that "there

²⁵ It may appear outwardly that the company beneficially and legally owns company assets, however in reality they are owned by the trust, leaving the company with very little. The Law Commission has noted that this impacts on the integrity of the companies register: *Court jurisdiction, trading trusts and other issues* above n 24 at 78-80.

²⁶ Insolvency Act 2006, s 194.

²⁷ Property Law Act 2007, s 346: The debtor must have had an intention to prejudice the creditor at the time of the disposition to trust.

²⁸ The Supreme Court in *Regal Castings* [2009] 2 NZLR 443 (SC) at 54 has interpreted "intention" broadly, equating intention with knowledge that a transfer to trust will prejudice a third party's rights. However, the requisite intention remains difficult to establish. For example in *Regal Castings* at [60]-[67], intention was inferred from circumstances involving secrecy and deceit towards the claimant, inadequate consideration, and retention of possession. Proof of these facts limits the sections use.

²⁹ *Snook v London & West Riding Investments Ltd* [1967] 1 All ER 518, at 528. This test has been adopted in New Zealand: *Marac Finance Ltd v Virtue* [1981] 1 NZLR 586 (CA) at p 593

³⁰ This is due to the absence of one of the three certainties of trust, intention.

³¹ *Official Assignee v Wilson* [2008] NZLR 45 (CA): If the Court of Appeal had held that only a common intention on the part of the settlor was necessary to find a sham, the doctrine would be far more effective at invalidating 'trusts' where there is effective control by a settlor over his former property. The decision has been criticized extensively for this reason: See generally Andrea Manuel "Family Files – how just is the trust?" *New Zealand Lawyer* (New Zealand, 15 December 2012); Jessica Palmer "What makes a trust a sham" (2008) NZLJ 319; M Conaglen "Shams, Trusts and Mutual Intention" [2008] NZLF 227.

³² *Ibid* at [39]: Note, where a trust is self-declaratory only the settlor's unilateral intention will be relevant to finding a sham.

could be [no] integrity or justification in allowing Mr Reynolds to seek relief which is effectively for his own benefit”.³³ Internationally, this reasoning has been criticised for its unfounded favouritism of the “gracious sham trust” over the deserving creditor.³⁴

Aside from the element of common intention between the settlor and trustees, the actual establishment of a ‘sham intention’ is by no means a walk in the park.³⁵ A court will only look behind a transactions apparent validity if there is good reason to do so, and good reason is a high threshold. Even then, unless a settlor admits a sham intention, the party alleging a sham will need to point to post settlement conduct³⁶ evidencing an intention to retain “personal control of the assets ostensibly held in trust”.³⁷

It can only be found by the parties conduct, usually post settled, which is difficult in the face of a legally effectuated trust instrument.³⁸ The undesirable consequence of this is that creditors continue to face significant legal hurdles in their attempts to obtain what is lawfully theirs. This problem has become all the more apparent in the past five years; in 2005, only about 0.5 percent of those adjudicated bankrupt had an interest in a trust, and by 2010 this proportion had increased to almost a third.³⁹

The increasing popularity of trusts, coupled with the fact that settlors, in their dual role as trustee and beneficiary, are continuing to take liberties with their ability to grant themselves extensive powers of control over management and access to trust property, has resulted in increasing investigation by the judiciary.⁴⁰ The case of *Hotchin v The Financial Markets Authority* presented a window of opportunity for the expansion of the elements of a sham trust. Here, Winkelman J questioned the legitimacy of a trust where a discretionary beneficiary has significant powers of control over trust property, despite having “certainty of intention to create a trust”.⁴¹ Specifically, she noted that the trust might be a sham because at the time of the trusts creation, Hotchin was the only trustee and the subsequently appointed co-trustee did not fetter his ability to treat the trust assets as his own.⁴² These comments give fresh support for the

³³ Honourable Justice Hayton “The Hayton Trust Law Overview” (paper presented to the Transcontinental Trusts Conference, Grand Hotel Lempinski Geneva, 20 June 2012): Why should it make any difference if [he] has been declared insolvent, so that instead of particular creditors bringing claims, the ... OA ... satisfies [his] creditor’s claims? The New Zealand Court of Appeal seemed to think that this was for the benefit of [Mr Reynolds]. With respect, this is surely for the benefit of [his] creditors, whose interests should prevail over the interests of the beneficiaries under [his] gratuitous sham Trust.”

³⁴ *Ibid.*

³⁵ Mark Henaghan “The Personal Side of Property” (NZLS Conference Paper, 2011) at 128.

³⁶ *Official Assignee v Wilson* above n 31 at [77]: established that when look to post settlement acts or omissions, caution must be exercised.

³⁷ *Hotchins v The Financial Markets Authority* [2012] NZCA 370 at 46.

³⁸ *Ibid.*

³⁹ *Some issues with the law of trusts in New Zealand* above n 5 at 13: In June 2004, out of a total of 2,792 individuals declared bankrupt, only 15 had an interest in a trust. By June 2010, this figure had grown remarkably to 879 individuals with an interest in trust, out of the 3,054 declared bankrupt.

⁴⁰ *Hotchin v The Financial Markets Authority* above n 37: Appeal against Winkelman J who held that it was possible the trust was a sham. Overall, the judgment demonstrates that Judges are starting to treat trusts in the commercial context with increasing suspicion. See also: Nicola Peart and Jessica Palmer “Freezing orders, the FMA and what it might mean for trusts”: *FMA v Hotchin*” (2012) 279 LawTalk 6.

⁴¹ Burton, Henaghan and Tomlinson “Trusts Under Attack – will your fortress hold?” (paper presented to the NZLS Property Law Conference, 2012) at 268: A lack of intention to create a trust could not be established because there was a prohibition against self-dealing in the trust, and he had no power to amend the trust deed to remove this clause.

⁴² *Hotchin v The Financial Markets Authority* above n 37 [53]: also, aspects of how the trust operated suggested that trust assets had been treated as Mr Hotchin’s property.

proposition that “self-dealing” may render a trust invalid.⁴³ The Court of Appeal held that Winkelman J was correct not to strike out the sham pleading, noting that “when a sham is alleged, the Court may look at the substance of the transaction and not just its form”.⁴⁴ In light of such comments, it remains to be seen whether the requirement of a sham will be expanded in the future; if so, there will be a significant number of trusts in New Zealand that are not trusts at all.⁴⁵

Relationship property

The purpose of the Property (Relationships) Act 1976 (PRA) is to recognise the equal contributions to a relationship, via the equal sharing of relationship property. Discretionary trusts actively defeat this purpose, as a discretionary beneficiary’s interest in a trust is not property for the purposes of the PRA.⁴⁶ This is especially so given the common practice of placing the family home in trust, which is more often than not, a couple’s largest and only asset. Unlike creditors, spouses and partners are usually aware of a trust’s existence. The problem lies in the fact that one partner often possesses more control than the other over a trust.⁴⁷ Consequently, if things sour in the relationship, as they often do these days,⁴⁸ the non-controlling partner loses out, either because it is highly unlikely that future distributions will be made to them, or because they are expressly removed as a beneficiary or trustee.⁴⁹ In this manner, trusts act as an alternative means to expressly contracting out of the PRA under s 21. As s 21 agreements require independent advice on the part of both parties, whereas trusts do not, the disposition of property to trustees serves as a back door for those wishing to dodge their statutory obligations without fuss. An additional concern is that while s 21 agreements can be set aside if they are or have become seriously unjust,⁵⁰ dispositions to trust are far more robust to challenge.

New Zealanders have a strong expectation to share equally in relationship property.⁵¹ Despite this, Parliament has asserted, “trusts are created for legitimate reasons and should be permitted to fulfill those purposes”.⁵² It is generally accepted that this is an implied assertion that trusts are superior to relationship property rights, and it is for this reason that the PRA does very little in the way of ‘trust busting’.

⁴³ Nicola Peart and Jessica Palmer above n 40: “The court’s reasoning could be seen to draw into doubt the legitimacy of trusts where appointers have the power to appoint themselves as sole trustee of a trust of which they are also a discretionary beneficiary. The assumption appears to be that they will act for their own benefit and disregard their duties to the other beneficiaries.”

⁴⁴ *Hotchin v The Financial Markets Authority* above n 37 at [52].

⁴⁵ Anthony Grant, “Justice Winkelmann and sham trusts” *NZLawyer* (New Zealand, 23 March 2012).

⁴⁶ Property Relationships Act 1976, s 2: Property, for the purpose of the Act, includes beneficial interests. A discretionary beneficiary has no beneficial interest in trust property: *Nation v Nation* [2005] NZFLR 103, at [74].

⁴⁷ As a trustee with the power to appoint and remove beneficiaries and trustees; or impliedly – controls the trust through other trustees.

⁴⁸ About one third of marriage end in divorce: Statistics New Zealand: Marriages, Civil Unions, and Divorces: Year ended December 2011: <<http://www.stats.govt.nz>>

⁴⁹ More often than not, distributions will not be made to the non-controlling after the termination of a relationship.

⁵⁰ Property (Relationships) Act 1976, s21 J.

⁵¹ The equal sharing regime arose in the context of the emancipation of women, and was enacted to recognise the equal contribution of both parties to a relationship, irrespective of their roles. Today, this basis is not as relevant due to the increased equality of the sexes. However, due to the strong element of sharing in a relationship – the equal sharing regime continues to have legitimacy in the minds of New Zealanders. Where it is not applicable to individual circumstances, couples can contract out of the PRA under s 21: See generally Susan Prager “Sharing Principles and the Future of Marital Property Law” (1970) 25 UCLAR at 1997 for further discussion on the rationale for equal sharing regimes.

⁵² Government Administration Committee *Report on Matrimonial Property Amendment Bill* 109-2 (1988), p xii.

The only trust busting section in the PRA, s 44, mirrors that of s 346 in the Property Law Act 2007, and requires an intention to defeat a claimant's rights under the Act.⁵³ Surprisingly, given the perceived greater injustice where a trust defeats a claimant's rights under the PRA, as opposed to a creditors, the establishment of intention in this context remains perhaps more stringent than proof of intention to prejudice the creditor.⁵⁴

In recognition of the fact that s 44 provides limited redress, Parliament enacted s 44C as a 'safety net' to catch those deserving claimants whose rights under the Act were defeated by dispositions to trust.⁵⁵ While on the face of it this section seems broad in the absence of the requirement of "intent", case law has revealed its numerous jurisdictional⁵⁶ and compensatory⁵⁷ holes; and thus with planning the section can easily be avoided. Parliament's stance as to the superiority of trusts, over the social and moral aims of the PRA is questionable in light of the increasing recourse of claimants to alternative avenues, specifically the Family Proceedings Act 1980 (FPA) or the general law, in order to achieve justice.

Section 182 of the FPA is an increasingly popular fall back provision, where the PRA fails to provide a satisfactory division of property.⁵⁸ The purpose of s 182 is to uphold the original expectations of the parties in changed circumstances,⁵⁹ in order to prevent the unfair benefit of one partner at the expense of the other.⁶⁰ Despite this variance from the purpose of the PRA, *Ward v Ward* demonstrates that practically, s 182 is able to inadvertently achieve what Parliament expressly denied when enacting s 44C by allowing the courts to interfere with trust capital.⁶¹ While the Supreme Court acknowledges this conflict, they noted that s 182 retains an important place in the law in light of the constraints that arise under sections 44 and 44C.⁶² This is a clear statement from the judiciary that the current relationship property regime is far from

⁵³ Property Relationships Act 1974, s 44: Dispositions may be set aside (1) Where the High Court or a District Court or a Family Court is satisfied that any disposition of property has been made, whether for value or not, by or on behalf of or by direction of or in the interests of any person in order to defeat the claim or rights of any person (party B) under this Act, the court may make any order under subsection (2).

⁵⁴ Originally, intention under s 44 was interpreted very narrowly: See *Coles v Coles* (1987) 4 NZFLR 612 (CA) in order to defeat" was interpreted narrowly, requiring a conscious desire to defeat a partner's property claims under the Act. The wider test established in *Regal Castings* is available, however its use has been limited. In *DKH v CAC* [2011] NZFLJ 70, at [32] the broader *Regal Castings* test of intention was applied. An inference was drawn that Mrs H was aware that transferring property to the Trust would deprive Mr H of his right under the Property Relationships Act 1976, as he was led to believe that the trust was a family trust. In contrast see *Lezaic v Bayne*, High Court, Auckland, CIV 2010-404-7010, 22 March 2011 where elements of improper motive were relevant. See also for a discussion on the limited use of a broader test for intention: Bruce Corkill QC and Vanessa Burton "Trustee Litigation in the Family Context: Tools in the Family Court, and Tools in the High Court" (NZLS Conference: Trusts, June 2011): The authors commented that the given the legitimacy of trusts, it is debatable whether a more 'water down' approach should be adopted.

⁵⁵ *Nation v Nation* above n 46 at [146].

⁵⁶ Property Relationships Act 1976, s 44 C: A claimant must establish that since the relationship began, there has been a disposition of relationship property to trust, by one or both of the parties. This disposition must have the effect of defeating a claimant's rights under the act. This latter requirement has been interpreted broadly; it is satisfied where, but for the disposition a claim could have been made under the Act, and this disposition resulted in inequality between the parties

⁵⁷ Property Relationships Act 1976 s 44 C(3): Awards can only be made from separate or relationship property, and as a last resort from the income of the trust. See also *Ward v Ward* above n 57 [19]: In this case all the jurisdictional elements of the section s 44C were satisfied, but the court was unable to grant an order, as there was limited property outside the trust and minimal income. This case exemplifies the typical discretionary family trusts in New Zealand; whereby a trust holds the majority of a couple's assets and generates limited, if any, income.

⁵⁸ *Ibid.*

⁵⁹ *Coutts v Coutts* [1948] NZLR 591 at 618-619.

⁶⁰ *Chrystall v Chrystall* [1993] NZFLR 772 at 789.

⁶¹ *X v X* [2009] NZFLR 956 (CA) at [45].

⁶² *Ward*, above n 24, at [52].

adequate. Of note, the section is of limited aid in that it applies only to married or civil union couples⁶³ who enter into nuptial settlements.⁶⁴

In contrast to the Judiciary's somewhat complacent attitude to creditors, they have attacked discretionary trusts where settlors have retained substantial control over trust assets with rigour.⁶⁵ Specifically, the past decade has seen the establishment of novel doctrines: illusory trusts,⁶⁶ alter egos⁶⁷ and the bundle of rights,⁶⁸ which all rely on the maxim that equity looks to substance over form.⁶⁹ Thus, where a settlor appears to retain the legal and equitable benefits of trust assets, the Judiciary has felt entitled to intervene in order to achieve justice in the individual case.

While the court has been persistent in its attack on trusts, its creativity has not withstood the rigours of trust law in New Zealand. Illusory trusts and alter ego trusts have been deemed untenable by virtue of their failure to attribute weight to the obligations imposed on trustees.⁷⁰ The doctrine of the bundle of rights has retained some scope for application on the grounds that property rights, for the purpose of the PRA, arise from personal powers of control and are external to the trust assets.⁷¹ While, for this reason, the doctrine was predicted to 'take-off' with the advent of gift duty, it has largely been disregarded as incompatible with trust law.⁷² Whether one endorses or criticises the deviation of the family court from orthodox trust law, one need only examine the case law in which these doctrine evolved to sympathise with the courts desire to afford a just and fair outcome on the facts, as this is, after all, why the claimants came to court in the first place.⁷³

⁶³ Not only is this obviously unfair, but it is inconsistent with Parliaments intention that de facto couples have equal status to married and civil union partners. See Section 1M(a): Purpose to reform the law relating to the property of married couples and civil union couples, and of couples who live together in a de facto relationship

⁶⁴ The High Court in *Kidd v Van den Brink* HC Auckland CIV-2009-404-4694 21 December 2009 at [31] held that a qualifying settlement is characterised by its provision for a particular marriage. In this case, the trust was created for the purpose of benefiting a range of beneficiaries. Thus, unlike Ms Ward, s 182 was not able to provide Ms Kidd with a remedy; she was left with nothing on separation. In light of the fact that both of these claimants were deserving, the outcomes from s 182 are arbitrary.

⁶⁵ This differential treatment can be attributed to the fact that spouses and partners do not operate at arms length, and also because the injustices afforded by trusts in this context are all the more obvious.

⁶⁶ *Harrison v Harrison* (2008) 27 FRNZ 202 HC.

⁶⁷ *Prime v Hardie* [2003] NZFLR 481; *Glass v Hughey* [2003] NZFLR 865.

⁶⁸ *Walker v Walker* [2007] NZFLR 772.

⁶⁹ *Harrison*, above n 66, at [19].

⁷⁰ *Official Assignee v Wilson* above n 31: As long as the beneficiaries are able to hold a trustee accountable, control cannot undermine the concept of a trust.

⁷¹ *LTEP v JMP*, above n 44.

⁷² The doctrine fits awkwardly with trust law, as it pre-supposes that trustees will breach their fiduciary obligations, either by exercising powers in a self-interested manner, or on the direction of a discretionary beneficiary. Placing a value on the likelihood of such an occurrence conflicts with the very nature of the trust relationship: See generally Bruce Corkill QC and Vanessa Burton "Trustee Litigation in the Family Context: Tools in the Family Court, and Tools in the High Court" (NZLS Conference: Trusts, June 2011). There is also great complication in ascribing a value to such an interest: See Shelly Griffiths "Valuation of interest in discretionary trusts" NZLS Relationship Property Intensive (2010) 60. Lastly, this doctrine is problematic as its scope and application of this doctrine is far from certain. See generally Anthony Grant, Justice Heath predicts the death of the Bundle of Rights 'doctrine', NZLawyer, 20 April 2012 at 13.

⁷³ See generally: *Harrison v Harrison* above n 66; *Ward v Ward* above n 57, *Prime v Hardie* above n 67 and *Glass v Hughey* above n 67 on alter egos which emerged due to frustration that in substance discretionary beneficiaries owned property, yet could avoid their legal obligations; see *Walker v Walker* above n 68, *SMB v GAC FC North Shore FAM-2007-004-946* 19 November 2012; *LTEP v JMP FC Auckland 2008-004-000715* on the doctrine of the bundle of rights.

Child support

The Child Support Act 1991 (CSA) guards its policy⁷⁴ zealously in comparison to the PRA. Section 104(4)(c)(i) of the Act, permits the court to consider the “financial resources” of the liable parent in relation to a formal assessments for child support would result in an unjust or inequitable determination of the support to be paid. “Financial resources” includes a liable parent’s access, in substance, to trust property. For example, in *BJR v PMMY*⁷⁵ Mr R was a discretionary beneficiary-trustee and had total control over the trust’s assets and income, which he used to meet his own needs.⁷⁶ Thus, the trust assets were his ‘financial resources’ for the purpose of the CSA, and were relevant to the determination of his support obligations.

While “financial resources” capture cases where a parent exercises control over trust property, it is more difficult to take into account a trust assets where a trust is properly managed. For this reason, one barrister has commented that the uses of trusts to avoid child support are “incredibly common”, and almost always involve wealthy fathers.⁷⁷ Parliamentary debates on the Child Support Amendment Bill reinforces this concern, noting that the Bill will grant greater powers to the Child Support Agency to go behind trusts to “ensure that wealthy parents pay their true child support obligations, rather than using artificial devices to avoid them”.⁷⁸

Income Tax

New Zealand has gained a reputation overseas as a “tax haven” for the wealthy due to the minimal restriction placed on what trusts are able to do. The Government has recently denied this criticism on the grounds that the practice of reducing income via trust, within the bounds of the law,⁷⁹ qualifies as “legitimate tax avoidance”.⁸⁰

This position, while indicative of public policy, must be weighed against egalitarian concerns.⁸¹ It is the middle and upper class sectors of New Zealand who utilize trusts and their subsidiary benefits, and thus the question needs to be asked whether the wealthy, by virtue of their wealth, should be able to distort tax payments. In the words of Peter McCall, it is difficult to justify “[ones] ability to do what [others] cannot afford to do” for this amount to saying, “to those who have shall more be given”.⁸² Clearly, this sits at odds with the values of a welfare state. Moreover, tax avoidance is difficult to justify as high earning individuals have obtained a greater benefit from the system and the wider community than lower socio-economic brackets of society. New

⁷⁴ Child Support Act 1991, s 4 outlines the numerous objects of the Act which includes the affirmation of the rights of the child to be maintained by their parents, and that the level of financial support is to be determined according to their capacity to provide financial support

⁷⁵ *BJR v PMMY* CRI-2008-000096 18 March 2010

⁷⁶ *Ibid*, at [25]

⁷⁷ Deborah Hollings QC, quoted in: Joanne Carroll “Child’s fight over \$2m in trust fund” *The New Zealand Herald* (New Zealand, 7 November 2010).

⁷⁸ (8 May 2012) 679 NZPD 2018

⁷⁹ Income Tax Act 2007, s YA 1: the commissioner can adjust taxpayers’ taxable income where he or she considers a tax avoidance arrangement exists.

⁸⁰ Patrick Gower “Government rejects tax haven claim” (2012) 3News <www.3news.co.nz>

⁸¹ These concerns must be taken seriously in a society where inequality has risen to “record levels under national government”: “Tax Inequality and Asset Sale Plants” (2012) Parliament Today <www.parliamenttoday.co.nz>; See also Gareth Morgan “Reviving values of an egalitarian society” *The New Zealand Herald* (New Zealand, 30 August 2011).

⁸² Christopher McCall QC “The trust as an enemy of the people” (paper presented to The Future of Trusts, Kings College, London, April 2012).

Zealand has chosen a progressive tax system for this reasons, and consequently the author struggles to see how its avoidance can be labelled legitimate.⁸³

While tax avoidance is 'legitimate, the line is drawn at evasion. Section YA 1 of the Income Tax Act 2007 stipulates that a tax evasion occurs where its avoidance is not merely incidental, but directly or indirectly has tax avoidance as its purpose or effect, or one of its purposes or effects. For example, in *Loader v Commissioner of Inland Revenue*,⁸⁴ a company-trust structure had been adopted for business and family reasons, and thus tax avoidance was legitimate.

The recent case of *Penny v Hooper*⁸⁵ demonstrates that the courts are taking a harder look at trusts that avoid tax. Here, two surgeons structured their business using a trust. The upshot of this was to significantly lower their income to a mere 18% of their original salary, subjecting them to significantly lower tax margins. The surgeons and their families continued to receive the full benefit of their original income via distributions from the trust. It was argued successfully in the High Court that they had other legitimate reasons for the trust, and that the avoidance was merely incidental and thus legal.⁸⁶ However, the Supreme Court looked at the commercial realities of the arrangement, concluding that the only realistic inference to be drawn was that the trust was established to avoid tax.

External costs and the dwindling morality of trusts

Trusts are an attractive doctrine from the individual's perspective as they enable property to be tucked away behind high walls, which, if constructed property, are impenetrable by claimants. While this is all very well for the individual who benefits directly from a trust, each time an individual avoids legal obligations, the cost is offloaded to another or the community at large. While this is not particular concerning from a utilitarian perspective, the accumulated effect of these costs, in a society infatuated with trusts, is making them increasingly difficult to ignore.⁸⁷ Despite this, Parliament continues to take a more apathetic view of trusts where the Government is not directly effected. Given however that external costs to the individual do indirectly burden the state,⁸⁸ this view may be worth considering.

The extent to which the external costs of trust fall on the state is unknown, however this does not change the fact that it seems rather odd that Parliament endorses a device, which not only has the ability to burden the welfare system but, more importantly, defeats the very laws which it enacts. Both Parliament and the Government acknowledged this, and have gone so far as to endorse the trust as a device of law avoidance, provided it does so within statutory limits.⁸⁹ While this fact seems incongruous to the author, it does raise the rather interesting question of whether it is public policy to allow trusts to override legislative purposes. Given that public policy requires a consideration of legislative, commercial and social trends, it is certainly very arguable that this

⁸³ This is especially so in light of the recent Mutual Administrative Assistance on Tax Matters, which called for cooperation between OECD states to combat tax evasion and avoidance: See OECD Better Policies for Better Lives, <www.oecd.org>

⁸⁴ *Loader v Commissioner of Inland Revenue* [1974] 2 NZLR 472 (SC).

⁸⁵ *Penny v Hooper* [2011] NZSC 95.

⁸⁶ *Ibid* at [6].

⁸⁷ Kent D Schenkel "Trust Law and the Title Split" (From the Selected Works of Kent D Schenkel, 2009) at 22.

⁸⁸ For example in *Kidd v Van den Brink* [2010] NZCA 169 Mr van den Brink retained access to a trust with substantial assets, including the couples would be relationship property, while Ms Kidd was forced to fall back on the state for welfare assistance.

⁸⁹ For example, in the field of tax avoidance, and relationship property rights.

question could be answered in the affirmative.⁹⁰ Indeed, the very fact that trusts play a pivotal role in the economy is one argument against “screwing around with trusts”.⁹¹

While the author does not purport to answer the question of public policy conclusively, the desire for commercial certainty and inferred legislative intentions must be weighted against the widely held public perception that there is something not quite right with trust law in New Zealand.⁹² This unease, in the author’s opinion, stems from the uses to which trusts are put; asset structuring to reduce tax or cheat the government, or simpler dispositions of property to trust to secure it against unsuspecting creditors, spouses and partners, all have one thing in common – they are associated with dishonest thinking. It is dishonest to make one self poorer than they actually are to attain welfare benefits, it is dishonest to create a trust with the intention of defrauding future creditors, and it is dishonest to use trusts as a back door to contracting out of the PRA. Thus, while the use of the trust to avoid the law may be ‘legitimate’, and while it is arguable that public policy reflects this thinking, it is by no means moral – and it is this aspect of the trust which is the most concerning.

The morality of the trust warrants investigation because morals, while separate to the law, are central to legal theory.⁹³ It is generally accepted that some shared idea of what is right and wrong is an essential element in the cohesion of society. For the majority of reputable legal jurists, the corollary of this perception is that the function of the law is to preserve the morals held by the majority.⁹⁴ This function is particularly valuable in the case of those morals classified within the bare “minimum essential for social life”, of which honesty is included.⁹⁵ Thus, given the fact that the trust encourages dishonesty and can be used for dishonest purposes, it is arguable that the trust sits at odds with the very nature of the law.

It is for this reason that the author believes that the trust is inherently problematic.⁹⁶ For how can a doctrine of law be flawless when its employment facilitates the erosion of a moral, which is “as necessary to society as, say, a recognised government”?⁹⁷ Now, this statement may seem to

⁹⁰ Samantha J Hepburn *Australian Principles: Equity and Trusts* (2nd ed, Cavendish Publishing Limited, London, 2001) at 323.

⁹¹ Nick Smith “Family Trust funds under siege” *The New Zealand Herald* (New Zealand, 17 June 2012).

⁹² Rob Stock “Most want trusts brought to heel” *Sunday Star Times* (New Zealand, 18 September 2011): Of the 3500 people who answered a Sunday Star-Times survey on their financial habits and attitudes, 51% agreed lawmakers needed to put limits (sometimes severe) on the use of trusts. Only 16% said lawmakers should keep their hands off trust law, and 33% had no view on the issue.

⁹³ Under every theory of law, morality is pivotal. Even Mills who was of the opinion that the law should, as far as possible, leave the individual to pursue their own ends, recognised that there were moral limits on this freedom. For example, he acknowledged the importance of duties to both creditors and family members as vital for a functioning society. Additionally, HLA Hart asserted that the separation of law and morality is for a moral reason. If morality is included in the question of a laws validity, there is a danger that people will assume the morality of a rule or doctrine simply because it is law. Separation makes it morally incumbent on all to reject the assumption that the existence of law settles the question of its morality. The law must always be open to criticism and reform: See generally HLA Hart, *Social Solidarity and the Enforcement of Morality* (1967) 35 UCLR at 2-3.

⁹⁴ Ibid. See also Patrick Devlin *The Enforcement of Morals* (Oxford University Press, London, 1965) at 11; Lon Fuller *The Morality of Law* (2nd ed, Yale University, Virginia, 1964) at 33 “[A] law which a man cannot obey, not act according to it, is void as no law: and it is impossible to obey contradictions, or act according to them”, citing *Vaughan in Thoman Sorrell*, 1677.

⁹⁵ HLA Hart above n 93 at 10: Hobbes and Hume constructed a list of these morals, include: restraint on the free use of violence, honesty, promise keeping, fair dealing and rules regarding property. These morals are referred to as ‘common morality’ by other legal jurists – and are by no means an exhaustive list.

⁹⁶ *Preferred Approach* above n 6 at 53.

⁹⁷ Patrick Devlin above n 94 at 10-11: “Society means a community of ideas; without shared ideas on politics, morals and ethics no society can exist. If men and women try to create a society in which there is no fundamental agreement

overstate the point – but it is an important point to make in the face of the Law Commissions conclusion that “the device is not itself the cause [of the problem]”.⁹⁸ This conclusion was reached in spite of the Commission’s finding that trusts are prolific in New Zealand, and are so popular precisely because of the aforementioned dishonest ends trusts so cleverly facilitate.⁹⁹

Despite these criticisms of the trust doctrine, it would be unintelligent to suggest that New Zealand does away with trusts all together. While the doctrine may have lost touch with morality, in New Zealand trusts have become central not only to the management of family assets but to the economy as a unique investment vehicle;¹⁰⁰ and thus, their abolition would quite possibly cause a “paralysis in the system”.¹⁰¹ Additionally, trusts remain an important means of caring for the vulnerable, a convenient tool for the future management of property stretching beyond a settlor’s death, and are useful in their ability to separate the assets of a first relationship from subsequent ones.¹⁰² It is perhaps for these reasons that the Law Commission has by no means sought to revolutionise trust law.

While it is important to keep these benefits of the trust in mind to maintain a grounded perspective of trusts in New Zealand, they should not be used as an excuse to ignore the less appealing facets of the doctrine. This is however, exactly what the Law Commission appears to have done in leaving the problem for respective policy areas to fix. Proponents of the trust appear so caught up in its ingenious ability to manage property by separating legal and beneficial ownership, that they have turned a blind eye to honesty and the very essence of a trust, to hold property for the benefit of another. In light of this concern, there is an elementary question that needs to be asked; and that is whether the cultivation of a “trust culture” is in fact desirable. If this question is answered in the negative, which the author believes it should be, New Zealand is in need of a solution to “set the law of trusts on its head”.¹⁰³

In considering solutions to this problem it is necessary to examine the history of the trust in order to pinpoint exactly when it became associated with dishonesty, and why this association was tolerated. Ultimately this examination reveals trusts were once regulated by “practical intelligence” – and that it was only when this aspect of management was lost, that the trust began to be used in a manner that has casts doubt over the claim that the trust is England greatest contribution to international jurisprudence.

about good and evil they will fail; if, having based it on common agreement, the agreement goes, the society will disintegrate. For society is not something that is held together physically; it is held by the invisible bonds of common thought”

⁹⁸ *Preferred Approach* above n 6 at 28.

⁹⁹ See generally *Some issues with the law of trusts in New Zealand* above n 5.

¹⁰⁰ *Preferred Approach* above n 6 at 17.

¹⁰¹ Paul Matthews “The place of the trust in English law and English life” (paper presented to The Future of Trusts Conference, Kings College, London, April 2012).

¹⁰² *Preferred Approach* above n 6 at 27.

¹⁰³ Rob Stock “Trust shakeup is a wakeup for trustees” *Sunday Star Times* (New Zealand, 18 November 2012) at D5.

CHAPTER TWO

Part one: the history of the not so equitable trust

The idea of the trust as an equitable doctrine is a remnant of its origins in the Courts of Chancery. Equity carries with it notions of consciousness and justice in the individual case. However, as chapter one has discussed, the use of trusts in New Zealand is certainly far removed from these principles. While this dissociation is often thought of as a modern day phenomena,¹⁰⁴ history reveals that this is not so; and thus, this first part of chapter two shall traverse the development of the trust in order to demonstrate that it has not, for a very long time, been the equitable doctrine it purports to be.

In the beginning

Trusts have always been used to avoid legal obligations. Indeed the predecessor of the trust, the use, was established specifically for this purpose.¹⁰⁵ The development of the use was secured by the absence of a fully developed law of contracts,¹⁰⁶ and involved a transfer of the legal title in land to a feoff, who would then hold it for the benefit of another. In essence, this arrangement enabled the original landowner to retain the economic and personal benefits of land, while avoiding the burdensome laws of tenure and taxation associated with feudalism.¹⁰⁷ As the common law did not acknowledge third party rights to an agreement, beneficiaries of the use were unable to enforce the feoffs undertakings. This is where equity stepped in, enforcing the original agreement in order to honour moral undertakings.¹⁰⁸

On the face of it, the idea that the courts of equity, associated with the underlying principles of morality and conscience, tolerated this 'ruse of ownership' seems like an anomaly. However, one must keep in mind that equity was established outside of the common law, and the laws of the 1300s were reflective of a very different culture, compared to those of the present day. Rather than concerning themselves with substantive equality, or the enforcement of promises, the laws of the time centred on cementing existing hierarchal structures within society, designed ultimately to retain power in the hands of the monarchy and the establishment.

Throughout the 1200 and early 1300s there was growing dissatisfaction with the restrictive nature of the law.¹⁰⁹ Not only did the laws of tenure restrict social mobility, making it very difficult for the individual to transcend the economic class they were born into, but they were also disadvantageous for wealthier sectors of society who wished to deal with land in ways for which the common law and feudalism did not provide.¹¹⁰

This dissatisfaction with the current system was instrumental to the development of the use, as it provided a simple solution to a common predicament. In upholding the use, Chancery gave effect to the increasing pressure for freedom and advanced the development of the law by ensuring that

¹⁰⁴ Tappenden above n 3.

¹⁰⁵ A K R Kiralfy *Potter's Historical Introduction to English Law* (4th ed, Sweet and Maxwell Ltd. London, 1958).

¹⁰⁶ George L Greeton "Trust's without Equity" (2000) 49 ICLQ at 599: the absence of contracts for the benefit of third parties at English law, was largely responsible for the trusts development.

¹⁰⁷ These legal obligations attached only to common law title, not chancery's equitable title. The use also enabled the testamentary transfer of land, which was impossible under the feudal system of tenure. See Donovan above n 9 at 216.

¹⁰⁸ Ibid: As beneficiaries had no legal rights in the land the common law unable to enforce agreements against a feoff, and thus fell on Chancery to enforce these obligations.

¹⁰⁹ Donovan above n 9 at 216-217.

¹¹⁰ Ibid.

it reflected the spirit of the time.¹¹¹ Thus, when the context of law avoidance is taken into account, particularly the use's ability to avoid an oppressive system that was inconsistent with the desires of the majority, the use was indeed equitable.

The end of feudalism and the continuation of the use

When the feudal system ended in the late 1300s, the use's work, as a legitimate device of law reform, was complete.¹¹² Despite this, the use persisted, not because it continued to pursue equitable ends, but because chancery placed paramountcy on settlor intention.¹¹³ Indeed, the equity in the use was associated not so much with its ends, but rather with ensuring that the feoff abided by the settlors wishes. Thus, the trust is unique in that it is an incredibly flexible doctrine, enabling settlors through the ages to customise the trust to comply with the social and economic needs of the time. It is by virtue of this flexibility that Maitland espoused the trust,¹¹⁴ and explains why such an archaic doctrine has retained relevance in the present day.

Like Maitland, Chancery was an avid supporter of the creation of the use, and thus acted to protect it against the Crown, who as early as 1376 attempted to put a halt to the doctrine of the use.¹¹⁵ Most notably, the Statute of Uses 1535 converted the interest of beneficiaries to legal ownership to prevent tax avoidance. However, this provision was interpreted very narrowly by Chancery¹¹⁶ and eventually the Statute was evaded completely by the concept of uses upon a use.¹¹⁷

Subsequent employment of trusts – a contrast to the original use

The subsequent employment of the use, and later the trust, can be contrasted to the original use, in that the device no longer served a common purpose. Indeed, for the majority of the trusts life, it has been utilised to advance the interests of the wealthiest members of society.

The landed trust

The landed trust emerged as a means to provide residence and income to successive generations of the landed gentry in 17th century England.¹¹⁸ While this use of the trust was primarily upheld to give effect to the settlor's intentions, their purpose of providing for family, was endorsed by equity as wholly unselfish and reflective of human nature.¹¹⁹ Despite these arguably 'honourable intentions', subsequent examination has cast doubt on Chancery's opinion of the landed trust.

Not only did the landed trust enable settlors to retain the enjoyment of their property without the burdens of tax,¹²⁰ its use is also somewhat ironic when viewed in light of the trust's original

¹¹¹ Ibid.

¹¹² The remnants of tenure were not extinguished until the late 1600s: See generally the Tenure Abolition Act 1660.

¹¹³ A K R Kiralfy above n 105.

¹¹⁴ FW Maitland above n 1.

¹¹⁵ 1376 50 Edw 5, c.6. See also The Statute of Mortmain 1391 15 Ric 2, c.5.

¹¹⁶ Chancery initially held that the use applies only where feoffs have active duties, or if property was only for a specified terms: See Kent Schenkel, above n 87 at 13.

¹¹⁷ Ibid: A use upon a use consisted in transferring land to A for the use of B to the use of C.

¹¹⁸ Donovan above n 9 at 220: Land was retained in families either by successive life interests in the estate, or by absolute estate.

¹¹⁹ A K R Kiralfy above n 105.

¹²⁰ While may sound like a nice idea to provide for future generations, and certainly this thought would have been at the forefront of many settlors minds, commentators have taken a more cynical view. They note that it is illogical for people to benefit generations so far down that line that they will never even know them. Assert the real reason these trusts were created was tax avoidance: See generally Lawrence Friedman, "Dynastic Trust" (1963-1963) 73 YLJ 574.

purpose to facilitate social mobility. Essentially the landed trust allowed wealthy families to retain a position of status in society by enabling them to own land in perpetuity. The corollary of this was to inhibit social mobility and thus the original use, as a tool of social advancement, was effectively turned on its head. Significantly, so crippling was the use of the landed trust that eventually Chancery was forced to step in, giving rise to the rule against perpetuities.

The development of the landed trust demonstrates that a doctrine governed by intention is inherently as fickle as the human mind. It is for this reason that the trust can be used to advance and hinder both social and economic ends – and importantly, why its implications must be monitored with care.

The investment or trading trust

The emergence of mercantilism in the 16th and 17th marked a turning point for the trust.¹²¹ Rather than being used to passively hold land, the trust was utilised by the capitalist class as a device of investment. This new use of the trust was instrumental in its development, as it was during this period that the trust overtly began to be utilised for individual gain.

In contrast to the landed trust, the increasing weight placed on the individual and financial gain, narrowed the scope of the trust to the nuclear family, and saw its use as a device to invest, rather than to passively hold land. Despite this change in the use of the trust, it remained a tool to be utilised by the affluent, and while this use of the trust could be justified in terms of asset management, it began to raise concerns in the early 20th century due to its use to avoid the law and creditors.

It is interesting to consider whether what the trust had become by this stage in its development, would have been tolerated by Chancery at the time of the doctrine's conception.¹²² Fundamental to the tolerance of the use was the fact that it assisted society as a whole to avoid laws that repressed social and economic development. Had the original use assisted only a small section of society to avoid the law, as it did post feudalism, the very emergence of the doctrine is questionable. If this is so, then why did Chancery continue to uphold it? The answer is relatively simple. By the 1600s the trust was not only very well established, but also incredibly useful by virtue its ability to mould to the needs of the time. Chancery viewed its creature through its various stages of development though 'rose-tinted glasses' as a tool which served the social good of caring unselfishly for others, while providing a practical means of asset management. This fact, coupled with Chancery's focus on correcting breaches of trust, as opposed to identifying their less obvious implications, such as tax avoidance, has served to retain a veil of equity about the doctrine though to the present day. While lingering's of the past have ensured the survival of the trust, they have also concealed its employment for less than genuine ends. At the end of the day, the trust continued as it started, to avoid the law, but it is the laws it avoids that makes all the difference.

¹²¹ David Sugarman and G Rubin "Towards A New History of Law and Material Society in England 1750-1914" in David Sugarman and G Rubin (ed) *Law, Economy and Society 1750-1914: Essays in the History of English Law* (Professional Books Limited, Great Britain, 1983) 1: Mill presented the idea that the state should act in a laissez faire way and endorsed the ideas of negative liberty.

¹²² *Earl of Oxford's Case* 1 Ch. Rep. at 4, per Lord Ellesmer.

As an aside, it is important to keep a balanced perspective of the trusts development. While it is certainly true that it was used to avoid the law, it is equally true that it embodied principles of responsibility and care. A paradigm example is the use of the trust as a device of marriage settlement, enabling married women to benefit from property without it passing automatically to their husbands. These settlements fuelled the development of the well known restraint on anticipation, which was established in response to the concern that married women were vulnerable to the influences of their husbands persuasions.¹²³ And thus, for a time, in nearly every settlement for the benefit to a married woman appeared the words: “for her separate use without the power of anticipation”. In this manner, the restraint on anticipation is similar to the original use in that it served to reform laws no longer reflective of social ideals.

The trust in New Zealand – a continuation of the trend

By the time the trust got to NZ, it was a well-established device of law avoidance. Historically, as in England, it was used exclusively by the upper class, and it was not until the 1950s that the rest of the population began to jump on the bandwagon. Characteristic of future surges in the trusts popularity during the 60s and 70s, this first increase was in response to the implementation of high death and income tax duties.¹²⁴ Similar increases in dispositions to trust have occurred in response to relationship property laws, the most recent being the inclusion of de facto couples into the regime. Given that these incremental increases in the trust over the past 60 years have been related directly to legislative change, New Zealand serves a model example of the trust as an instrument of law avoidance.

During the early period of the trusts development in New Zealand, trust deeds were characterised by provisions restraining settlors from attaining any beneficial interest in a trust. These provisions, while appearing to foster equitable intentions, were nothing more than a means to avoid the Estate Duties Act 1968 which ensnared those settlors who obtained benefit from their own trusts.¹²⁵ Despite clear parliamentary policy regarding the importance of estate duty and provision in the act attempting to curb its avoidance these intentions were defeated by mirror trusts,¹²⁶ precipitated by the Matrimonial Property Act 1963. Spouses or partners would divide their assets under a s 21 agreements and each would create a trust for the benefit of the other. In this manner, the trusts flexibility was effectively utilised to avoid the law. It enabled couples to enjoy the benefit of each other’s assets during the marriage, while paying reduced taxes and avoiding estate duty.¹²⁷

The abolition of estate duty in 1992 saw a pivotal change in the structuring of trusts. No longer constrained by the restriction on common identity between settlors and beneficiaries, mirror

¹²³ Wives were vulnerable to pressure by their husband to divest themselves of their separate property for the husbands benefit. To prevent this, it was necessary to qualify and fetter the gift of the separate estate by prohibiting alienation: See *Fullett v Armstrong* (1839 4 Myl & Cra. 390) at 394. The restraint on anticipation was abolished in 1949.

¹²⁴ WM Patterson “When is a Trust a Trust? A brief history of the express trust in New Zealand” at 1: Trusts were used specifically for the purpose of restricting income in order to avoid placement in higher payment brackets. In 1957 the top rate of taxation was 60% on income over \$7200 per annum. The rate of death duty was 40% on estates valued over \$200,000. The top tax rate increased to 66% during the Muldoon era in the 1970s.

¹²⁵ Estate and Gift Duties Act 1968, ss 11 and 12. See also *Ibid*: “many commentators took the view that the ability to derive even an indirect benefit was too close for comfort and could result in the trust assets being treated as the settlor’s for the purposes of the assessment of death duty”.

¹²⁶ The incentive to settle trust to avoid estate duty applied to all socio-economic brackets: *Some issues with the use of trusts in New Zealand* above n 5 at 9.

¹²⁷ Patterson above n 124 at 3-4.

trusts were replaced by parallel trusts.¹²⁸ These trusts also involved the creation of matching trusts, the difference being that both of the settlors were beneficiaries of each trust.

The saying ‘give them an inch and they’ll take a mile’ accurately denotes the evolution of trust in New Zealand. The corollary of Estate Duty was that it provided a check on the use of the trust as a tool for individual wealth management. Given that the essence of a trust is to provide for others – it is at this point that that the trust began to overtly depart from its essence in New Zealand.

The recent repeal of gift duty is noteworthy, as it “has had a significant impact on trust practice in New Zealand”.¹²⁹ While the Inland Revenue Department was of the opinion that it was unlikely the repeal would encourage tax avoidance, it was inevitable that it would increase the ease with which individuals could dispose of their assets to a trust. In response to concerns that this would spell disaster for creditors, spouses and partners, as well as granting greater opportunity for individuals to take advantage of social assistance policies, Mr Dunn stated that legislation negated these worries.¹³⁰ This statement only serves to draw attention to the fact that the Government is either not fully aware of the extent of the problem with trusts in NZ, or even worse, has simply turned a blind eye.

The type of laws trusts avoid makes all the difference

From this examination of the history of the trust, it is apparent that the trust is and always has been a device of law avoidance. This however is no excuse to take a blasé attitude to law avoidance in the present day.

Feudal laws in the 1300s derived from the ‘divine rights of Kings’, which decreed that the King owned all the lands by virtue of his birthright.¹³¹ Feudalism and tenure, in contrast to the laws of the present day, were not based on any kind of democratic system and were certainly far removed from the views of the majority. Thus, the use was instrumental in eroding a system that was authoritarian and undemocratic.

Today, New Zealand has a representative Parliament. Legislation such as the CSA and the PRA are founded on fundamental societal values and for this reason they deserve respect. The application of the use to these modern day laws is at odds with its original function; no longer does it defend social values, but defeats them. Simply put, it was legitimate for the use to avoid the laws of the past – however its continued ability to avoid the law, in a completely different social and legal context, is questionable.

¹²⁸ Ibid at 4: Parallel trust provided for the deletion of beneficiaries as a precautionary provision, in the event that estate duty was reintroduced.

¹²⁹ *Some issues with the use of trusts in New Zealand* above n 5 at 14-15.

¹³⁰ Hon Peter Dunne, Minister of Revenue “Gift Duty to be Abolished” (Media statement, 1 November 2010)

¹³¹ John Neville Figgis *The Divine Right of Kings* (Cambridge University Press, England, 896) at 22: The Conqueror crystalized the system of tenure in England.

Part two: the trust is not suited to the rigidity of the common law

The danger of a flexible doctrine

Very early on, Chancery recognised that inherent in the trust's defining feature of flexibility was the danger for abuse. Equity however was a very flexible institution in itself, and the trust, being Equity's 'creature', was subject to the controls of equity.¹³² It was this capacity, to mould a decree to the exigencies of a particular case, that was considered one of the "most striking advantages which procedure in chancery enjoys over that at common law, and must have been one of the elements which contributed in no small degree to the growth of equitable jurisprudence".¹³³ Chancery was certainly well equipped to respond to what, in its opinion, were improper uses of the trust as they arose.

While equity, in contrast to the Crown, never saw tax avoidance¹³⁴ as a policy issue, there are instances in the trusts development where Chancery has used the flexible and discretionary attributes of equity to act pragmatically in order to keep the doctrine in check; the rule against perpetuities, the use of the restraint on anticipation as an anti-creditor device, and any use of the trust to avoid agreements.

The rule against Perpetuities

The rule against holding land in perpetuity arose in response to the landed trust of the 1600s. While it was always clear that these trusts removed land from market circulation, this was not seen to be problematic until the 1700s when tension between old wealth, and the new capitalist class who wished to purchase land, reached a head.¹³⁵ Given the flexible nature of equity Chancery was able to resolve this dispute in accordance with the needs of an emerging market economy, which included the flow of property into the hands of those who would put it to its most productive use. As the holding of land in perpetuity placed a clog on this end, the rule in Chancery emerged, albeit over an extended period of time, that this was no longer an acceptable use of the trust.¹³⁶

¹³² Equity was also able to use the trust for what it believed were necessary ends. This resulted in the emergence of the married women's restraint on property. Essentially, the restraint created a new species of estate: *Bagget v Meux* (1849) 1 Phil. 627.

¹³³ George Tucker Bispham *The Principles of Equity* (Banks Law Publishing Company, New York, 1905), at 9.

¹³⁴ While it is unethical to avoid tax, Chancery was primarily concerned with the moral obligations bestowed on the trustee, and with enforcing these obligations according to the deed of settlement. Thus, less attention was given to the inequitable consequences of trusts. See p 15 for a more detailed discussion of why inequitable uses of the trust were tolerated by Chancery.

¹³⁵ Thomas William Heyck *The People of the British Isles: A New History, Volume II* (2nd ed, From 1688-1870, Lyceum Books): See generally Chapter 3, Society and Economy in England 1715-1763.

¹³⁶ *Jee v Audley* (1 Cox, 325) Lord Kenyon, Master of the Rolls: "The limitation on the alienation of a personal estate is void unless the interests vest within a life or lives in being and 21 years... afterwards": See also *Wilkinson v South* (7 Terms Rep 558) confirming this position and *Sabbarton v Sabbarton* (Cas Temp Talb 55, 245): "The law appears now to be settled, that an executor device, either real or personal estate, which must, in the nature of the limitation, vest within twenty-one years after the period of a time in being, is good; and this appears to be the longest period et allowed for the vesting of such estate."

Refusal to extend the married women's restraint and the birth of the discretionary trust

In the early 1800s settlors attempted to extend the restraint on anticipation to act as an anti-creditor device.¹³⁷ This use of the trust was met with disapproval in the landmark case *Brandon v Robinson*,¹³⁸ where Lord Eldon held that equity could not deprive property of its natural consequences, as to do so would be contrary to the very nature of ownership.¹³⁹ In this manner, Chancery acknowledged that the weight placed on a settlor's intention was not unqualified, but was to be balanced against the trusts substantive implications and thus, for a time, the principle that a man could not place property in trust against his creditors was wholly endorsed by Chancery.¹⁴⁰

The irony here was that in denying settlors the use of the restraint on public policy grounds, Lord Eldon unknowingly fuelled, what is today, the ultimate vehicle for getting around the law. Settlor's recognised that if their equitable interest in trust assets could not be immune to creditors, then matters had to be arranged so that what the beneficiary possessed was not property at all.¹⁴¹ This was achieved by granting trustees an *absolute discretion* to make distributions to a trust's beneficiaries.¹⁴² Eventually, this degree of discretion was held to be insufficient to constitute any interest in trust property, and thus settlors were successful in utilising the trust's flexibility to get around what Chancery originally had expressly denied.

To give the Court of Equity its due, it did not at first tolerate the individual's attempts to creditor proof assets. Judges would interpret beneficial interests so as to ensure that they remained the owner in equity, and expressed disapproval of settlors attempting to avoid honouring their obligations.¹⁴³ For example, in *Green v Spicer*,¹⁴⁴ the beneficiary interests appeared to be discretionary: "for the benefit of my son Robert Pinning at such times and in such manner as they shall think proper... it is my wish that the rents and profits for the benefit of my said son be at the *entire discretion* of the said John Spicer and Daniel Robertson." Despite this clear statement, the Master of the Rolls declared that the beneficiary had a vested life interest, thus impliedly rejecting the notion that a man who benefited from property could simultaneously deny his creditors their legal entitlement.

The case of *Higinbotham v Holme*¹⁴⁵ is notable for Chancery's clear stance against the use of trusts as anti-creditor devices, giving force to the principle that trusts perceived to be contrary to public policy, will not be upheld in equity.¹⁴⁶ In this case, Chancery looked forward in time, to hold that the alienation of the settlor's property was at least in part due to his intentions of taking

¹³⁷ See Chapter One, Part one p 16 for brief discussion on the emergence of the restraint.

¹³⁸ *Brandon v Robinson* 34 Eng Rep 379 (1557-1865).

¹³⁹ *Ibid*: Lord Eldon held that such a trust would only be legitimate if the interest terminated on bankruptcy.

¹⁴⁰ *Phipps v Lord Ennismore* 4 Russ 139; See also *Bradley v Pexioto* (1797) 3 Ves; *Ross v Ross* (1819) 1 Jac & W 154; *Cuthbert v Primer* (188) Jac 41 for the principle that settlor cannot attach conditions that contradicted the essential nature of ownership.

¹⁴¹ William Cornish and others, *The Oxford History of the Laws in England XII* (1st ed, Oxford University Press, USA, 2010) at 250 to 252. Professor Stuart Anderson noted that to avoid an unsatisfactory interpretation of a discretionary interest, "trustees had to be given real control, including [a] power to withhold income from the beneficiaries as it was due".

¹⁴² *Twopeny v Peyton* (1840) Sim 250.

¹⁴³ *Graves v Dolphin* (1826) 1 Sim 66 at 67: "the policy of the law does not permit property to be so limited that it shall continue in the enjoyment of the bankrupt, notwithstanding his bankruptcy".

¹⁴⁴ *Green v Spicer* (1830) 1 Russ & M 395.

¹⁴⁵ *Higinbotham v Holme* 19 Ves 88 at 92.

¹⁴⁶ Samantha J Hepburn above n 90 at 323.

up the occupation of a trader. Looking to the substance of the transaction, it was concluded that his express object was to take it outside the reach of bankruptcy laws: “Trusts created by a man protective of himself are considered a fraud on his creditors, even if he was solvent at the time of settlement”.

While chancery’s resistance to the use of the trust as an instrument to avoid creditors persisted for a while, the concurrent systemisation of Equity into the Common law gradually limited the Court’s discretionary approach to the interpretation of the trust. Ultimately this has served to compromise the integrity of the trust instrument, as it was only the innovative and flexible nature of equity, which was able to keep the trust in check.

Systemisation of the common law and equity and its implications for trust law

While equity has always claimed to follow the law, the strict application of this maxim was impossible for a court governed by conscience.¹⁴⁷ The very creation of the use as a doctrine to ameliorate the severity of feudalism, demonstrates that Equity was by no means subservient to the law. The trouble with this inclination for justice however, was unrestricted discretion and unpredictable decision making, hence the often-repeated saying that “Equity is a roguish thing”.¹⁴⁸ A greater desire for commercial certainty in the 16th century caused these concerns to reach a head, thus marking the beginnings of the gradual erosion of conscience as the governing principle in Chancery.¹⁴⁹

The systemisation of equity began in earnest in the early 1800s. Lord Ellsemere and his predecessor Lord Nottingham introduced the previously foreign idea of precedent into equity, while his predecessor Lord Eldon, crystallised the process by converting broad equitable maximums to general rules of application. By the end of Eldon’s retirement in 1827, the rules of equity were as fixed as those of the common law.¹⁵⁰ And thus, the Chancellor was no longer permitted to give justice according to the length of his foot.¹⁵¹

The Judicature Acts of 1873 to 1875 completed the process of systemisation in the 1870s, effectuating the admission of equity and the common law by one court. Given that the 1873 Act stipulated that the rules of equity prevailed where there was a conflict,¹⁵² it remains contentious whether the legislature ever intended equity to merge with the common law.¹⁵³ However, whatever side of the fence one is on, this is exactly what occurred;¹⁵⁴ equity gradually lost its

¹⁴⁷ Ibid, citing St Germain: “In some cases it is necessary to leave the words of the law and follow that which reason and justice requireth”.

¹⁴⁸ John Selden *Table-Talk: Being the Discourses of John Selden, Esq.* 43 (London, E. Smith 1689), at 44.

¹⁴⁹ Gregory S. Alexander “The Dead Hand and the Law of Trusts in the Nineteenth Century” (1984-1985) 37 SLR 1189 at 1209-1210.

¹⁵⁰ John McGhee *Snell’s Equity* (30th ed, Sweet and Maxwell, London, 2000) at 9.

¹⁵¹ *Gee v Pritchard* (1818) 2 Swans 402 at 414.

¹⁵² Judicature Act 1873, s 25(11).

¹⁵³ R P Meagher, W M C Gummow and J R F Lehane *Equity: Doctrines and Remedies* (3rd ed, Butterworths, Sydney, 1992), See generally Chapter 2.

¹⁵⁴ Of interest, Maitland correctly predicted the complete mergence of equity into the law: “The day will come when lawyers will cease to inquire whether a given rule be a rule of equity or a rule of common law: suffice it that it is a well established rule administered by the High Court of Justice”: FW Maitland *Equity: A Course of Lectures* (Cambridge University Press, Cambridge, 1909) at 22. See also *Re National Funds Assurances Co* (1878) 10 Ch. D. 118 at 128; *Re Telecom Syndrate Ltd* [1903] 2 Ch 174 at 195: “It is not for the court to pass judgment upon the personal integrity, good taste or self-respect of the litigants if that it not an issue in determining legal or equitable rights of the litigants. Chancery is not a court of conscience, but a court of law”; *Tinsley v Milligan* [1994] 1 AC 340, Lord Browne-Wilkinson

characteristic of elasticity and, importantly, its ability to control its own doctrines by ensuring justice in the individual case.¹⁵⁵

The statement made in *Tito v Waddell*, that the rules of equity have come to suffer the fate of the rules of law, is very true in NZ.¹⁵⁶ While traditionally the NZ courts respected the substantive differences between the law and equity, this was short lived.¹⁵⁷ Throughout the 1980s, the Judiciary launched an attack on equity in response to growing concern that the application of equity amounted to “tabulated legalism.”¹⁵⁸ Ultimately this concern has resulted in the integration of equitable principles into the common law.¹⁵⁹ While this integration has been praised for its increasing certainty and simplicity in the law, the price was to put a cap on the development of equity in NZ, with the result that today we have a very orthodox application of the law.¹⁶⁰

What have the implications of fusion been for trust law in New Zealand?

Whether or not one believes that fusion was good or bad, in hindsight, its implications on the development of trusts in New Zealand is indisputable. Specifically, as general principles of trust law arose, the court was bound to apply them in subsequent cases; and, while this may have been beneficial from a commercial standpoint – the application of fixed rules to a flexible doctrine was flawed from the outset.

This is particularly true regarding the well-established principle that a beneficiary has no equitable interest in trust property. Interestingly, for the majority of the discretionary trusts existence, discretionary beneficiaries have held a joint equitable interest in trust property.¹⁶¹ It was not until 1968 in *Gartside v IRC*,¹⁶² that Lord Reid rejected this principle on the grounds that it was infeasible to hold that discretionary beneficiaries possessed any interest in trust property, where “you cannot tell what any one of the beneficiaries will receive until the trustees have exercised their discretion”. The idea that discretionary beneficiaries possess nothing but a “mere hope” of benefiting from a discretionary trust was subsequently adopted in New Zealand in the

said that English law was now a single law which was made up of legal and equitable interests; *Napier and Ettrick (Lord) v Hunter* [1993] AC 713 is in accord with this: “No doubt our task nowadays is to see the two strands of authority, at law and in equity, moulded into a coherent whole”.

¹⁵⁵ Aristotle, *Nicomachean Ethics V*, 1137b11-13 (WD Ross trans, 1925), cited in: Aristotle noted that equity was of paramount importance to the system of law because it was able to account for the particular facts of the case. Notably, this notion of Equity was of great influence during Chancery’s development: Eric Zhand above n 173 at 271.

¹⁵⁶ *Tito v Waddell* (No. 2) [1977] Ch. 106 at 256-260.

¹⁵⁷ See generally: *McManaway v Cleland* (1870) 1 NZCA 343 (CA) at 372; *Day v Hammett* (1873) 1 NZ Jur 64 at 65. This belief was based on the fact that the Judicature Act only intended to fuse the administration and procedural aspects of the common law and equity.

¹⁵⁸ *Minister of Home Affairs v Fisher* [1980] AC 319 at 328 (PC), per Lord Wilberforce; *New Zealand Maori Council v Attorney-General* [1987] 1 NZLR 641; *MOT v Noort* [1992] 3 NZLR 260, 268.

¹⁵⁹ See generally, Andrew Butler “Simplicity and Innovation in the Law of Equity and Trusts: The Cooke era” 39 VUWLR 167 (2008-2009). See also: *Aquaculture Corporation v NZ Green Mussel Co.* [1990] 3 NZLR 299 at 301: “For all purposes now material, equity and common law are mingled or merged”

¹⁶⁰ See Meagher, Heydon and Leeming, above n 153 at xi: “In New Zealand, the prospect of any principled development of equitable principle seems remote short of a revolution in the Court of Appeal. The blame is largely attributable to Lord Cooke’s misguided endeavors. That one man could, in a few years, cause such destruction exposes the fragility of contemporary legal systems and the need for vigilant exposure and rooting out of error.”

¹⁶¹ The rationale for this principle was that because a discretionary trust imposes equitable obligations on a trustee, it followed that equitable title to the property was vested in the class of potential beneficiaries as a whole: See *Re v Smith* [1928] Ch 915. See also *Re Nelson* [1928] Ch 920n: the principle for a class of beneficiaries was to “treat all the people put together just as though they form one person.”

¹⁶² *Gartside v IRC* above n 10: Interestingly, this case concerned liability for tax, thus raising the question of whether it was tax that drove the issues, not some conceptual formulation of what a discretionary trust was.

case of *Hunt v Mullo*,¹⁶³ and was seized upon with the demise of estate duty to facilitate the evolution of the trust into a device for the pursuance of individual gain. The strict application of this principle to this day, when coupled with a trusts 'irreducible core', which has prevented the New Zealand judicial from looking to substance over form,¹⁶⁴ is, in the author's opinion, the root of problem with trusts in New Zealand.¹⁶⁵ Unfortunately, this has been at the expense of legislative policy, the wider community, and the integrity of the trust doctrine itself.

Had the body of rules governing trusts remained flexible, what the trust has become today would have been curbed long ago. Part one of this chapter reached the conclusion that it was questionable whether the trust of the 17th and 18th centuries, characterised by assistance to only a small section of society, would have withstood the scrutiny of Chancery, had the use first emerged in this form.¹⁶⁶ In contrast, it is indisputable that what the trust has become today in New Zealand would have little support in an equitable jurisdiction.

The majority of trust today are characterised by settlor control for the benefit of themselves and, as discussed, Chancery held a poor opinion of the individuals who created trust protective of themselves, in part because this was contrary to the very essence of a trust, to hold property for the benefit of another and in part because equity would not have permitted the trust to be used as an instrument of fraud.¹⁶⁷ Specifically, equity protected the deserving creditor from the implication of a trust because equity looked to the realities of the transaction, over its mere formalities, and thus was able to ensure that trusts were not used to defeat voluntary obligations. With regard to legislative obligations, such as those under the PRA and CSA, these would most certainly be vulnerable to the scrutiny of the court, as they have been in other jurisdictions such as Australia in *Kennon v Spry*,¹⁶⁸ as equity was a jurisdiction associated with justice and fairness, and it would be against the conscience of a court of equity to enforce a trust in circumstance where it has the effect of promoting immoral behaviour.¹⁶⁹ This fundamental sentiment of Chancery, would of course also limit the use of the trust as a device to obtain government subsidies by undeserving applicants.

In applying an equitable lens to the modern day discretionary trust, it is apparent that the doctrine far removed whence it came. This division of the trust from conscience however is not surprising in light of its incompatibility with a black and white application of the law. The result is that today the trust can be used for dishonest ends. Indeed, the doctrine is an enigma; not only because it can facilitate both good and bad, but because its flexibility has been both its defining attribute, and its downfall.

¹⁶³ *Hunt v Muollo* above n 10 at 325: Discretionary beneficiaries possess "no more than a mere expectancy. It is simply an expectation or hope...that the trustee's discretion may be exercised in the beneficiary's favour"

¹⁶⁴ *Armitage v Nurse* [1998] Ch 241 (CA): the irreducible core is the "...minimum necessary to give substance to the trust" and includes the duty of a trustee to manage the trust in good faith for the interest of the beneficiaries. Due to the existence of this duty, mere control on the part of a trustee is not sufficient to render a trust invalid. See for a more thorough discussion of analysis in accordance with this

¹⁶⁵ *Nation v Nation* above n 46.

¹⁶⁶ See Chapter 1, p 116.

¹⁶⁷ See *Brandon v Robinson* (add in above cases).

¹⁶⁸ *Kennon v Spry* above n 8: The High Court held that the assets of a family trust established before marriage could be taken into account in property settlement orders under the Family Law Act 1975. The majority held that without the 1998 variation and the 2002 dispositions, Mrs Spry would have had a right to consideration as a beneficiary, and that Dr Spry would have had a power to appoint to her the whole of the assets of the trust. The Court held that in substance these rights were property of the parties to the marriage.

¹⁶⁹ *Samantha J Hepburn* above n 90 at 323.

CHAPTER THREE

A comparison of New Zealand and American Trust Law

In challenging the doctrine of the trust in New Zealand, a comparative assessment with America is useful, as the American Judiciary has preserved discretion in the law governing trusts. Indeed, to the author's knowledge, America is the only country that truly applies the equitable principle that a settlor's wishes shall only be followed to the extent that they do not contravene the law or public policy.¹⁷⁰ The purpose of this chapter is to demonstrate the important role this fundamental principle has played in ensuring that trusts do not perpetuate undesirable social consequences.

Discretion is inseparable from public policy as it requires careful contemplation of what the relevant public policies are to the matter in question, and secondly a reasoned determination of the policy that should prevail. By adhering to this process to control the trust, the general rule has emerged in America that individuals cannot settle property on trust for themselves.¹⁷¹ Before discussing the foundations of this rule in more detail, it is first necessary to place the discretionary approach of the American judiciary to the trust in context.

Historically, the application of equity and the common law in America has followed a very different path to England and New Zealand. In the United States, equity avoided the gradual erosion suffered by its counterpart in Chancery, as it was already a well-established jurisdiction in the colonies prior to the era of systemisation and jurisdictional reform. Despite this, equity was not unanimously accepted in America until the Constitution affirmed that judicial powers, in all cases, extended to equity.¹⁷² Aristotle's writings on equity were "tremendously important" in the development of Anglo-American law.¹⁷³ For Aristotle, a central feature of the law was that it accounts for the particular facts of a case by adapting in order to rectify any deficiencies of the law that may result from its universality. In relation to trusts, this view of the law is very apparent – as judges have created exceptions to rules of general application in order to ensure the trust is not used to violate, what Aristotle termed "practical intelligence".¹⁷⁴

The foundation of the rule against self-settled trusts – a matter of policy

The rule against self-settled trusts in America originated in the context of spendthrift trusts, which while rejected in England, were held to be legitimate in America due to the importance of a settlor's freedom to deal with property as they pleased.¹⁷⁵ While individual freedom has always

¹⁷⁰ Ibid.

¹⁷¹ Restatement (Third) of Trusts (2003).

¹⁷² Further developments on a previous symposia: the application of universal law to particular Cases Eric Zhand "A Defence of Equity in Aristotelianism and Anglo-American Law" 59 Law and Contemporary Problems 263 at 264: prior to this point, equity was regarded in some colonies with suspicion due to its association with arbitrary decision-making.

¹⁷³ Aristotle's concept of the law was quoted in judgment up until the late 1900s: *Commissioner v Beck's Estate* 129 F.2d 243, 245 n.4 (2d Cir. 1942); *Simonds v Simonds* 380 NE2d 189, 192 (NY 1978). Aristotle was very influential on the early development of equity in America.

¹⁷⁴ Eric Zhand, above 172 at 268: For Aristotle, central to the idea of equity was practical intelligence; a state of grasping the truth by involving reason, and establishing what is good and what is bad for human beings.

¹⁷⁵ See *Nichols v Eaton* US 716 (1875): held that if someone wishes to create provisions entirely protective of others, they should be able to do so. The weight of authority in America is supportive of this proposition. See also *Broadway v National Bank v Adams* 133 Mass 170 (1882): The settlor was the absolute owner of property, and his directions should be followed unless they are contrary to public policy.

been a very important policy consideration in America, it has been subject to reason. And thus, when settlors attempted to create trusts protective of themselves, the freedom of donors was fettered by much stronger and more compelling public policies.¹⁷⁶

The most influential public policy against self settled trust and applicable across the board, is that “a man should not be allowed the continued enjoyment of property without satisfying the claims of the people he injured”.¹⁷⁷ Additional policies have been identified in the particular, specifically; implied agreements, creditor contracts and tort law.

Implied Agreements

Implied consent agreements include those associated with legislative obligations that reflect socially recognised moral responsibilities. In New Zealand, both the PRA and the CSA would fall into this category. The majority of States in America recognise that a settlor’s wishes cannot defeat implied consent agreements for policy reasons.

*Sullivan v Burkin*¹⁷⁸ provides a good example, as it is concerned not with a spendthrift trust, but a discretionary one. As in New Zealand, the orthodox position that discretionary beneficiaries have no interest in trust property is applicable in America.¹⁷⁹ However, the court did not adhere blindly to the legal realities of ownership, but looked to the reality of the situation; the discretionary beneficiary of the trust was able to direct dispositions to themselves. Consequently, the trust not only violated the policy that one cannot benefit from property while simultaneously avoiding statutory obligations, but also relationship property policy in Massachusetts. Thus, the court looked though the trust to enforce the claimant’s relationship property rights.

This reasoning is comparable to recent cases in New Zealand, where the judiciary has challenged trusts where settlors have retained effective control over trust property. In *Harrison v Harrison* for example Fogarty J considered that by virtue of the powers retained by the settlors, there was no trust; it was merely ‘illusory’. Specifically, as in *Sullivan*, the husband and wife had the ability at any time to vest the entire trust assets to themselves, and thus in substance they were the owners of the property.¹⁸⁰ Commentators were quick to pick this reasoning apart on the ground that control is immaterial because it overlooks the fact that a trustee (here, a trustee company controlled by the settlor) has a fiduciary duty to act in good faith for the best interest of the trust’s beneficiaries.¹⁸¹ The leave application of the Court of Appeal also suggests that it would have overruled Fogarty J’s decision as the “legal structures which the parties have mutually created *must* be the starting point for an assessment of what property is available for distribution... in relationship property proceedings”.¹⁸² This statement reflects that of the Court of Appeals earlier assertion in *Wilson*, that they will be slow to go behind formal trust documentation”.

¹⁷⁶ *Nelson v. California Trust Co* 202 P.2d 1021, 1021-22 (Cal. 1949); *Windram*, 133 Mass at 176-77; In *re Mogridge's Estate* 20 A.2d 307, 309 (Pa. 1941); *Glass* 330 S.W.2d at 534; Restatement (Second) of Trusts s 156 (1959).

¹⁷⁷ Jeremy Veit “Self-settled Spendthrift Trusts and the Alaska Trust Act: Has Alaska Moved Offshore?” (1999) 16 ALR 269; See also *Buchbinder v Bank of America* 30 SW 3d 707 (Ark. 2000); *United States v Murra*, 217 F. 3d 39 1st (iv. 2000); *Tilcon Capaldi, Inc v Feldman*, 249. 3d s4 (1st Cir. 2001); *In re Brown*, 303 F. 3d 1261 (11th Gr. 2002); *Re Cattafi* 237 B.R 853 (Banker M. D. Fla. 1999).

¹⁷⁸ *Sullivan v Burkin*, 406 N.E.26 572 (Mass. 1984)

¹⁷⁹ *Leigh v Hamilton*, 69 Miss. 923. 1150. 604 (1892); *First Northwestern Trust Co. of South Dakota v. Internal Revenue Service*, 622 F.2d 387 (8th Cir. 1980)

¹⁸⁰ *Harrison v Harrison* above n 66 at [26].

¹⁸¹ The duty of the trustees to perform the trusts honestly and in good faith is owed to all discretionary beneficiaries: *Armitage v Nurse* [1998] Ch 241.

¹⁸² *Harrison v Harrison* above n 66 at [22].

Criticisms such as these again highlight how truly devoid trust law has become from equity. *Harrison* provides a very good example of a judge attempting to apply “practical intelligence”, that is, an examination of the particulars of a case to ensure that the application of a universal rule does not lead to an illogical conclusion. In *Harrison*, the “illogical conclusion” would be a situation where the settlor is able to continue to enjoy the benefits of wealth, without its responsibilities. Such a conclusion, while looked upon with incredulity in a system which has not lost touch with its equitable roots, is not only perfectly acceptable in New Zealand,¹⁸³ but is true of a very large number trust structures.

The ‘illusory’ trust having been deemed untenable, Fogarty J attempted again to inject some sense into New Zealand law. *B v X*¹⁸⁴ concerned the determination of a father’s income for child support, which was distorted by the existence of a trust. The father was a settlor-beneficiary and held an unfettered power of appointment with regards to distributions of income or capital. Consequently, the trust did not impair him in any way from using trust assets for his own benefit. Fogarty J utilised the equitable maxim that “Equity looks beneath the surface” to hold that in practice, the father did not owe any fiduciary obligations to the beneficiaries.¹⁸⁵

Given that this reasoning was not all that different from the illusory trust – it was discredited for ignoring the other trust beneficiaries and the rights they have against the trustee to hold him accountable. Again, applying “practical intelligence”, this criticism does not take account the unlikelihood that a child beneficiary would enforce a trust against their father, and fits awkwardly with the law.¹⁸⁶ If discretionary beneficiaries have only a “mere hope” of benefiting from a trust, thus possessing no interest in trust property, what have they really lost in the event that trust property is used to fulfil the ‘controlling’ beneficiaries legal obligations? In the context of debt payments barred by a trust, this argument is even more compelling given that essentially the competing interests are between a mere volunteer and a legally deserving creditor. It has, and remains an important principle in equity that legal interests prevail over volunteers. For these reasons, American courts have not been impressed with the argument that looking to substance denies other discretionary beneficiaries their rights. In short, they are too limited to warrant consideration.¹⁸⁷

Creditors

The policy relevant to the protection of creditors against trusts in American rests on the age-old view, that self-protective trusts against current or future creditors are not an appropriate uses of the doctrine. Indeed, as far back as 15th century England, “all deeds of gifts and chattels made or to be made to trust to the use of that person, [were] void”.¹⁸⁸

Influenced by this rule, the policies that agreements entered into expressly must be honoured and that all the property of a debtor, including property in substance must be available for the

¹⁸³ See for example *Harrison v Harrison* [2009] NZCA 68, where William Young J overruled Justice Fogarty’s attempts to look though a trust where the father as a discretionary beneficiary has effective control of the assets.

¹⁸⁴ *B v X* [2011] 2 NZLR 405 (HC)

¹⁸⁵ While Fogarty J’s reasoning was suspect with regard to his assertion that the father owed no fiduciary duties, this does not detract from the point that in substance he could be treated as the owner of the trusts assets.

¹⁸⁶ This statement applies to the facts of this case. Many adult children do enforce trusts against their parent-trustees.

¹⁸⁷ *Vanderbilt Credit Corp v Chace Manhattan Bank* 473 NYS 2d 242 (NY. App. Div. 1984).

¹⁸⁸ 3 Henry. VII, C 4. 1487

payment of debts, are applicable in America when a trust bars a creditor from the collection of debts.¹⁸⁹ These policies allow the court to look through trusts created by individuals protective of themselves, and to order trustees to pay the creditor the maximum amount which they *could* pay to the beneficiary, even though the beneficiary could not compel the trustees to do so.¹⁹⁰ It is immaterial in creating the trust that the settlor had no intention to defeat his creditors – policy alone is paramount.¹⁹¹

Contradictory to this position, New Zealand seems to have forgotten about basic concepts of fairness and honesty. Policy does not enter the equation when a creditor is faced with a trust, leaving creditors to grapple with evidence suggestive of a sham or fraudulent intention.¹⁹² In the absence of these intentions, traditional precedent asserting that the “mere expectancy” discretionary beneficiaries hold, is insufficient to amount to an interest in trust property, precludes the judiciary from examining cases in substance.

In *Isolare Investments v Featherston*,¹⁹³ Justice Williams questioned the bases of this rule in a modern day context. Perhaps in order to avoid untoward criticism, he impliedly, rather than explicitly, drew attention to the fact that the structuring of trusts has come a long way from the time of *Gartside* and *Hunt v Mullo*. A much greater degree of control is vested in trustees compared to the past, and common identity between settlors, beneficiaries and trustees is now routine. Despite these changes, trust law in New Zealand has remained stagnant, continuing to apply traditional rules – which often result in anomalies. The Featherston’s trust deed provides a classic example. Mr and Mrs Featherston were the settlors, beneficiaries and trustees of their family trust. The deed went so far as to *require* Mr and Mrs Featherston (as trustees) to favour themselves (as beneficiaries) over their children’s discretionary interests.¹⁹⁴ Thus, they certainly had more than a “mere hope” of benefiting from the trust’s property, yet their creditors were left remediless.

In light of cases such as this, whether the traditional position survives “remains to be seen”.¹⁹⁵ Certainly, its continuance, in the words of George Bogart, gives “opportunity for unscrupulous people to hide their property in trust, before engaging in speculative business enterprises”.¹⁹⁶ Whether or not the business New Zealanders engage in is speculative or not, it remains true that we are promoting a culture where it is considered legitimate to dodge agreements and the law.

Tort claims

Lastly, both discretionary and spendthrift trusts in America are vulnerable to claims in tort. Here, the absence of policy based on expressly or impliedly consenting to obligations does not

¹⁸⁹ *First National Bank v First Cadco Corp* (1973) 189 Neb 734 at 738: “It is uniformly held to be against public policy to permit a person to tie up his own property in such a way that he can still enjoy it but can prevent his creditors from reaching it.” Here, the court held that when a trust with spendthrift provisions terminated and the beneficiary had the right to demand distribution from the trustee, “a construction which would allow the spendthrift protection to continue after the termination of the trust when the beneficiary had the right to demand delivery would, in effect, allow her to establish a spendthrift trust for herself”.

¹⁹⁰ *Vanderbilt Credit Corp* above n 187.

¹⁹¹ *Colorado: In Re Cohen* 8 P 3d 439 (Colo, 1999).

¹⁹² See *Regal Casting*, applying s 326 of the Property Law Act.

¹⁹³ *Isolare Investment Ltd v Featherston* [2006] BCL 932

¹⁹⁴ At [52].

¹⁹⁵ *Ibid* at [51]

¹⁹⁶ See George G Bogert and George T Bogert *Law of Trusts* (5th ed, 1973) at 177, cited in Jeremy Veit above n 177 at 274.

legitimise trusts which bar the claims of tort victims. The policy that one cannot continue to benefit from property, without compensating those he or she injured is applicable,¹⁹⁷ as is the policy that these trust undermine the deterrent effect of civil liability.¹⁹⁸

Trusts that protect against tort liability are very common in New Zealand, and have helped to fuel a culture whereby it is acceptable to make one's self 'judgement proof'. The result is that individuals are able to engage in commerce without having to worry about their personal liability, thus limiting incentive to take care. While immunity from the civil justice system is, quite obviously, not desirable, the relevant policies are more difficult to apply to partnerships.

In partnerships, because partners are jointly and severally liable, it is considered a rationale and legitimate use of the trust to protect individual or family assets, which may be lost due to the blunder of another. This fact alone suggests that the rule pertaining to joint and several liability is out-dated. If the rule was repealed, the legitimacy surrounding the use of trusts in partnerships would be negated which could resolve the current conflict between the rational protection of assets and the tort victim's rights.¹⁹⁹

Incorporation of practical intelligence into the Restatement of Trust Law

The judiciary's equitable application of trust law in America is reflected in federal legislation. The judicially established policy, that one should not be able to enjoy the benefits of property without its burdens, has manifested itself in America's Restatement of Trusts. Specifically, the following provisions place limits on the uses of trusts in America:

1. *Section 58*:²⁰⁰ Reflective of the policy that one should honour their agreements; both self-settled discretionary and spendthrift trusts are permanently subject to the claims of creditors.
2. *Section 60*:²⁰¹ Where a person creates a trust for their own support, or a discretionary trust for their own benefit, their transferee or creditors can reach the maximum amount that the trustee under the terms of the trust *could* pay or apply to them for their benefit.²⁰² Here, the trustee-beneficiaries rights represent a limited form of ownership.²⁰³ The policy behind this rule is so strong that it disregards the interests of other beneficiaries, and grants creditors greater rights than the settlor themselves in terms of compelling distributions.²⁰⁴

¹⁹⁷ Greer "The Alaska Dynasty Trust" (2001) 19 ALR 253 at 272.

¹⁹⁸ See generally, Lynn M Lopucki, The Death of Liability, 106 Yale LJ. 1. 14-38 (1996).

¹⁹⁹ This is merely a suggestion. The author has insufficient knowledge in the area of partnership law to make any definite comments.

²⁰⁰ Restatement (Third) of Trust Law (Tentative Draft No. 2). It is worth noting that there are numerous "tentative drafts" of the Restatement (Third) of Trust Law. These drafts have been approved up to "tentative draft no. 6", which was approved in 2011.

²⁰¹ Restatement (Third) of Trusts (Tentative Draft No. 3)

²⁰² Notably, this rule has been overridden in 12 states that have enacted legislation stating the legitimacy of self-settled asset protection trusts. These provisions have raised much concern in America and have been subject to substantial critique and discussion: See generally David Shaftel "Comparison of the Twelve Domestic Asset Protection Statutes" (2009) 34 ACTECJ 293.

²⁰³ Comment (b) of the Restatement (Third) of Trusts: this essentially disregards a trustee-beneficiaries fiduciary position and treats the beneficiary as if were the settlor of the trust and disregards any remainder beneficiaries. See also Greer above n 197 at 272.

²⁰⁴ Danforth "Rethinking the Law of Creditors' Rights in Trusts" (2002) 53 Hastings LJ 287 at 293-295.

3. *Section 59(a)*: “[t]he interest of a beneficiary in a valid spendthrift trust can be reached in satisfaction of an enforceable claim against the beneficiary for support of a child, spouse, or former spouse.”²⁰⁵
4. *Section 153(2)*: A beneficiary’s control places a limitation on protective trust provisions. Whether or not the beneficiary was also the settlor of the trust; the relevant policy being that if a beneficiary has free access to trust assets, then creditors may claim no lesser rights.²⁰⁶
5. *Section 27(2)*:²⁰⁷ “A private trusts, its terms, and its administration must be for the benefits of its beneficiaries”. This serves to limit the control a settlor is entitled to over a trust.

In terms of discretionary trusts, these rules effectively disregard the general law that discretionary beneficiaries have no interest in trusts, because to follow this legal fiction strictly would compromise the integrity of trust law.

Trust law in New Zealand has lost touch with practical intelligence

To summarise, orthodox trust law in New Zealand asserts that a discretionary beneficiary has no interest in trust property, and to hold otherwise would be to disregard the formal legal duties placed on the trustees. This conception of trust law is so ingrained in the minds of commentators, the judiciary and the legislature, that it has become very difficult to think outside of the box in terms of applying these general laws to the particular facts of the case.

At Provided that the three certainties of trust; intention, subject matter and objects, are established a trust exists and is robust to intervention in the absence of applicable trust busting legislative provisions.²⁰⁸ To look to the substance of a transaction is widely considered to be a perverse intrusion on the well-established law of trust, and where judges have turned their minds to solutions ‘outside of the box’, they have quickly been discredited by a supposedly more logical application of the law. However, if one considers the ‘New Zealand approach’ to trusts in light of “practical intelligence”, that is the ability of a judiciary to mould general laws to the particular facts of a case, the logic of this approach becomes unconvincing. How can one deem logical the situation whereby the only thing that stands between a claimant and redress, or a settlor’s ability to attain welfare assistance, is a piece of paper that denotes complete control of trust assets to the former owner.²⁰⁹ Yes – this piece of paper imputes ‘duties’ on a trustee,²¹⁰ but should we really be focusing on this rule to the degree that it pulls us into what Schenkel terms, “a false comfort of logical coherence”?²¹¹

²⁰⁵ Restatement (Third) of Trusts, s 59: This is a carry over from the Restatement (Second) of Trusts, s156 (1971), which provided that where a person creates for his own benefit a trust for support or a discretionary trust, his transferee or creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit.

²⁰⁶ Restatement (Second) of Trusts (1959), s 153(2).

²⁰⁷ Restatement (Third) of Trusts, s 27(2); See also Thomas Gallanis “The New Direction of American Trust Law” (2011) 97 ILR 215, for a more thorough discussion of settlor control in America.

²⁰⁸ Note that a sham does not invalidate a trust – but is a finding that there never was one in the absence of the request intention to create a trust.

²⁰⁹ This reasoning applies where any discretionary beneficiary (including non-settlors) has substantive control over trust assets.

²¹⁰ The strict application of a trustee’s obligations to beneficiaries is a large part of the problem with trusts in New Zealand: See Chapter Two, p 21 for a more in depth discussion.

²¹¹ Schenkel above n 87 at 29: “A formal approach to the legal interpretation of trusts informed by the title-split fiction... leads to a false logic of coherence”.

The law is primarily about justice, and justice consists in the careful balancing of universally applicable laws and judicial discretion. Currently, the common law and legislation governing trusts in New Zealand sits firmly on the certainty and stability side of the fence. Faithful adherence to this “logical extreme” however is only serving to undermine the integrity of trust law. This danger would be equally true in a wholly discretionary system, for it is only when these two logical extremes work in conjunction with one another that practical intelligence is achieved.

The absence of practical intelligence from trust law in New Zealand is particularly worrying as judicial norms inevitably have a flow through effect on statutory law and solutions.²¹² In light of this, it is not surprising that the Law Commissions “Preferred Approach” makes little inroads into the issue of injustices facilitated by trusts, because they are attempting to ‘fix’ trusts based on orthodox principles of the law, which are, in actuality, the very crux of the problem in the first place.²¹³

In contrast, America has a much better balance between general principle and judicial discretion. This is due to the fact that Anglo-America, though to the present day has a “tendency to seek extra-legal attainment of just results in [individual cases], while preserving the form of the law”.²¹⁴ This statement is practical intelligence in a nutshell and in the author’s opinion, trust law in New Zealand could do with a heavy dose.

CHAPTER FOUR

Overview of the problem

Thus far, this paper has been concerned with identifying why trusts in New Zealand are legitimately able to serve less than honest ends by avoiding the law and social policy. In examining the origins of the doctrine, and comparing modern day trust law in New Zealand to America, it is clear that the problem resides *within* New Zealand’s trust law, as a result of its rigid application. The consequence of this is that trusts can afford the situation where a person may have recourse to substantial assets but can avoid their obligations, or attain government welfare subsidies. While the government and commentators may call this use of the trust legitimate, to the onlooker it is devoid from reason.²¹⁵

The question remains as to how these uses of the discretionary trust can best be eradicated in order to disconnect the doctrine from its present association with dishonesty. In the author’s opinion, such a solution is essential to preserve the integrity of trust law. Before turning to solutions however, it is first necessary to briefly examine the Law Commissions response to the problems associated with discretionary trusts; and to clarify how the solutions proposed by this paper will fit in with the Commissions proposals for reform.

²¹² Ibid.

²¹³ *Preferred Approach* above n 6 at 5: The Commission purports to reform trust law by clarifying the existing law.

²¹⁴ Roscoe Pound *Jurisprudence* (Minn. West Publishing Co, Minnesota, 1959) at 14.

²¹⁵ In the author’s opinion, reason is something with which the law should always be primarily concerned.

The Law Commission's 'Preferred Approach' will not solve the problem

The Law Commission's Second Issues Paper was the first comprehensive summary of the instances where discretionary trusts defeat legislative policy in New Zealand. In response to this problem, the tentative suggestion was made that broad statutory controls over trusts may provide a solution. This idea however was dismissed, as the Commission turned down its premise: that the conflict between trusts and legislative policy is a problem fundamental to trust law.²¹⁶ Rather the Commission has decided that the ability of trusts to contravene the law is an issue to be resolved in respective legislative domains. Consistent with this view, the Commission's "Preferred Approach" does not purport to overhaul the uses of trusts, but simply to clarify and confirm the pre-existing law,²¹⁷ in particular the relationship between trustees and beneficiaries.

While a clarification of a trustee's duties is necessary, given the finding that many trustees in New Zealand are unaware of the extent of their obligations to trust beneficiaries, it will not prevent the use of trust for dishonest ends because these uses rely on the very propositions of law, which the Commission purports to codify. Specifically, the "irreducible core" of a trust, imposing obligations of good faith upon a trustee towards beneficiaries, has been the primary obstacle standing between the anomalies which discretionary trusts afford and a more practical application of the law. And thus, the Commission has placed an aspect of the problem in the solution. This is not to say that the Law Commission's suggestions will be wholly ineffective, it simply draws attention to the fact that they are directed at entirely different problem within trust law, that is ignorance, rather than the injustices currently afforded by trusts in New Zealand. In leaving this latter problem to 'respective policy areas' the Commission has left the problem hanging.

Solutions

The solutions in this paper do not purport to discredit any of the Law Commission's suggestions for reform, as they are not concerned with a breach of trust, whether the three certainties of trust exist, or sham law. Rather, they are aimed purely at preventing the use of trusts for dishonest ends.

The view of the Law Commission was that general controls on the use of trusts would be necessary if the injustice they afford is a problem inherent to trust law. As this paper has argued that this is so by virtue of the doctrine's association with dishonesty, enabled by an orthodox application of the law, the solution must be located within trust law yet go beyond what is presently familiar.

The suggestion that the solution must lie 'outside the box', is not so innovative in light of the history of trusts, as fundamental to their very nature their adaptation to the needs of a constantly shifting society. Over the past seven centuries, trusts have been instrumental in facilitating social

²¹⁶ *Preferred Approach* above n 6 at 5: The Law Commission did consider where the "interaction between trusts and other area of the law is creating any pressure points that can and should be addressed within Trusts Law", however "Only where interactions of trust law and another area of the law [create] problems with fundamental trust law [are] reform measures... warranted".

²¹⁷ *Ibid* at 35.

reform, used with the very best of intentions to care for ones family and as a useful device of investment, yet at the same time have been taken advantage of for less honourable purposes. There is nothing to say that the law of trusts that we have now should remain set in stone. If integral to the nature of the trust is its ability to mould to the contemporary, then the solution should be focused on shaping trust law to reflect not only economic need, but the values of New Zealand society. In the author's opinion, it is indisputable that honesty is a core value in New Zealand, and thus, the remainder of this chapter discusses possible solutions to bring trust law back in line with this ideal. Broadly, two options shall be discussed: judicial and legislative intervention.

Judicial Intervention – a more equitable examination of trusts

If the loss of practical intelligence is the root of the problem, this suggests that the solution lies in reintroducing the concept into trust law, which would effectively bring trusts full circle back to their equitable roots. As the American judiciary is the only jurisdiction that has retained a degree of discretion comparable to Chancery, they provide a modern day model of how equity interacts with trusts in the present day. As discussed, judicial reasoning in America that has placed restraints on the use of the trust stems from the principle that a trust cannot contravene public policy.

It is at this point that this solution faces its first hurdle; the New Zealand Courts are strangers to policy in trust law. On the few occasions where the court has felt bold enough to look through a trust in the absence of legislative permission, effective control has been the only expressly relevant justification for doing so.²¹⁸ Returning to *Harrison v Harrison*²¹⁹ and *B v X*,²²⁰ Justice Fogarty never stated *why* he felt compelled to disregard the trusts, but rather proceeded directly to invalidate them on the ground that the settlors' possessed substantial authority over dispositions of trust property. Of course, it can be assumed that he did so because he felt that it was wrong for the trusts to defeat the respective legislative policies, however this does not change the position that policy has never been a ground for decision making in New Zealand trust law. Historically, the American judiciary has done things in the reverse to New Zealand, looking first at policy then control;²²¹ and thus trusts were looked through whenever they overstepped the mark of what was a socially acceptable use of the doctrine. Given the importance placed in New Zealand on certainty, it is unlikely that this degree of discretion would be tolerated.

However, the New Zealand judiciary would have no need to enter the uncertain realm of public policy as the "domination and control" test, with which the New Zealand courts are more familiar, is just a simpler way of expressing the paramount policy in America that a beneficiary cannot circumvent their obligations while simultaneously enjoying access to trust assets.²²² "Obligations" in the New Zealand context would include for example the avoidance of creditors, evasion of tax, and legal duties under the PRA and the CSA.

²¹⁸ See Chapter One, p 8: Alter egos, illusory trusts and the bundle of rights all rely primarily on control.

²¹⁹ *Harrison* above n 66 at [26].

²²⁰ *B v X* above n 184.

²²¹ See generally: *Sullivan* above n 178.

²²² *In re Boon*, 108 BR 697, 708 n.19 (W.D. Mo. 1989).

Would looking to the substance of the transaction remedy the problem in New Zealand?

As discussed, equity does not shy away from looking through the legal fictions created by a discretionary trust, because equity acts when a universal law falls short of achieving justice due to its universality.

As the problems with discretionary trusts arise where discretionary beneficiaries enjoy the benefits of property, to the degree that there may as well be no trust, the question for the judiciary would be to determine *when in substance a discretionary beneficiary enjoys control over trust property?* This question would be applicable to cases where obligations were avoided, or underserving government aid was attained, by virtue of a trust. As in America, a determination of substantive ownership would allow the court to look through the trust in that particular instance.

This solution would ameliorate the current association of dispositions to trust with dishonesty, because they would be ineffective where used as a device for individual gain. Fundamentally, this would not only preserve the integrity of trusts in New Zealand, but would serve to return family trusts to their essence, to hold property for the benefit of others.

While this solution would go a long way to resolving the problem with discretionary trusts, it is deficient for two reasons. First, giving the judiciary discretionary power to review the substance of trusts would create great uncertainty for trustees, as until case law evolved, they would be unaware of what conduct was indicative of substantial control on the part of a discretionary beneficiary. This would prove unacceptable due to the popularity of trusts in the commercial context.

Secondly, the very idea that the judiciary could hold in its hands the ability to look through a trust on the grounds that there was ownership in substance, even in the absence of a policy examination, would grant the judiciary considerable discretion. What exactly would be effective control? Clearly it would include the situation in *Harrison* where a settlor had the ability at any time to transfer capital or income to himself. But, what about the settlor-beneficiary with more limited powers of control, for example the power of appointment over trustees? Leaving this line for the judiciary to draw would throw trust law into uncertainty.

The only reason such a high degree of discretion works in America is because the judiciary has over one hundred years of jurisprudence establishing the boundaries of the doctrine, based on public policy. New Zealand in contrast has relatively limited trust jurisprudence,²²³ and the courts have long walked the path of certainty and solidarity. While the author is sure that this would not prevent a select few from jumping at the opportunity to look to substance over form; the judiciary, in the author's opinion, is too far down this path to make a complete turn around. The very suggestion that a trust's fortress could be invalidated, by what to many would be seen as 'judicial whim' would be met with strong opposition. This is especially so given that thousands of trusts in New Zealand serve commercial purposes, and because the adverse economic impacts of this solution would prove troublesome.

²²³ Preferred approach above n 5 at 8.

The solution must be realistic. While introducing practical intelligence into the law may sound appealing to achieve ‘justice in the individual case’, it is not feasible given the current judicial climate and the role trusts play in the economy.

Legislative intervention

It has already been established that if trust law is inherently flawed, the solution must reside within trust law, rather than the respective policy areas with which trusts interact. A general application of the solution is important as, to reiterate, the problem goes further than defeating respective legislative policy, to that of the fundamental policy that one should not avoid the benefits of property while avoiding statutory obligations. For this reason, it is suggested that the guidelines be enacted in the Trustee Act. Legislative provisions in respective policy areas would act as ‘fall-backs’ in the event a trust was not being used as a tool for individual gain.

Given that it would not be acceptable to grant the judiciary a total discretion to determine what constitutes ownership in substance, legislative qualification is necessary. In answering this question, two options shall be discussed:

1. Adoption of s 60 of the Restatement of Trust Law. This would enable the court to ‘look through’ a trust whenever a settlor was also a discretionary beneficiary.
2. Principles to guide the court in finding that an individual in substance enjoyed the benefits of a trust.

Adoption of s 60 from the Restatement of Trust Law

The easy option would be to follow America’s Restatement of Trusts to render vulnerable *all* trusts where there is common identity between a settlor and beneficiary. This solution both goes too far, and not far enough.

It goes too far because the culture of trusts in New Zealand is very different to that in America, where it has been held for almost a century that self-settled trusts are unacceptable. In contrast, self-settled trusts in New Zealand have long been acceptable and thus a very large proportion of the trusts have been settled on this assumption. A blanket application of the rule against settlor beneficiaries would capture those settlors who, while discretionary beneficiaries of their trusts, did not in substance enjoy the benefits of property. For example, assets may have been settled on trust by a couple for the benefit of their whole family, but the deed may stipulate that the trust assets are to be used primarily for the benefit of the children’s education. Thus, the settlors may never have received any benefit from trust funds. In this circumstance, the policy justification for the settlor-beneficiary rule, that one must honour their obligations where in substance they have access to trust property, would not be applicable.

This paper has discussed extensively the dangers of applying general rules across the board, as they will seldom afford justice on a case-by-case basis. In finding a workable solution to the problem, one must be careful not to fall into the same trap, which catalysed the use of the trust inequitable ends in the first place.²²⁴

²²⁴ Strict adherence to orthodox trust law facilitated the problem with trust: See Chapter Two, Part two.

On the flip side of the coin, a rule allowing the court to look through trusts where there is a settlor beneficiary does not go far enough, because a solution which does not extend to the situation where a non-settlor beneficiary enjoys the benefits of property without its burdens, would be open to criticism on the grounds of inconsistency. This situation arose in the State of Massachusetts following the decision in *Sullivan* that a settlor could not effectively own property without complying with their relationship property obligations. In *Bongaards v Millen*,²²⁵ a mother created a trust for her own benefit and on death the interest passed to her daughter along with the powers of appointment over assets to amend or terminate the trust, or distribute property to herself indefinitely. When the daughter died, her husband attempted to enforce relationship property rights. The majority's refusal to extend *Sullivan*,²²⁶ was "surprising" as the same policy, whereby it was wrong to enjoy the benefits of property without its burdens, was directly applicable.²²⁷

If a blanket rule will not work, and confining the solution solely to settlor-beneficiaries would be inconsistent, the solution can only lie in a more moderate yet holistic application of the rule against individuals hiding behind trusts, while continuing to enjoy the benefits of trust property.

A more plausible solution – Legislative guidelines

Legislative guidelines aiding a court or authority to determine when a discretionary beneficiary in substance owns trust assets would be the most effective solution to ameliorate the problem. As with option one, greater judicial discretion, this solution is also aimed at administering some equity into the law by placing limits on what trusts can achieve, however it is more feasible because it will avoid the issues associated with judicial 'free-rein'.

PROPOSED GUIDELINES

(1) Stage One

The primary inquiry of the court should be to give effect to the following policy considerations:

- (a) The trust defeats the principle that a person should not be allowed the continued enjoyment of trust property, without first satisfying their obligations to creditors or claimants under any Act; or
- (b) The trust, directly or indirectly, restructure assets to enable a discretionary beneficiary to qualify for social assistance.

(2) Stage two

In reaching either of these determinations the following guidelines, concerned with establishing whether a discretionary beneficiary has ownership of trust assets in substance, should be relevant:

- (a) Does the trust have a clear purpose?
- (b) Is there any evidence that dispositions to the trust have been structured to avoid consideration in assets and means testing for government aid?
- (c) Has the discretionary beneficiary received any benefits from the trust? If so, to what degree?

²²⁵ *Bongaards v Millen* 793 NE.2d 335 (Mass 2003).

²²⁶ *Sullivan* above n 178.

²²⁷ Kent Schenkel above n 87 at 25.

- (c) Is there is common identity between the discretionary beneficiary and trustee, or the discretionary beneficiary, settlor and trustee? If so, this is indicative of substantive ownership.
- (d) Does the discretionary beneficiary hold the power of appointment with regards to capital and income distribution? Can they make distributions to themselves?
- (e) Does the discretionary beneficiary hold the power to appoint and remove trustees? If so, is there any objective evidence that they have exercised this power to their advantage?
- (f) Consideration of whether there are independent trustees.

The remainder of this chapter shall discuss the implications of a discretionary beneficiary's effective ownership of trust assets, and demonstrate, by applying the guidelines to factual situations, how they would work in practice.

What would the implications of effective ownership be?

From an equitable standpoint, it is known that Chancery looked though a trust "created by a man protective of himself".²²⁸ Whether this position would alter were a trust not only self-motivated, but also granted an individual substantive control over trust property, is uncertain. The question thus remains: would these trusts simply be looked though (this is the approach of the American courts), or would Chancery have taken more drastic action and simply invalidated them?

Arguably, as effective control by a discretionary beneficiary does not upset the three certainties of trust, nor the irreducible core of obligations owed by trustees to beneficiaries, it would contrary to current law to invalidate these structures. However, from an equitable stand point, it was well established that when a trust, or an aspect of a trust, was flawed by reason of conflict with public policy, the offending part was invalidated. For example, where a trust restricted the rights of alienation, such restrictions were void on the ground that they were repugnant to the essential nature of property rights.²²⁹ A more novel example is those trusts in which fathers attempted to place restrictions on whom their daughters could marry. Of course, by the late 1800s, these structures were contrary to policy and thus void.²³⁰

Previously, this paper raised the question of whether the use of trusts to avoid legislative aims (given the current state of trust law in New Zealand) was public policy. As discussed, the notion of public policy is complicated, though the author did argue that it would be difficult to find support in favour of a policy endorsing dishonest thinking and action.²³¹ In spite of the confusion surrounding this policy question, there remains support for the proposition a trust, which meets the proposed test for effective ownership, is incapable of being a trust, and thus should not be simply 'looked though', but void from the outset.

First, there is authority for the proposition that a "trust which offends fundamental moral tenants, which a court holds to be against community values, may be invalidated on the ground

²²⁸ *Higginsbottom* above n 142 at 92

²²⁹ See *Cadell v Palmer* (1833) 131 Eng. Re. 859 at 863.

²³⁰ *Morley v Rennoldson* (1843), *Jenny Turner* (1880). Trusts which encourage a party to dissolve a marriage are also again public policy and thus were void: *Re Caborne* (1943); *Ramsay v Trustees Executors and Agency Co Ltd* (1848); *Seilder v Seilder* (1982), cited in Samantha Hepburn above n 90 at 323.

²³¹ See Chapter One p 11 for a more detailed discussion on this point.

that it is against public policy.”²³² Secondly and policy aside, one thing is certain: the use of a trust for dishonest ends violates a moral central to social solidarity. While the implications of this may not be ostensibly obvious, theoretically, it does mean that this use of the trust is flawed; and in equity, where an “infirmity” existed within a trust, it was void for this reason.²³³

This solutions chapter began with the proposition that reform poses an opportunity to shape trust law so that it is consistent with societal values, for only then will the integrity of trusts be preserved. Integrity cannot be administer into a doctrine which itself inherently flawed (though this is contrary to the view of the Law Commission). On this view, the solution must not merely look though flawed trust, but invalidate them. Indeed, where a trusts is associated with dishonesty, this not only compromises the integrity of trust law as a whole, but a trusts essence and most probably public policy (if not public opinion); and, in the absence of this characteristics, the doctrine becomes a hollow one.

Where a trust is declared invalid from the outset, all previous dispositions to the trust, and from the trust are void. Thus, a power similar to that in s 44 of the PRA would be necessary to allow the court to claw back assets in the absence of those received in good faith and for adequate consideration.²³⁴

What about the other beneficiaries?

In holding that no trust existed, where substantive ownership is established on the part of one discretionary beneficiary, the other beneficiaries to the trust will inevitably be affected. Not only will they loose any hope of benefiting from the trust in the future, but dispositions made to them will be subject to claw back as they are mere volunteers.²³⁵

In the author’s opinion this should not be used as an excuse to stick to the well-worn path of orthodox law; hindsight has shown that this does not lead to a reasonable nor rationale outcome.²³⁶ Discretionary beneficiaries do not posses any equitable interest in trust property and thus should not be valued over deserving creditors or those enforcing their legal entitlements.²³⁷ In fact, given that the proposed guidelines invalidate a trust from the outset, no one ever had any ‘interest’ or anything to lose in the first place.

Importantly, the types of trusts these guidelines are aimed at are those appearing to be a façade of ownership. Thus, even where other discretionary beneficiaries, for example the children of a settlor, were benefiting considerably from trust distributions, in all likelihood they would have done so had there been no trust in the first place.

²³² Samantha Hepburn above n 90 at 323.

²³³ Limitations against alienation were not only void for policy reasons, but because they were considered to be an “infirmity” in the trust structure: See generally *Cadell v Palmer* above n 229; *Jee v Audley* above n 133; *Wilkinson v South* above n 133; *Sabbarton v Sabbarton* above n 133.

²³⁴ Property Relationships Act, s 44(4): Relief (whether under this section, or in equity, or otherwise) in any case to which subsection (1) applies shall be denied wholly or in part, if the person from whom relief is sought received the property or interest in good faith, and has so altered his or her position in reliance on his or her having an indefeasible interest in the property or interest that in the opinion of the court, having regard to all possible implications in respect of other persons, it is inequitable to grant relief, or to grant relief in full, as the case may be.

²³⁵ Kent Schenkel above n 87 at 38.

²³⁶ By reasonable and rationale, the author is referring the situation where one benefits from trust property without suffering the burdens of ownership.

²³⁷ See Chapter Three p 25.

How would these guidelines work in practice to find substantive ownership?

In order to demonstrate how these guidelines would work in practice, they shall be applied to three examples: the facts of *Harrison v Harrison*, the fact of *Kidd v Van den Brink*, and a self-settled discretionary trust for the benefit of an incapacitated individual.

*Harrison v Harrison*²³⁸

This case has been discussed previously, and involved a typical family discretionary trust.²³⁹ Mr and Mrs Harrison were the settlors of the trust, which contained assets accumulated during their marriage, the family home and some shares. The sole trustee was a company controlled jointly by Mr and Mrs Harrison as directors. Under stage one of the investigation, the trust defeats the principle that one should not enjoy the benefits of their proper without first satisfying claimants under any Act, here the PRA. Under stage two, the following factors would be relevant in finding that in substance, both parties had had ownership of the trust property: the trust served no obvious purpose aside from protecting assets (a); the parties continued to benefit from the use of the family home (b); the trustee company was controlled by the parties (d); there was no independent trustee (g); they had the sole power to appoint and remove trustees (e); and as Fogarty J said, at any time “they had the power to vest the entire assets of the “trust” to themselves”²⁴⁰ (d).

*Kidd v Van den Brink*²⁴¹

In this case, a father established a trust for the benefit of his five children, their spouses and so on. One of his children married Ms Kidd. They lived in a house owned by the trust and most the material benefits bought to the marriage were from the trust also. When the parties separated, Ms Kidd was unable to access the trust to enforce her relationship property rights.²⁴²

While Mr Kidd retained the benefits of trust property while avoiding his statutory obligations to Ms Kidd (stage one), it would be difficult to establish that he enjoyed substantive ownership over trust property. While certainly he benefited substantially from the trust, he was not a trustee, nor on the facts did he exercised any control over their decision-making. The purpose of the trust was to provide for the settlors children, and was by no means a mere façade of ownership. Clearly, the guidelines would not be sufficient to bust this trust – and nor should they be, for they are designed only to ameliorate situations where it would be dishonest not to honour agreements or statutory obligations. The dishonesty lies in the fact that to the onlooker an individual continues to enjoy all the benefits of property, while avoiding its burdens; here the injustice is inherent to the trust. By contrast, there is no dishonesty in the mere fact of being a beneficiary of a properly managed trust. In this instance the injustice is external to the trust as it resides solely in the fact that a third party has lost out by virtue of its existence. In the author’s opinion, it is circumstance such as these where respective policy areas need to step in.

²³⁸ *Harrison v Harrison* above n 66.

²³⁹ Anthony Grant “Trusts – an international rebuke for our Courts” NZ Lawyer 110, 17 April 2009

²⁴⁰ *Harrison v Harrison* above n 66 at [26].

²⁴¹ *Kidd v Van den Brink* above n 64.

²⁴² *Ibid* at [31].

Notably, the outcome would have been very different had the son exercised substantial control over dispositions. These guidelines are not aimed solely at settlor-beneficiaries, but any discretionary beneficiary who falls within their ambit.

A self-settled trust

This last example is based on a scenario from a paper defending the self-settled trust.²⁴³ Miss A comes from a wealthy family and inherited an agricultural estate, which is leased to a sheep and beef farmer. Seven years ago she suffered a brain haemorrhage. While she has retained full mental capacity, she experiences phases where she cannot and will not do certain things, for example she has been failing to collect the rent from her tenants. The solution was to persuade her to settle her interest in the estates on a protective settlement. She is the primary beneficiary of the trust and her nieces and nephews will receive the remainder on her death. Her lawyer and brother are trustees. While they have an absolute discretion to vest her income and capital, in practice she is vested income whenever she asks for it.

Miss A has applied for residential care subsidies. Assuming that the estate was gifted to trust in a manner to avoid consideration in her assessment for residential care, would the trust be invalid? Arguable, the application of the guidelines here is much more difficult as the trust was established for good reason. Outwardly, it does not appear to harbour dishonest intentions. This however would need to be balanced against the primary consideration the trust could enable Miss A to attain government benefits, which without a trust, she would have no right to. While Miss A was not a trustee, nor held power over them, in reality she enjoyed distributions at her will. Importantly, the fact that the estate was gifted so as to ensure it would not be included in a residential care assessment, is objectively dishonesty. If the solution is truly aimed at eject dishonesty from trust law in order to preserve its integrity, then Miss A's trust would not meet the mark.²⁴⁴

Conclusion on the use of guidelines

If implemented, these guidelines would provide a useful hand break on the use of discretionary trusts to depersonalise wealth and remove it beyond the reach of those who should have access, namely the deserving claimant or an asset and means testing authority. Currently these uses of the doctrine are a threat not only to its integrity but the integrity of the institutions governing trusts, which have thus far failed to keep trusts in check. Ultimately, the proposed guidelines would serve to ameliorate the currently dishonest thinking associated with dispositions to trust, which is paramount if trust law in New Zealand is to regain respect.

What alternative mechanisms would people use to hide property?

Secret trusts

Subsidiary to the issue of discretionary trusts as a means to hide assets is the fact that trusts are a very private affair in the absence of registration requirements.²⁴⁵ Thus, they remain undetected

²⁴³ Wilson Cotton "The Self-Protective Trust" (paper presented to The Future of Trusts Conference, Kings College, London, April 2012).

²⁴⁴ The property here would need to be resettled on trust, or the parties could simply continue to manage the estate as they had always done so (based on the informal agreement they thought was a trust).

²⁴⁵ There is no requirement to register inter vivos or testamentary trusts.

when a creditor comes knocking, or an application for social assistance is filed. This issue is especially problematic in the case of simple declarations of trust and trading trusts.²⁴⁶

In short, if no one knows of a trusts existence, no solution will prove effective against the dishonest uses to which they are put. It is primarily for this reason that the author disagrees with the Law Commission's decision that the benefits of a trust register would not outweigh the costs.²⁴⁷ This conclusion was based on the following considerations: the majority of submissions (unsurprisingly) were against registration, it would put people off trusts (in the author's opinion this would be a good thing), it would be expensive,²⁴⁸ and lastly it would be inconsistent with the traditionally "private nature" of the trust transactions.²⁴⁹ With respect, this last point, relying on a past characteristic of the doctrine, is unconvincing in light of the contrast between its traditional and modern day employment. Trusts play a central role in the economy, and as pointed out by the Inland Revenue Department, the modern day investment trust's association with secrecy threatens the integrity of an open market. While in response to this concern, the Law Commission has recommended that companies disclose when they are acting as trustees, this would not capture those declarations of trust that serve to effectively erase property off the map.

At the end of the day, the solution must be consistent. If one truly wishes to eliminate New Zealand's growing habit of dishonest dispositions, the registration of trusts, in addition to the suggested legislative guidelines, is necessary.

Mirror Trusts

As discussed, mirror trusts are created when a couple splits their assets in half, and then each settles a trust for the benefit of the other. While the proposed settlor-beneficiary test²⁵⁰ would not capture this type of structuring, the proposed guidelines would do so. Specifically, as the guidelines are not limited to settlor-beneficiaries, they capture mirror trusts that enabled a non-settlor beneficiary to enjoy the benefits of property without its burdens.

Companies

While like trusts, companies can also hide assets, it is very unlikely that New Zealand will ever have a "company culture", remotely comparable to the ubiquitous influence of trusts. Not only are companies more difficult to set up and maintain, but they are also transparent as registration is compulsory. Additionally, companies could never be as popular as trusts because they are only a viable option for self-employed business owners.

The time may well come when a device will generate issues, similar to those associated with discretionary trusts. However, these speculations, while sensible to discern, are confined to the realm of future discussion and remedies, and certainly are no excuse not to preserve the integrity of trust law.

²⁴⁶ *Court, jurisdiction, trading trusts and other issues* above n 24 at 78.

²⁴⁷ *Preferred Approach* above n 6 at 263.

²⁴⁸ *Ibid*: Though as IRD recommended, costs could be reduced if it was included in the company's registrar.

²⁴⁹ *Ibid* at 264.

²⁵⁰ Restatement (Third) of Trust Law, s 60: See Chapter Four p 33.

CONCLUSION

In reforming trust law, it is imperative that the Law Commission gets it right, because trusts are the device by which individuals, businesses and companies in New Zealand have chosen to structure, manage and invest their assets. ‘Getting it right’ does not just involve a restatement of the law but requires a solution to ensure that trusts have integrity. In the author’s opinion this is impossible for as long as they are associated with dishonesty. A dishonest use of a trust lies in the ability of discretionary beneficiaries to defeat legislative obligations, or make use of welfare aid, *while they are simultaneously enjoying the benefits of trust property*. This is a flaw within trust law because dishonesty is antithetical to the very idea of a trust and the theory law generally.

Given that the trust has strayed so far from its equitable origins, Chapter Two examined the history of trusts to determine at what point, and why, this transpired. Essentially, this investigation revealed that since the time of the original use, the trust has not been as wholly legitimate as Maitland made it out to be.²⁵¹ Indeed, to the author, it appears that the doctrine has long been hiding behind the claims of its defenders, as for over four centuries trusts have been associated with less than scrupulous purposes. This however cannot continue; the injustices afforded by trusts today have never been so ostensibly obvious. Not only are the laws avoided by trusts more legitimate than those of the past,²⁵² but the trust has evolved into a device which poses a threat to the integrity of trust law itself.

Ironically, it was Lord Eldon who unknowingly facilitated the unfortunate conundrum of the present day. In denying the use of the trust as an anti-creditor device (which fuelled the emergence of the discretionary trust), while at the same time holding that equity followed the law, the situation has eventuated whereby trusts are now used in a manner that would have astonished Lord Eldon.²⁵³ In short, by the time trusts began to enable the depersonalisation of riches, the system of law governing the doctrine was too rigid to assess, let alone respond to, the undesirable implications of this use. This problem is particularly pronounced in New Zealand, where strict adherence to trust principles,²⁵⁴ for certainties sake, has paid the price of reason. As discussed, when one steps back from orthodox law and takes a look at the injustices trusts are able to afford, they would appear unseemly from both a moral and common sense point of view.

In America the Judiciary has kept a firm hand on reason in managing trusts. Specifically, in applying practical intelligence as the benchmark for its use, trusts have not (without legislative aid)²⁵⁵ been able to be employed for dishonest purposes. Here, the judiciary recognised what New Zealand has failed to see: a rigid body of law can never adequately govern a discretionary doctrine. It is on this premise that the solutions chapter was based, and for this reason that guidelines as opposed to any hard and fast rule was adopted as to ameliorate the problem.

²⁵¹ FW Maitland above n 1.

²⁵² See Chapter Two, Part one p 17-18: The laws of the past were not representative of societal values.

²⁵³ *Schmidt v Rosewood Trust Ltd* [2003] AC 709, PC, at 723, [34]: Over the 20th Century, “the forms and functions of settlements have changed to a degree which would have astonished Lord Eldon.”

²⁵⁴ The principle that discretionary beneficiaries have no interest in trust property, despite the fact that in reality they benefit from it greatly, allows the individual to separate the benefits of property from its burdens. The irreducible core of trusts has been a bar to looking through these structures.

²⁵⁵ David Shaftel above n 203.

To conclude, the solution proposed by this paper is not designed to resolve the clash between trusts and respective policy areas (though it would come in useful where this occurs), but the current flaw within trust law: the affiliation of trusts with a moral essential to social solidarity. If honesty is essential to the nature of a trust, an objectively dishonest ‘trust’ is flawed and thus void from the outset.

The author is sure that many will see this solution as an extreme measure in a nation where discretionary trusts for individual gain are so prevalent. However, what would be the implications of a status quo? Should New Zealand really be fuelling a system in which dishonesty is the norm and where the individual can choose not to be accountable for their behaviour? Is there a legitimate basis for the facilitation of this end? And is such a system beneficial to society as a whole? In the author’s opinion these questions can only be answered in the negative; and if this is so – then the solution will, and rightly should, turn trust law on its head.²⁵⁶

²⁵⁶ Rob Stock above n 103.

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