Is our Trust in the Court an illusion? A critique of the law of Illusory Trusts post *Clayton v Clayton* [2015] NZCA 30

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"…'tis too much proved, that with devotion's visage and pious action, we do sugar o'er the devil himself."

William Shakespeare, Hamlet, Act III, Scene i

Chapter I: Introduction

New Zealanders have a love affair with trusts. From the wealthy, to companies, to small families with just their home, many New Zealanders are involved with them in some way. Since trusts are abnormally common in this jurisdiction, estimates for their number have been as high as 400,000 in recent years.[1] The problem is that, due to their number, there is greater potential for their abuse. Trust deeds are emerging with wider and wider powers, often coupled with trustees' duties being whittled down to practically the "irreducible core".[2] Therefore the question this dissertation seeks to answer is one of vital importance: When is a trust not a trust?[3]

There are two main problems facing trust law: 1) that a growing number of discretionary trusts have incredibly wide powers conferred on settlors/trustees with them owing few duties; and 2) that people are settling trust deeds, and either have no conception of what a trust is, or intend the relationship to be different than that in the deed. In either situation, it seems hard to argue that the "settlor" intended to create a trust in fact. Due to their prevalence, some feel that these "trusts" are potentially being abused to counter the claims and rights of third parties such as partners and creditors.[4] The Vaughan Road Property Trust (VRPT) deed in *Clayton v Clayton* gave Mr Clayton the unfettered powers of removing and adding both trustees and beneficiaries, along with the release from many duties.[5] His ex-wife has been trying to claw all the trust property back into his person estate by arguing that the trust is either a sham or that her husband had so much control that the trust is illusory. Chapter II will provide a critique of the case.

To answer this, a back-to-basics approach is necessary. Whilst it is trite to say that a trust is a relationship, and that the three certainties are necessary,[6] there is still ambiguity as to certain aspects of a trust. Chapter III will analyse the cases that establish how to quantify the certainty of intention, with emphasis on the early cases that define trust principles. The

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[1] Nicola Peart "Intervention to Prevent the Abuse of Trust Structures" 2010 NZ L Rev 567, at 568.
[2] *Armitage v Nurse* [1998] Ch 241 (CA); [1997] 2 All ER 705 at 713.
[3] All references to a "trust" mean a private express trust unless otherwise stated.
[4] Peart, above n 1, at 569.
[5] *Clayton v Clayton* [2015] NZCA 30.
[6] *Knight v Knight* (1840) 49 ER 58.

question that the chapter will answer is: What does one need to actually intend when intending to create a trust?

Recently, trusts have been held not to be trusts when they are a "sham". The sham trust doctrine is that the objective intent of the deed is enough to create a trust, and will only be void if there is a common intention to mislead between the settlor and trustees.[7] There has been much debate over the doctrine, a debate that has direct implications for the illusory trust doctrine.[8] There is continuing debate as to whether the argument of an illusory trust as a separate doctrine is valid, or if it cannot exist due to the sham trust doctrine.[9] Chapter IV will analyse and critique the sham doctrine and will argue that it is inapplicable to trusts.

Chapter V will analyse the "illusory trust" concept and how it has gained ground both implicitly and explicitly. While there have been different formulations, the argument is that since the trust lacks substance, it is void. While the argument appeared to be successful in Bermuda,[10] and was successful in New Zealand in both the Family Court[11] and in the High Court, [12] the doctrine has been dealt a blow. The Court of Appeal in *Clayton v Clayton* held that there is no "halfway house" between a valid trust and a sham trust;[13] in their view, there is no such thing as an "illusory trust". Even the authoritative *Lewin on Trusts* states that a "trust is either a sham…or it is valid and enforceable."[14]

This dissertation will argue that there are two forms of intent when creating a trust: formal intent (e.g. a trust deed) and substantive intent (the knowledge and actual intent of the settlor to divest their interest and dominion over the property). Since Equity prefers substance/intent over form,[15] the formal intent of a trust deed will be good evidence of the substantive intent to create a trust but it is this substantive intent that is required to create a trust. However there

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[7] *Official Assignee v Wilson & Clyma* [2007] NZCA 122, [2008] 3 NZLR 45.
[8] Mathew Conaglen "Sham Trusts" (2008) 67 CLJ 176 at 188.
[9] Jessica Palmer "Dealing with the Emerging Popularity of Sham Trusts" [2007] NZ L Rev 81; *Clayton v Clayton* (CA), above n 5, at [85].
[10] *BQ v DQ* [2010] SC (Bda) 40 Civ (16 April 2010).
[11] *MAC v MAC* FC Rotorua FAM-2007-063-652, 2 December 2011.
[12] *Clayton v Clayton* [2013] NZHC 301.
[13] *Clayton v Clayton* (CA), above n 5, at [84].
[14] Lynton Tucker and others *Lewin on Trusts* (19th ed, Sweet & Maxwell, London, 2015) at [4-030].
[15] John McGhee *Snell's Equity* (33rd ed Sweet & Maxwell, London, 2015) at [5-013]; *Clayton v Clayton* (CA), above n 5, at [62]; *Official Assignee v Wilson & Clyma*, above n 7, at [26].

may be other evidence that shows, despite the formal intent, there was no substantive intent, and therefore no intention to create a trust.

Chapter VI will propose an "illusory trust" theory along the lines of that suggested by Winkelmann J in *Financial Markets Authority v Hotchin.*[16] It will focus on the substantive certainty of intention. A trust will be a trust when the settlor has the substantive intent to divest themselves of their interest, control and dominion over the property for their own benefit, and for it to be held for the benefit of others.

[16] *Financial Markets Authority v Hotchin* [2012] NZHC 323.

Chapter II: *Clayton v Clayton*

A. Background

The question here is: was the Court of Appeal correct in its analysis of sham and illusory trusts?[17] The VRPT was settled by Mr Clayton in 1999, with him as the sole trustee. The discretionary beneficiaries are Mr and Mrs Clayton, and their children are the final beneficiaries. Mr Clayton has wide powers and many exclusions from duties under the deed. Clause 4.1 allowed trustees to distribute income to one or more beneficiaries and clause 6.1 allowed trustees to apply some or all of the capital to one or more beneficiaries before the vesting day. In his capacity as "Principal Family Member", Mr Clayton had the power add or remove discretionary beneficiaries and trustees under clauses 7.1 and 17 respectfully.

Clause 11 gave the trustees unfettered discretion to exercise the powers in the trust, allowing them to not consider the interests of all beneficiaries and to act contrary to the interests of present or future beneficiaries. Clause 12 stated that trustees had all the powers of natural persons subject to the deed and could deal with the trust fund as if they were the "absolute owners of and beneficially entitled" to it. Clause 14 allowed a trustee that was also a beneficiary to exercise a power/discretion in their favour. Clause 19.1 negated conflicts of interest for the trustees, while clause 23 allowed the revocation of the administrative/management clauses of the trust.

While the Family Court and High Court both held that the VRPT was not a sham, they were quick to find that it was "illusory", albeit on different grounds. The High Court did not hold that the trust was void for lacking certainty of intention (and in fact found that Clayton had intended to create a trust), but Hansen J held that the VRPT was "illusory" as Clayton did not intend to give or part with control over the property sufficient to constitute a trust.[18]

B. Court of Appeal

Citing numerous authorities, the Court held that it is well known that there is nothing inherently wrong with a person being both settlor and trustee of a trust and that a person may

[17] This dissertation will only deal with the sham/illusory trust part of the judgments, not the other issues, such as powers as property.
[18] *Clayton v Clayton* (HC), above n 12, at [79].

be a trustee and beneficiary of a trust.[19] The Court also held that a trustee may not be the sole beneficiary of a trust as there would be no separation of the legal and equitable/beneficial ownership and therefore no trust.[20] However, the Court did fail to look at the early cases that created trust principles. In particular it did not analyse *Hughes v Stubbs*, which held that a settlor needs the substantive intention to create a trust, i.e. divest their interest and dominion in the property.[21]

The Court incorrectly analysed the trust deed. It stated that if Mr Clayton exercised his power of appointment to become the sole beneficiary of the trust, there would be no trust.[22] Mr Clayton only had the power to add or remove *discretionary* beneficiaries. The final beneficiaries were impossible to remove, and therefore that situation could never arise.

The Court held that the trust contained the three essential certainties needed for a valid trust; Mr Clayton had intended to create a trust for legitimate business purposes; there was identifiable trust property held by a trustee; and the trust objects were able to be ascertained.[23] The Court held that while the deed conferred wide powers on Mr Clayton it "did not (and could not)" eliminate the fiduciary obligations that could be enforced by other discretionary beneficiaries, namely the "irreducible core of obligations" from *Armitage v Nurse*.[24] The Court held that the duties of acting honestly and in good faith still remained and were enforceable by the discretionary and final beneficiaries.[25]

The Court disagreed with Hansen J's finding that the powers in cls 4.1, 6.1, 12 and 14.1 of the trust meant that Mr Clayton retained powers tantamount to ownership.[26] This was as Mr

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[19] *Clayton v Clayton* (CA), above n 5, at [46]; Andrew S Butler "Creation of an Express Trust" in Andrew S Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 69 at [4.1.1(1)]; *Drosier v Breteron* (1851) 15 Beav 221, 51 ER 521 (Ch); Andrew S Butler "Breach of Trust" in " in Andrew S Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 225 at [10.3.1(3)]; Andrew S Butler "The Trust Concept, Classification and Interpretation" in Andrew S Butler (ed) *Equity and Trusts in New Zealand* (2nd ed, Thomson Reuters, Wellington, 2009) 43 at [3.1.2].
[20] *Clayton v Clayton* (CA), above n 5, at [47].
[21] *Hughes v Stubbs* (1842) 1 Hare 476; this will be analysed and expanded upon in Chapter III.
[22] *Clayton v Clayton* (CA), above n 5, at [48].
[23] At [50].
[24] At [51].
[25] At [53].
[26] At [55].

Clayton was still obligated to act in accordance with the "irreducible core of obligations". The Court therefore held that it was a valid discretionary trust.[27]

The Court analysed if the VRPT was a sham trust and cited *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* for a summary of the law: [28]

> In essence, a sham is a pretence. …A document will be a sham when it does not evidence the true common intention of the parties. They either intend to create different rights and obligations from those evidenced by the document or they do not intend to create any rights or obligations, whether of the kind evidenced by the document or at all. A document which originally records a true common intention of the parties may become a sham if the parties later agree to change their arrangement but leave the original document standing and continue to represent it as an accurate reflection of their arrangement.

This test implies that a trust could become a sham if the trustee and settlor later agreed to use the trust as a pretence. This is inconsistent with the explicit mention of this as an impossibility in *Official Assignee v Wilson & Clyma* and also is impossible as if it was a valid trust in its inception, the beneficiaries have acquired their equitable interest.[29]

The Court held that when determining if the trust is a sham, the Court will focus on the actual intentions of the parties and compare them with the actions that have been done, or the documents that were created.[30] The Court is able to look beyond the legal transaction and look at all relevant evidence that pertains to the parties' intentions.[31] The Court's reasoning behind this is Equity's "preference for substance over form."[32] This implies that the Court can look at the entire substance of the transaction, but the Court limited it to the intention to mislead.[33]

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[27] At [56].
[28] *Ben Nevis Forestry Ventures Ltd v Commissioner of Inland Revenue* [2008] NZSC 115, [2009] 2 NZLR 289 at [33].
[29] *Official Assignee v Wilson & Clyma*, above n 7, at [57].
[30] *Clayton v Clayton* (CA) above n 5, at [61].
[31] At [61].
[32] At [62].
[33] This will be expanded upon in Chapters III & IV.

The Court cited academic work and held that there is no dispute that the sham doctrine applies to trusts.[34] While the Court had obviously never heard of me, I certainly dispute it.[35] The Court then held that if there is evidence that, regardless of a document purporting to be a trust deed, the settlor and trustee(s) had no intention of creating a trust, there will be no trust.[36] This statement is correct, but the Court is incorrect that sham intent is the only way to invalidate a trust for lack of intention.

The Court held that if a sham has been found, and if legal title had been transferred to a purported trustee other than the settlor, the trustee will hold it on a resulting trust for the settlor (whose beneficial interest remained).[37] The Court declined to address whether or not a mutual intention is needed between the purported settlor and trustee if they are not the same person as Mr Clayton was both in this case.[38] This is disappointing as they had the opportunity to review the decision of *Wilson* on the issue, but chose not to because it was unnecessary on the facts.

The Court then analysed whether a sham trust requires the establishment of specific shamming intention, or simply establishing the lack of certainty of intention on behalf of the settlor. On this issue, the Court accepted the approach of *Wilson* in that subjectively assessed shamming intention is required.[39] Therefore on the factual findings of the lower courts, the Court held that the VRPT was not a sham as there was no specific sham intent.[40]

The Court then analysed the "illusory" trust theory, noting it was the first case in New Zealand that considered it a distinct concept from that of a sham trust. Disagreeing with the High Court, the majority held that finding the trust "illusory" resulted in the inconsistent findings of:

(a) The trust was not a sham as Mr Clayton genuinely intended to create a trust (and therefore did intend to part with control over trust property);

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[34] *Clayton v Clayton* (CA) above n 5, at [63]; Tucker and others, above n 14, at [4-020].
[35] See Chapter IV for the analysis.
[36] *Clayton v Clayton* (CA), above n 5, at [63].
[37] At [63].
[38] At [64].
[39] At [66].
[40] At [67]-[70].

(b) The trust deed did not erode the irreducible core of obligations;
(c) The other beneficiaries would be able to enforce these obligations against Mr Clayton for a breach of trust.

The Court held that it could not support the distinction between a sham trust and an "illusory" trust as (in their opinion) the definitions overlap as an "illusory" refers to an arrangement that looks like a trust, "but has no real substance or effect that no trust was intended."[41] In this, the Court has over-stated itself. A sham trust is when a settlor (and trustee) intend for the trust deed to conceal the true intentions of the arrangement; an "illusory" trust (according to the Court) is where an arrangement is called a trust yet in substance was not intended to be one. While a sham trust has no "real substance," it also requires an intention to mislead. Therefore the definition of a sham trust is subsumed by the substantive approach for certainty of intention.[42] If one intends a sham, they therefore do not substantively intend a trust. The majority found that there was no distinction between a sham trust and an "illusory" trust, and that the terms have been used synonymously in foreign jurisdictions.[43] While these semantics may be true, it is irrelevant for an analysis.

The Court held that both terms focus on the intent of the settlor, and that the question in both cases is: did the settlor (notwithstanding the trust deed) genuinely intend to create a valid enforceable trust?[44] With respect, the Court is incorrect on this point. Current sham trust theory only looks to see if the settlor had sham intent, not if they lacked the genuine intent to create a trust. While finding sham intent obviously means there is lack of genuine intent, there are other situations where the settlor will not have the genuine intention to create a trust. It is hard to say that someone has the requisite genuine intention to create a trust when they have no idea what one is. While they may ask his solicitor to set up a "trust", they cannot genuinely intend a trust in fact, as they have no idea what they mean to intend.

The Court then held that if a court accepted that a valid trust had been established on the settlor's intention (and not a sham) but held the trust to be non-existent because the trustee had wide powers of control over the property, it would undermine the court's original

[41] At [77].
[42] This will be analysed and expanded upon in Chapter III.
[43] At [77].
[44] At [78].

acceptance of a valid trust and overlooks the irreducible core of obligations and the beneficiaries' right to hold them to account.[45] While this analysis is correct, the Court has looked at it the wrong way. If a settlor-trustee retains so much power that he has not divested his interest and dominion over the property, then a valid trust *in fact* was not created from the very beginning.[46] It would simply be lack of certainty of intention to create a trust. If a "trust deed" that specifically stated the arrangement was to be a trust but also stated that a trustee must run every decision by the settlor for approval, it seems very unlikely that a court would find this arrangement constituted a valid trust, irrespective of sham intent.

The settlor may have genuinely intended to create a "trust" but they did not have the requisite substantive intention to create a trust; i.e. the split in equitable and legal ownership, held for the benefit of others, divesting their interest and dominion. There was never an intent to divest their dominion and beneficial interest, and therefore there is no trust and no duties owed. The trust will not be void because the settlor-trustee has wide powers, the "trust" would just have never existed as the amount of power retained show that the "settlor" never substantively intended a trust. A valid trust is not invalid for the lack of certainty of subject matter; it is void ab initio as if there is no property, there is no trust. This is exactly the same for certainty of intention.

The Court was reluctant to invalidate trusts on grounds other than that of a sham as it was concerned about the unintended consequences it might have on other trusts in New Zealand.[47] The Court did not have access to information on what generally are the accepted terms of trusts are and that reform should be left to the Law Commission and Parliament. With the utmost respect to the Court, this is an unprincipled decision. Trusts are the jurisdiction of the Court and the Law Commission itself stated that this area of law should be left to judicial development.[48] It does not matter if there are generally accepted terms of trusts if those terms are illegal, inequitable and go against established trust principles. Trusts can have a tendency to be abused in this country, especially due to little statutory oversight. If a trust lacks the substantive certainty of intention, it is void an initio and should not be protected simply because its terms are widespread.

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[45] At [80].
[46] *Hughes v Stubbs*, above n 21.
[47] *Clayton v Clayton* (CA), above n 5, at [83].
[48] Law Commission *Review Of Trust Law in NZ Introductory Issue Paper* (NZLC IP19, 2010) at 38.

The Court held that there is no real difference between the terms "sham" and "illusory" and that there is no "halfway house" between a valid trust and a sham; there was held to be no "third state of affairs" between the two.[49] For the aforementioned reasons, the Court held that there is no such thing as an "illusory" trust. In its view, there was no separate principle where a trust that is not a sham (and therefore valid) could be set aside as invalid for being "illusory."[50]

C. Analysis

With respect to the Court, its analysis is incorrect and inconsistent. Equity tends to look prophetically, in that if one has a power, they will probably use it, hence why duties and limitations are imposed.[51] Therefore it was inconsistent of the Court in relation to the sham/illusory argument to be willing to assume that Clayton would not act in his own interests, but held that he had clearly given himself these powers to use them if he wished and therefore they were property.[52] This has led to the unprincipled decision to make the powers property for the purposes of the Property (Relationships) Act 1976 (PRA).[53] The Court is only looking to commonly held "sham" substance when preferring it over form, instead of the numerous other instances of lack of substantive intent. This provides a remedy for partners under the PRA, but does not solve the actual problems of settlor control or people who lack the conception of a trust. The Court should only hold that there is a trust when there is substantive intention on behalf of the settlor to create one.

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[49] *Clayton v Clayton* (CA), above n 5, at [84].
[50] At [85].
[51] Hence the duties to act in honestly and good faith, only taking into account relevant matters etc; See generally Tucker and others, above n 14, at [29-135]-[29-184]; McGhee, above n 15, at [10-017]-[10-036].
[52] *Clayton v Clayton* (CA), above n 5, at [91]-[104].
[53] This dissertation will not be going into the substantive argument for whether or not powers are property.

Chapter III: Intention to create a trust

A trust is a relationship where one holds property on behalf of another[54] and is in a fiduciary relationship with the beneficiaries.[55] There also must be an intention on the part of the settlor to create a trust.[56] It is hard to imagine that a person has the requisite intention to create a trust if they ask a solicitor to set one up, yet they have no idea what one actually entails. To say that one must manifest an intent to create a trust implies that the person must have actual knowledge of what a trust is in fact.[57] Since Equity is routinely stated to regard substance over form,[58] the current approach of an objectively valid trust deed is conceptually inconsistent.[59]

The onus of proving intent lies with the party alleging it and the Court will take into consideration the construction of the words and the surrounding circumstances.[60] If a deed is clear in its objectives and not merely expressing intent to transfer property absolutely or a gift, it could be seen expressing the intent to create a trust. However if there is any doubt as to the intent of the "trust" the Court may look at the current and subsequent acts of the settlor.[61]

While trust intention should not be viewed as an objective/subjective debate,[62] there are two forms of intention: formal intent, which is evidenced by the existence of a trust deed or words; and substantive intent, what the "settlor" actually intended, as shown by their actions and knowledge. Formal intent will be good evidence of substantive intent and will create a presumption of trust. Since substance is more important than form, blatant and continuous breaches of trust could show that the settlor had no intention to create a trust despite the objectively valid form of the deed. While the formal intent of the deed will be important, the presumption of trust it creates should be rebutted if there is evidence of a lack of substantive

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[54] *Beckford v Wade* (1805) 17 Ves 87 at 95.
[55] *Plowright v Lambert* (1885) 52 LT 646 at 652.
[56] *Re Burton* [1965] NZLR 712; *Paul v Constance* [1977] 1 All ER 195; [1977] 1 WLR 452 (CA).
[57] HAJ Ford and William A Lee, *Principles of the Law of Trusts* (Sweet & Maxwell Ltd, London, 1990), at [202].
[58] McGhee, above n 15, at [5-013].
[59] *Official Assignee v Wilson & Clyma*, above n 7.
[60] *Thexton v Thexton* [2001] 1 NZLR 237.
[61] *Bentley v Mackay* (1815) 15 Beav 12 at 19; *Shephard v Cartwright* [1955] AC 431 (HL), [1954] 3 All ER 649
[62] As many disagree with and worry about the potential consequences of a subjective approach; see generally Conaglen, above n 8.

intent. This will not degenerate into a purely subjective approach; evidence of the lack of substantive intent will be required. One cannot successfully claim a settlor lacked substantive intent without some objectively manifested evidence supporting the assertion.

A. Contemporary Cases

Some contemporary cases have followed this approach, and have (without explicitly stating) looked for the substantive intention to create a trust and have even found a trust void ab initio for lack of intention despite a valid deed. Other cases have followed a strict objective approach in finding intention, but this goes against the early case law and does not remedy current trust problems.

In *Twinsectra Ltd v Yardley,* Lord Millett held that while a settlor must have an intention to create a trust, their subjective intentions are irrelevant.[63] He stated that as long as they enter into arrangements that have the effect of creating a trust, it is not necessary for them to appreciate they have done so as long as they intend to enter into the arrangement. Under this ruling, a "settlor" could sign a trust deed, intend for the arrangement it created to come into effect, but have absolutely no idea what the content of that arrangement was.

The majority of the High Court of Australia preferred a subjective approach for trust intention in *Commissioner of Stamp Duties (QLD) v Jolliffe*.[64] The Court held that there was no authority stating that using any form of words could create a trust contrary to the settlor's real intention and that the Court will not impute a trust when it in fact was not contemplated.[65] *Jolliffe* was overturned in *Byrnes v Kendle,* where a husband argued that, despite the trust deed, he did not actually intend to create a trust. [66] Gummow and Hayne JJ (with French CJ in agreement on the point) held that in finding intention, the question to ask is "what is the meaning of what the parties have said?" and not "[w]hat did the parties mean to say?"[67] This finding is dangerous, as it takes a far more restrictive approach to construction of words (especially contracts, which trusts are not) compared to New Zealand or England.[68] While there has been a retreat from the contextually liberal position of *Vector Gas Ltd v Bay of*

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[63] *Twinsectra Ltd v Yardley* [2002] UKHL 12, [2002] 2 AC 164 at [71].
[64] *Commissioner of Stamp Duties (Qld) v Jolliffe* (1920) 28 CLR 178.
[65] At 181.
[66] *Byrnes v Kendle* [2011] HCA 26.
[67] At [53].
[68] Jessica Palmer "Equity and Trusts" (2012) NZ Rev 141, at 145.

Plenty Energy Ltd, the context of the contractual words can still be taken into account.[69] Therefore the overly restrictive view of *Byrnes* should be ignored.

In *Antle v The Queen,* Miller J held that the "parol evidence" rule of contract is irrelevant for ascertaining trust intention.[70] He stated that a trust is a property relationship, and not a matter for contractual interpretation. He noted that the intention to create a trust is relevant and therefore the search for it should not be limited to the words of the trust deed, but also should include the subsequent actions of the settlor. This implies that the evidence of a trust deed could be outweighed by the subsequent behaviour of a settlor, and cause the trust to be void ab initio, supporting the substantive intent approach.

In *Hyhonie Holdings Pty v Leroy* it was held that the "settlor" had no intention to create a trust.[71] Robert Yazbek declared bankruptcy in 2002, and claimed that he did not beneficially own shares as they were held on a trust declared in 1997 (which was not stamped until 2001). There was absolutely no evidence apart from the deed that a trust existed, and evidence pointed to Yazbek as being the beneficial owner as the company returns listed him as such. It was held that the trust never existed, despite the existence of the deed. To create a trust, "words alone may suffice but where those words are at odds with the donor's action proof may be lacking."[72]

In *Star v Star* a declaration of trust over bank accounts was declared void as the "settlor" used them as if they were his own.[73] Whenever he needed money, he would transfer it from the "trust" account to his personal one, and then later closed two "trust" accounts after he transferred the money from them into his personal account. In *Paul v Constance,* the Court held that the repeated statement of "this money is as much mine as yours" and the subsequent actions of joint withdrawals were enough to constitute an intention to create a trust.[74] While there was no trust deed, the substantive intention (shown by subsequent actions) of Mr Constance was important in holding whether a trust existed. It was his actions that showed

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[69] *Vector Gas Ltd v Bay of Plenty Energy Ltd* [2010] NZSC 5, [2010] 2 NZLR 444; *Arnold v Britton* [2015] UKSC 36.
[70] *Antle v The Queen* (2009) TCC 465 at [44].
[71] *Hyhonie Holdings Pty v Leroy* [2003] NSWSC 624.
[72] *Arthur v Public Trustee* (1988) 90 FLR 203.
[73] *Star v Star* (1935) SASR 263 (SC).
[74] *Paul v Constance*, above n 56.

that Ms Paul was beneficially entitled to the money, while he retained legal title of the account (i.e. a trust in fact).

B. Early Case law

Earlier cases that were important in defining trusts and trust principles demonstrate that a more substantive approach to certainty of intention should be taken. In *Jones v Lock* there lacked sufficient certainty of intention to create a trust.[75] The father wrote a cheque to his child saying "I give this to baby" and that "it is his own, he may do what he likes with it." The cheque was put in a safe and the father died before it could be validated. Lord Cranworth L.C. held that the father intended to settle something on the child, but that the act was simply a symbolic gesture of what he was going to do. The father therefore did not intend to deprive himself of the property in the note or to declare himself a trustee for the child over the money at that time. While *Jones* is regarded as the seminal case for certainty of intention it did not actually state what one needs to intend to do when intending to create a trust. However, there are important cases that pre-date *Jones* that state what is necessary.

In *Hughes v Stubbs* the testatrix left £100 to Ms Gelling in her will.[76] After its execution, but before she died, she gave £150 to John Cropper and gave him verbal instructions to use it or as much as necessary to make up to Gelling the difference in value between the legacy and the price of one share of £100 in a company. Cropper was informed by the testatrix that the share was supposed to go to Gelling instead of her legacy, but she did not alter her will as she did not think it was necessary.

It was held that if "a person intends to give property to another and vests that property in trustees, and declares a trust upon it in favour of the object of his bounty…the gift is perfected and the author loses all dominion over it."[77] The Court stated that this extends to situations where the author of the gift retains legal dominion of the property, but declares themselves trustee of that property for another person, i.e. settlor-trustee. The Court did make a critical distinction. It was possible "that a person not intending to give or part with the *dominion* (emphasis added) over his property, may retain such dominion, notwithstanding he may have vested the property in trustees, and have declared a trust upon it in favour of third

[75] *Jones v Lock* (1865) 1 Ch App 25.
[76] *Hughes v Stubbs*, above n 21.
[77] At 478.

persons."[78] This would not be a trust, as they lacked substantive intent, regardless of form. This would mean the "settlor" would still have beneficial title, and the "trustee" would hold it on resulting trust for him or her.

Therefore the Court will look at the nature of the transaction and determine if its effect divested the owner of their interest in the property. The question is: did Gelling (beneficiary) acquire an equitable interest in the property and whether the testatrix (settlor) deprived herself of the property, to the extent Gelling acquired the interest? The Court held that the testatrix did not create a trust, as she intended the arrangement to stand on the same footing as the will.[79] It was held that there was nothing in the transaction that implied the disposition of property took it "out of her control in her lifetime."[80] Therefore will be no trust if they did not intend to divest their control, dominion and interest in the property. This would be irrespective of sham intent, merely the lack of substantive intention to create a trust.

In *Fletcher v Fletcher*, Mr Fletcher covenanted with trustees that if one or either of his sons should survive him, his executors were to pay the trustees £60,000 upon trust and they were to receive it if they attained the age of 21 and survived him.[81] If neither of the sons did, the trust was upon Mr Fletcher and his executors and administrators. Mr Fletcher did not tell his children nor the trustees about this deed. Years later, he wrote a will that bequeathed all his property upon trust for his wife, the two sons and his legitimate children. The Vice-Chancellor assumed "the validity of the instrument [trust deed] at law,"[82] and held that the original deed was not testamentary in nature, and therefore the settlor did not have the power of revocation. It was also held that retaining the deed and not telling the trustees and beneficiaries of their position did not affect its validity. Therefore the Court ordered the money to be paid to the surviving son.

Since the trust was valid despite both the trustees and beneficiaries having no knowledge of it, only the settlor's intention matters, as long as they have the intention to divest themselves of (dominion over) the property. The intentions of trustees are entirely irrelevant, and a trust

[78] At 479.
[79] At 481.
[80] At 481.
[81] *Fletcher v Fletcher* (1844) 4 Hare 67.
[82] At 73-74.

is therefore a unilateral transaction that is created without the acceptance of trustees. This is supported by the fact that a trust will not fail for want of a trustee.[83]

In *Smith v Warde,* Sir Smith sent letters to his agents directing them to invest part of his balance in stock, in his and his wife's name on trust for their son.[84] The agents made the purchase but the bank did not want trust accounts on its books, and therefore the trust was not expressed on the accounts; Smith was informed of this, yet thanked the agents for making the investment "in the stocks for his boy." He allowed the stock to remain without establishing a trust account and received dividends from the stock until he died. Later, Smith invested more money using the same account without any reference to a trust. He also wrote to his wife that he had invested money for their children and that "I intend to leave all the money I have to go to Lionel [the son]." The money he referred to included the original £4000 of stock. Smith often took money from the account as his own. At his death there were papers that included the total sum as part of his property and was included in his will.

It was held by the Vice-Chancellor that Smith's acts showed that he did not intend what the letters expressed.[85] He held that on the facts (being told the investment was made without a declaration of trust) whatever Smith's original intention was, that he was content that the property should continue "under his own absolute dominion" and treated the stocks "as his own property."[86] Therefore if he did have trust intention, it was not contemporaneous with the certainty of subject matter (as the actual amount to be invested was not explicitly stated in his directions to the agents). He also held that the correspondence proved that Smith did not have "any conception that an immediate and express trust was created for his son." It was held that the first and second investments were treated as if they were the absolute property of Smith, and he never contemplated that the property was the property of his son and he continued to have total dominion over it. Therefore the Court held that the property was part of Smith's estate.

Smith v Warde shows that it is not the formal intent of the arrangement that matters, but the substantive intention and knowledge of the "settlor". While Smith may have intended the

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[83] *Sonley v Clock Makers' Co.* (1780) 1 Bro CC 81.
[84] *Smith v Warde* (1845) 15 Sim 56.
[85] At 61.
[86] At 63.

stock to be held "on trust" for his son, this intention was not carried out. He knew about this, and then used the property as his own and would have been surprised if someone told him his son was the equitable owner of the stocks. Smith's acts after the "declaration of trust" was used as evidence that he had no intention to divest himself of his dominion in the property at the time of certainty of objects. Smith had neither fraudulent nor sham intent, the case shows that it is the *substantive intent* to create a trust (divesting one's interest and dominion) that is necessary to create one. The case shows that the search for intent does not stop at the formal intent (letter) but can include the substantive intent and knowledge of the "settlor". Since Equity prefers substance over form, it seems that if a declaration of trust had been made it would have still be found void, as one cannot insist on the form in order to defeat the substance.[87]

In *Bentley v Mackay*, Mr Mackay settled a trust on trustees for his son and his wife as final beneficiaries, and himself as an income beneficiary for life.[88] After some time, Mackay stopped receiving the dividends from the trust and transferred it to his son. He wrote a letter to the stock brokers telling them of his intent. He stated that he wanted the trustees to receive the dividends and pay them to his son half yearly, and in fact communicated this to the trustees (i.e. that his son was now entitled to the dividends).

The Master of the Rolls held that the facts showed the intention of Mackay (as the equitable owner of the dividends) to make a new trust in favour of his son. In order to achieve this purpose, he desired the trustees to pay the dividends received to his son. The Court felt that this expressed a clear intention and that Mackay had "intended to divest himself of the right to it."[89] There was no instruction to stop after a certain time and there was no way he could revoke his direction. The Court stated that in order to give effect to such a gift, it needs clear evidence of a declaration of trust and therefore looks at the "acts and writings of the donor"[90] to gather such evidence of a declaration of trust. The Court explicitly stated that it is "material to consider whether the acts of the settlor are in conformity with the alleged declaration of trust,"[91] and that "the acts must be unequivocal."[92] Therefore the Court will

[87] *Parkin v Thorold* (1852) 16 Beav 59 at 66.
[88] *Bentley v Mackay*, above n 61.
[89] At 21.
[90] At 19.
[91] At 19.
[92] At 19.

look to see if the substantive intent lines up with the formal intent of the "settlor" as substantive intent is required to create a trust. The Court did distinguish the case from *Smith v Warde*. The Court held that if Smith had actually made a payment of dividends to his son, it might have been different and therefore constitute an irrevocable trust. The Judge held that Smith's acts were not "consistent with a declaration of trust,"[93] and in fact they were diametrically opposed it.

In *Paterson v Murphy*, the testatrix lent £300 to Mr Paterson as an equitable mortgage.[94] She received the title-deeds and a memorandum that was written by Paterson at her direction which she signed. In it he was instructed to pay off the mortgage, and once he had paid a certain amount, he was to invest the remainder for the Murphy children. Later, before any money had been invested, another memorandum was signed by the testatrix informing Paterson not to invest money for the children, but to make all of the remaining payments to her. After her death, the Murphys claimed the money that was to be theirs in the first memorandum, and the associated dividends arguing that it constituted a trust.

The Vice-Chancellor held that there had been a declaration of trust.[95] It was held that there was no precedent stopping the creation of a trust simply because the beneficiaries had no knowledge of it. The Court referenced *Kekewich v Manning* as authority that the question is "whether the settlor meant to *declare or pass an interest* (emphasis added)" in the property to the beneficiary.[96] The Vice-Chancellor held that the writing was a clear statement of what the testatrix wished to be done with the fund and that it "cannot amount to less than a declaration of trust" and that there was no power of revocation in the document which would enable the second memorandum to be valid.[97] Therefore it was ruled that the children were entitled to the fund.

While the testatrix's subsequent behaviour was inconsistent with a trust, it can be distinguished from *Smith* v *Warde.* Smith did not substantively intended to give up his dominion over the property, while the testatrix did intend to give up her dominion over the property (and divested it via memorandum), but later, after she had divested it, she changed

[93] At 21.
[94] *Paterson v Murphy* (1853) 11 Hare 88.
[95] At 90.
[96] *Kekewich v Manning* (1851) 1 De G M & G 176; *Paterson v Murphy*, above n 94, at 91.
[97] *Paterson v Murphy*, above n 94, at 92.

her mind. These cases show two distinct situations. Firstly, never having the substantive intention to give up dominion/divest one's interest in the property (which can be shown by subsequent acts) and therefore there is no trust. Secondly, where someone does have the intent to divest themselves, does in fact do so and creates a trust, but later wishes they had not and acts against it (this is simply a breach of trust).

C. Analysis

If there is no trust deed, we look to the words and actions of the "settlor" in order to establish their (substantive) intent. While a deed is good evidence of this intent, the other factors should not be abandoned just because one exists. A settlor must therefore have the substantive intention to divest themselves of their interest, control and dominion over the property in order to create a trust. A trust is also therefore a unilateral transaction, arising regardless of trustees. While the formal intent of the deed is important, the substantive intent must match up with it,[98] and it is the substantive intent that creates a trust. If the acts of the "settlor" are contradictory with the formal intent of a deed, the Court may infer that they did not have the substantive intent required at settlement, and therefore the trust is void ab initio.

Not just any breaches of trust will definitively show that the "settlor" lacked substantive intent. Repeated breaches such as treating the property as their own (and therefore showing they had not divested their interest and dominion), manifested proof of lack of knowledge of what a actually trust is, and potentially a situation where the formal intent of the deed shows that the "settlor" never did intend to divest themselves of their control, dominion and interest in the property. As in *Star v Star* and *Hyhonie*, their actions showed that they did not intend to divest themselves of their interest and dominion in the property.

The early cases are critical as they show that the "settlor" must have the substantive intention to create a trust. Therefore, when intending to create a trust, the person must intend to divest their interest and dominion over property for the benefit of others. Currently the only way to challenge a "trust" on the basis of control is to argue it is a sham. This is problematic as the sham doctrine requires a common intention to mislead between the settlor and trustees, not a lack of substantive intent on behalf of the settlor and is therefore incorrect.

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[98] *Bentley v Mackay*, above n 61.

Chapter IV: Sham Trusts

A. Shams

According to sham trust theory, the trust is void due to lack of certainty of intention as there is no trust;[99] the documents that purport to be a trust are the sham.[100] The "sham" doctrine originated with the famous dicta of Lord Diplock over a hire purchase agreement (Common Law, not Equity).[101] Recent cases have held that certainty of intention is found upon the construction of the words in the document, and that the point is to find the objective intent from it.[102] When someone alleges a sham, they are alleging that the document is not a true representation of the agreement that was made and that it should therefore not be enforced in law.[103]

There are two problems with the sham doctrine being applied to trusts. Firstly, that the intention to mislead is only one of the ways to lack the certainty of intention to create a trust. Secondly, the common intention approach is inapplicable to trusts as they are unilateral transactions that rely only on the intention of the settlor. The sham trust doctrine is effectively protecting "trusts" that should not be recognised as trusts because courts have conflated an equitable transaction with contractual formation. While the sham doctrine is compelling for bilateral transactions at Common Law, it cannot apply to trusts. Trusts are unilateral transactions that are creatures of Equity. Only the settlor's substantive intent is necessary to create a trust, and therefore there is no need for a common intention between settlors and trustees nor intent to mislead for the trust to be void ab initio for lack of intention. Therefore the sham doctrine cannot apply to trusts.

B. Official Assignee v Wilson & Clyma

The sham doctrine was applied to trusts in New Zealand in *Official Assignee v Wilson & Clyma*. The Court analysed the certainty of intention to create a trust and held that a trust cannot be held to exist unless the Court is satisfied that there was the intention to create it.[104]

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[99] *Knight v Knight*, above n 6.
[100] *Official Assignee v Wilson & Clyma*, above n 7, at [48].
[101] *Snook v London and West Riding Investments Ltd* [1967] 2 QB 786 (CA) at 802.
[102] McGhee, above n 15, at [22-071].
[103] At [22-071].
[104] JD Heydon and MJ Leeming *Jacob's Law of Trusts in Australia* (7th ed, LexisNexis Butterworths, Sydney, 2006) at [501].

The Court stated that "[e]quity will look to the substance not simply the form of any purported trust.[105] Citing academic authority, it held that a trust will not be created if a settlor creates what is in fact not a trust, but labels it one anyway.[106] The Court supported this with *Tito v Wadell (No 2)*, where it was held that the use of the word "trust" will not necessarily manifest the intention to create a trust if there was no intention to create a property relationship so described.[107] This discussion implies that all that is needed for a "trust" to be void ab initio is lack of substantive intention, however the Court incorrectly restricted the lack of substantive intention to an intention to mislead.

While technically obiter,[108] the Court in *Wilson* favoured the common intention approach; both the settlor and trustee need to have sham intent. The Court came to this conclusion due to the fact that if "only the settlor's duplicitous intention would be required, then it is relatively straight-forward to set aside a 'sham' trust"[109] and that the common intention requirement "promotes commercial certainty".[110] Apart from relying on past authority and commercial certainty, the Court did not give any conceptual or principled reasons for favouring the common intention approach. The fact that trusts are used in commercial settings is not a justifiable reason to override Equity.

The Court formulated an objective-subjective test for sham trusts. If a court finds a trust to be ostensibly valid (objective) it will only look behind it for sham intent (subjective) if there is a "good reason" to do so. The Court failed to define what a "good reason" is, but stated it would be a high threshold due to the premium placed on commercial certainty.[111] While consistent with recent authority, this goes against early cases which show that only the substantive intent of the settlor is necessary, not just limiting the analysis to formal intent and only indulging in a subjective approach for an intention to mislead.[112]

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[105] *Official Assignee v Wilson & Clyma*, above n 7, at [44].
[106] Geraint Thomas and Alastair Hudson *The Law of Trusts* (Oxford University Press, Oxford, 2004) at [1.32].
[107] *Tito v Wadell* (No 2) [1977] 1 Ch 106 at 220 -225.
[108] *Official Assignee v Wilson & Clyma*, above n 7, at [24]-[25].
[109] At [53].
[110] At [53].
[111] At [52].
[112] *Bentley v Mackay*, above n 61; *Fletcher v Fetcher* above n 81; *Smith v Warde* above n 84.

The Court correctly distinguished *Marac Finance Ltd v Virtue*, holding that once a trust is validly created, it cannot later become invalid (a sham, as they stated).[113] The only exception is when other property has been transferred to the trust at a later date (with sham intent). The trust would be a sham in regard to that specific piece of property, while the rest of the trust would remain valid as each disposition of property is a separate trust.[114] Since there was certainty of intention at the trust's inception, the beneficiaries have acquired their equitable interest. A valid trust does not become invalid due to mismanagement, abandonment of trust obligations or by allowing the settlor to control the trust.[115]

The Court analysed the law regarding "alter ego" trusts: where an outsider has so much power and effective control over the trustees of a trust that it is practically their instrument. While it has made ground in Australia,[116] the Court held that it did not apply in New Zealand as an independent cause of action due to the statutory framework.[117] Statutes in Australia allow their Courts to look at the "financial resources" available to spouses on separation.[118]

The Court agreed with Jessica Palmer that factual control by someone other than a trustee does not make the trust invalid.[119] Factual control may constitute a breach of trust or could potentially be used as evidence that the trust is a sham, but it is not in of itself an independent action and an alter ego trust is not a sham trust.[120] The Court clarified that establishing breaches of trust do not necessarily or decisively make the trust a sham, but are of evidential value in finding one.[121] The Court noted that finding a properly executed trust a sham is an "extreme finding" as it has major effects on the interests of the beneficiaries (by essentially

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[113] *Marac Finance Ltd v Virtue* [1981] 1 NZLR 586 (CA); *Official Assignee v Wilson & Clyma*, above n 7, at [57].
[114] *Official Assignee v Wilson & Clyma*, above n 7, at [57].
[115] Peart "Intervention to Prevent the Abuse of Trust Structures", above n 1, at 583.
[116] *In the Marriage of Ashton* (1986) FLC 75; *Ascot Investments Pty Ltd v Harper* (1981) 148 CLR 337; *Re Richstar Enterprises Pty Ltd v Carey (No 6)* (2006) 153 FCR 509; *Kennon v Spry* [2008] HCA 56.
[117] *Official Assignee v Wilson & Clyma*, above n 7, at [65]-[72].
[118] Family Law Act (Australia), s79(4)(e).
[119] Palmer "Dealing with the Emerging Popularity of Sham Trusts", above n 9, at 81; *Official Assignee v Wilson & Clyma*, above n 9, at [69].
[120] *Official Assignee v Wilson & Clyma*, above n 7, at [71]-[72].
[121] At [77].

voiding them).[122] The Court's views on acting as though there was no trust after settlement as being merely evidence of a sham is consistent with academics and recent authority.[123]

Under *Wilson*, if a settlor executes a trust deed, has no conception of a trust, and then treats the property entirely as his own, the trust will be valid. For a sham trust argument to succeed, both the settlor and the trustees need to have a common and subjective intent to mislead, to conceal the true nature of what is going on.[124] However, there is no subjective/substantive intent to mislead. The settlor-trustee simply has no substantive intention to divest their interest and dominion over the property, as they have no conception of trust. Therefore the claim of sham trust will fail, the trust will be valid, and every action will simply be a breach of trust. It defies logic that someone who has no conception of a trust can be said to have manifested intention to create one in fact. While commercial certainty is important, the fact that some trusts are used in commercial settings is not a good enough reason to override long standing trust principles.

In *JEF v GJO*, Duffy J held that the trust deed, with the details of trustee powers, is enough evidence of settlor's objective intention to create a trust.[125] Justice Duffy held that once objective intention has been found, the only way to challenge the trust for lack of intention is to raise a sham argument.[126] A sham trust was found in *Rosebud Corporate Trustee Ltd v Bublitz* where a bankrupt arranged for a trust to be settled by his solicitors' company to carry out a business venture as he could not.[127] The company then acted as trustee. The bankrupt was not in the original trust deed, but added later by a separate deed. Justice Wylie held that sham intention requires a deliberate concealment and the misleading of third parties or the Court.[128] The solicitors admitted that the trust was established to enable the bankrupt to carry on with business and it was shown that the bankrupt clearly exercised factual control. Trust accounts were used for the day-to-day expenses of the bankrupt, and the payments made by the trust were paid directly to his wife.

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[122] At [77].
[123] McGhee, above n 15, at [22-069]; *Minwalla v Minwalla* [2004] EWHC 2823 (Fam), [2005] 1 WLR 771.
[124] *Official Assignee v Wilson & Clyma*, above n 7, at [26].
[125] *JEF v GJO* [2012] NZHC 1021 at [61].
[126] At [62].
[127] *Rosebud Corporate Trustee Ltd v Bublitz* [2014] NZHC 2018.
[128] At [90].

C. Sham Intent v Absence of Certainty of Intention

The sham trust doctrine finds that the "trust is void for the lack of intention to create a trust," with the requisite lack of intention being the intention to mislead.[129] This is conceptually incoherent as the early trust cases show that there must be a substantive intention to create a trust.[130] One must substantively intend to divest their interest and dominion in the property for the benefit of others. Therefore intending to mislead a court or third party into believing that arrangement existed is simply *one* of the ways to lack the substantive intention to create a trust. This part of the sham doctrine is inapplicable to trusts.

Lewin states that there is a difference between sham intent and absence of certainty of intention.[131] It claims that there will be times where someone attempts to settle a trust, but fails to as it does not fit the objective trust criterion,[132] e.g. an *inter vivos* trust that is actually a will. A distinction is made between a person who pretends to have the relevant intention to create a trust and executes documents to the effect, and someone who intends that their documents are to take effect according to the terms, but the terms do not constitute a trust.[133] While neither are a trust, they both are simply the lack of substantive intention to create a trust.

There could be a situation where there is an objectively valid deed, but the "settlor" lacks the substantive intention to create a trust. The authors have conflated contractual theory with an equitable transaction. Equity looks to intent rather than form,[134] so if the form fits the objective criteria of a trust, it will be void ab initio if the "settlor" did not have the substantive intent to create one, whether it is sham intent, or just lack thereof. Since a trust is "only a sham because there was no true trust intention as required for the valid creation of a trust",[135] it is artificial to limit that lack of intention to an intention to mislead. If there is a lack of substantive intention to create a trust (whether due to sham intent or not), there is no certainty of intention and there is no trust.

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[129] At [90]; *Official Assignee v Wilson & Clyma*, above n 7, at [26].
[130] See analysis in Chapter III; *Hughes v Stubbs* above n 21; *Bentley v Mackay* above n 61; *Smith v Warde*, above n 84.
[131] Tucker and others, above n 14, at [4-031].
[132] *Welsh Development Agency v Export Finance Co Ltd* [1992] BCLC 148 at 160.
[133] Tucker and others, above n 14, at [4-031].
[134] *Official Assignee v Wilson & Clyma*, above n 7, at [26]; McGhee, above n 15, at [5-013].
[135] Jessica Palmer "Controlling the Trust" (2011) 12 Otago L Rev 473 at 476.

D. Common Intention

The rationale for the need of a common intention to mislead in the context of *bilateral* transactions is conceptually justified, as it is upholding the certainty of bilateral transactions.[136] In the situation where someone's subjective intent is different to the formal intent of the document and they intended to mislead, the court will refuse to give effect to the objective transaction.[137] However the early cases show that it is a *unilateral* transaction that creates a trust.[138] Therefore the need of a common intention is incorrect. If the settlor and trustee have different intentions, it will not be a sham under the orthodox approach, but that does not prevent a trust from being invalid.[139]

Matthew Conaglen states that a "settlor" cannot set aside a trust after the property has been transferred to a trustee just because he secretly never intended to transfer his beneficial interest.[140] He states that it would be unfair for the settlor to set aside the trust in connection to the trustee due to the bilateral arrangement and sue the trustee for distributing the "trust" assets in accordance with the "trust" terms (although he admit this could be solved by estopping the "settlor").[141] He argues that third parties should have no standing to deny the existence of the trust due to this secret misleading intent,[142] and that is why the common intention is important.

Conaglen accepts that the settlor's intention is the only relevant factor as plausible when the settlor is the only trustee, but disagrees with it applying when there are separate trustees.[143] His reasoning is that the weight of modern authority is against it, but he does not indulge in any ideological enquiry.[144] Palmer has argued that when there is "no intention by the settlor to create a trust, there cannot be a trust."[145] Conaglen argues against that as he asserts it is not

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[136] Conaglen, above n 8, at 188.
[137] At 188.
[138] *Fletcher v Fletcher* above n 81; *Kekewich v Manning* above n 96.
[139] Peart "Intervention to Prevent the Abuse of Trust Structures", above n 1, at 583.
[140] Conaglen, above n 8, at 188.
[141] At 189.
[142] At 189; supported by Rimer J in *Shalson v Russo* [2003] EWHC 1637, [2005] Ch 281 at 342.
[143] Conaglen, above n 8, at 189.
[144] *Grupo Torras S.A. v Al-Sabah* [2003] JRC 092, [2004] 1 WTLR 1; *Shalson v Russo*, above n 142*; MacKinnon v Regent Trust Co Ltd* [2005] JCA odd, [2005] WTLR. 1367; *A v A* [2007] EWHC 99 (Fam).
[145] Palmer "Dealing with the Emerging Popularity of Sham Trusts", above n 9, at 97.

the focus of the sham doctrine. While he is correct about the sham doctrine, he is incorrect on its application to trusts.

Conaglen argues that the unilateral intention approach ignores "the importance of the point that a court needs a sound justification for ignoring the ordinary limits on the evidentiary material to which it may have regard to when determining the existence and meaning of a transaction."[146] He argues that since the intent of the settlor is determined objectively, then the court is not justified in ignoring it unless both settlor and trustee have a common subjective misleading intent. He states that to do otherwise would "unnecessarily and unjustifiably subvert the common law's commitment to the security of the objectively ascertained meaning of bilateral transactions."[147] First, a trust is unilateral. Second, Conaglen has made the critical mistake by grafting the sham doctrine onto trusts. Trusts are not common law, they are the realm of Equity and Equity looks to *intent* rather than form. Therefore the common law's commitment to objectively ascertained meanings is irrelevant.

Palmer argues that intention is to be ascertained objectively, but it cannot be ascertained only "by subjective intentions that are not manifest or expressed."[148] Palmer's argument is similar to mine in that one can look at evidence outside the trust deed of the settlor's *objective* intention. She is therefore objectifying the subjective, by looking at this other evidence and evaluating it. Therefore there may be a rare case where there is sufficient evidence outside the deed to show that the settlor did not objectively intend a trust.[149] Palmer is not resorting to a subjective analysis, but is analysing the *substantive* intent of the "settlor". Her argument that the entire substance of the transaction can be looked at, not just the formal intent of a deed. This is conceptually coherent as Equity always prefers substance over form.

The common intention approach is incompatible with *Fletcher v Fletcher*. Since a trust can be created without trustees, their intention is irrelevant. While no one can be compelled to be a trustee, a trust will not fail for want of one.[150] Due to this, the common intention approach must be incorrect. Testamentary trusts are created without the acceptance by a trustee and while they may agree to the terms and duties, they do not have to; the trust still exists without

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[146] Conaglen, above n 8, at 189.
[147] At 190.
[148] Palmer "Equity and Trusts", above n 68, at 144.
[149] At 146.
[150] *Re Lysaght* [1966] Ch 191; McGhee, above n 15, at [27-007].

their involvement. The Court itself stated that the "trustee's intentions are not critical."[151] This is supported as a settlor can unilaterally create a trust and it is complete without acceptance from trustees (who have disclaimed their role).[152] The common intention approach is relevant to contracts, as commonality of intention is essential in a contract's creation; common intention is relevant because it takes common intention to create a contract.[153] Only the settlor's intention is relevant for trusts, only they can intend to divest their interest and dominion.

[151] *Official Assignee v Wilson & Clyma*, above n 7, at [45].
[152] Tucker and others, above n 14, at [12-019].
[153] Palmer "Dealing with the Emerging Popularity of Sham Trusts", above n 9, at 93.

Chapter V: Illusory trusts

Before the Court of Appeal held they did not exist, illusory trusts were an alternative to the sham trust argument. While there are different formulations of the theory, the general point is that while there appears to be a trust, it lacks substance and therefore does not exist. They have been the only way to argue that there is no trust due to the control over the property, without the requirement of the shams' common intention to mislead.

While not using the term illusory, Fogarty J decided two cases that were the first to question whether there was actually a trust in existence due to the amount of power and exclusions from duties in the deed. His point of enquiry was whether the trust existed in substance. During this time, the Supreme Court of Bermuda explicitly found that a trust was illusory.[154] While the Court of Appeal seemed to disagree with Fogarty J's reasoning, it was not the end of illusory trusts. The concept found new life in the *Hotchin* litigation, in both the High Court and the Court of Appeal. Justice Winkelmann's point of enquiry was whether the settlor retained such control that they did not intend to give up control over the property sufficient to constitute a trust. This looks at whether the trust existed in substance, not just in form.

A. Developing cases

In *Harrison v Harrison*, a married couple settled a trust appointing a corporate trustee, with them as its directors and shareholders.[155] They possessed the power to appoint and remove trustees, and could appoint themselves if they wished. They were the primary beneficiaries, with their children (and others) being discretionary beneficiaries. The trustee had the power to appoint all the income and capital to any beneficiary, so the husband and wife could vest all the trust property in themselves by appointing themselves as trustees and exercising the power.

Justice Fogarty citied *Snell's Equity*[156] stating that "equity always prefers substance to form" or alternatively, "[E]quity looks to intent not form."[157] It appeared to him that nothing in substance had changed. He held that it appeared that the intention of the spouses when entering into the deed was "to retain complete control over the use and enjoyment of all the

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[154] *BQ v DQ*, above n 10.
[155] *Harrison v Harrison* (2008) 27 FRNZ 202 (HC).
[156] McGhee, *Snell's Equity* (31st ed, Sweet & Maxwell, London, 2005) at [5-24].
[157] *Harrison v Harrison*, above n 155, at [19].

assets."[158] Due to this ability and apparent intention he stated that there was a serious argument that the legal and equitable estates were still being held by the husband and wife.[159] As per *Selby v Aston*, when the legal and equitable estates are united in one person and are "co-extensive and commensurate, the latter is absorbed in the former."[160]

With respect to Fogarty J, his analysis is flawed. The legal and equitable estates would only have been commensurate if the settlor had been the only trustee and beneficiary or if the settlor was the sole director of the trust company and the corporate veil was lifted. [161] While the couple did have wide powers under the trust deed, they were not trustees. They still would be bound by the "irreducible core" and other duties that had not been excluded by the deed.[162] As they were not the only beneficiaries, the others could hold them to account for any abuse of the powers they had. It appears that Fogarty J's reasoning, while appealing in the situation, was to make up for the inadequacies of the PRA.

The Court of Appeal granted leave on this point, even though it was not one of the pleadings.[163] Justice Robertson stated that the legal structures created by the parties were the starting point for distribution, i.e. the trust deed could not be ignored.[164] The appeal was abandoned, but this strongly suggests that the Court of Appeal would have overruled Fogarty J.[165] This illustrates the continued reluctance of the Court to find that a trust does not exist when the parties have created a trust deed and transferred assets.[166]

Justice Fogarty also decided *B v X & Commissioner of Inland Revenue.*[167] B had settled a trust by transferring his company and home into trust. He was the sole trustee and a beneficiary along with his children, future spouse and a charity. He had the unfettered discretion to distribute income and capital to himself as one of the beneficiaries. The trust

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[158] At [26].
[159] At [26].
[160] *Selby v Alston* (1797) 3 Ves 338, 340-41.
[161] Nicola Peart "Relationship Property and Trusts: unfulfilled expectations" (paper presented to New Zealand Law Society Relationship Property Intensive, 2010).
[162] *Armitage v Nurse*, above n 2.
[163] *Harrison v Harrison* [2009] NZCA 68; [2009] NZFLR 687.
[164] At [22].
[165] Nicola Peart "Trusts and Relationship Property" (paper presented to Family Court Judges' Conference, Wellington, 2011).
[166] *Official Assignee v Wilson & Clyma*, above n 7, at [74].
[167] *B v X & Commissioner of Inland Revenue* [2011] NZFLR 481 (HC).

reduced his personal income and his liability to pay child support, but was administered completely separately from his estate. While it was argued that the trust was a sham, Fogarty J held that it was not as B had not intended to conceal the true nature of the transaction, entered it in good faith and intended to create a trust.[168]

Justice Fogarty held that the deed did not stop B from using the trust property for himself or his children in any way he wanted and therefore could use the property "in the same way he could have done but for the trust."[169] He also held that the deed imposed no constraint on the father in exercising the powers of the trust and that he owed no fiduciary obligations to his children a beneficiaries because no fiduciary obligations had been created by the deed.[170] The Judge held that B had a general power of appointment, which has "never been recognised in equity as constituting a fiduciary obligation."[171]

With respect, Fogarty J erred in two aspects. Firstly, there were fiduciary obligations as B was subject to the "irreducible core," and other duties not excluded by the trust deed.[172] Even though B had the power to self-deal, this did not detract from his obligations to the other beneficiaries and he still had to consider whether to appoint income or capital to them.[173] If he committed any breach of trust, the beneficiaries could still hold him to account. Secondly, B did not have a general power of appointment. A general power would have allowed him to appoint income and capital to anyone.[174] B only had a special power of appointment as he was restrained to those in the deed and had to consider his own interests and the interests of the beneficiaries.[175] Therefore B was subject to duties that were fiduciary in nature.[176] The trust was therefore valid, and neither a sham nor "illusory". One must be careful in this analysis however, as just because the deed puts a settlor-trustee under equitable obligations, it does not necessarily mean that they had the substantive intention to create a trust.[177]

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[168] At [83]-[85].
[169] At [82].
[170] At [95].
[171] At [95]
[172] *Armitage v Nurse*, above n 2, at 713.
[173] Peart "Trusts and Relationship Property", above n 165.
[174] Tucker and others, above n 14, at [30-002]-[30-003].
[175] Nicola Peart "Trusts and Relationship Property", above n 165.
[176] *Re Beatty* [1921] 1 Ch 34 (CA).
[177] This will be expanded upon in Chapter VI.

In *BQ v DQ*, the Supreme Court of Bermuda explicitly held that the trusts were "illusory."[178] Mr Q settled the trusts for the benefit of his children and grandchildren and he was initially the sole trustee of both. Q had the power of revocation over the trust and only he was entitled to the income and the capital of the trust during his lifetime.[179] He also possessed the power to add and remove trustees, which he exercised to add his wife. At his death the trust was to become irrevocable and trust property was to be divided equally for the beneficiaries. Article VIII H also gave him the power to completely release trustees (including himself) of any liability or responsibility owed to anyone.

It was argued that the trusts were testamentary, and therefore had been revoked by his marriage. Chief Justice Ground held that the "concatenation of rights and powers in the Settlor, when coupled with the fact that he was the sole trustee as the time of the constitution of the Trusts, rendered the trust illusory during his lifetime."[180] His Honour held that the effect of the deed was that Q was in de facto control of the trusts, which meant that he could not be held to account during his lifetime. He held that the settlor did not have the necessary intention to create a trust, but had rather intended the trust to take effect upon his death as part of estate planning.[181]

Chief Justice Ground stated that if the ability to release trustees from any liability was vested in an independent trustee, he may have found differently.[182] In his opinion, this ability pushed the case "over the top" when coupled with the other provisions. With respect, this is incorrect. As per Millet LJ in *Armitage v Nurse* "if the beneficiaries have no rights enforceable against the trustees there are no trusts."[183] Therefore the trusts were "illusory" not because of who possessed what powers in the deed, but the fact that the beneficiaries had no rights that were enforceable due to Art VIII H during Q's lifetime. If there are no enforceable rights, there is no trust. While the decision was correct, the reasoning was wrong.[184] Q did not substantively intend a trust as he retained all control and owed no duties.

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[178] *BQ v DQ*, above n 10, at [29].
[179] At [5].
[180] At [29].
[181] At [30].
[182] At [29].
[183] *Armitage v Nurse*, above n 2, at 253; which was even cited in the case.
[184] Peart "Trusts and Relationship Property", above n 165.

B. Hotchin litigation

In *Financial Markets Authority v Hotchin*, the FMA applied for freezing orders over property from two trusts.[185] Mr Hotchin was the settlor, had the power to appoint and remove trustees from both trusts and was the sole trustee of one trust, but had since removed himself and appointed a corporate trustee. For one of the trusts, Mr Hotchin was a discretionary beneficiary and had the power to add and remove discretionary beneficiaries, with his children being the final beneficiaries.[186] These powers were made unfettered in the deed, and could be exercised even if the interests of the beneficiaries were not considered, or if the exercise of the power might be contrary to the interests of a future beneficiary.[187] The deed also contained a self-dealing clause that prevented a trustee who was also a beneficiary from exercising a power or discretion in their favour. The deed also gave the trustee (with settlor's consent) the power to revoke or amend the administrative provisions in the trust.[188]

Justice Winkelmann cited *Welsh Development Agency v Export Finance* Co *Ltd* to highlight the distinction between when parties enter into an agreement as a sham "to mask their true agreement",[189] and when the transaction fails to be the agreement intended due to failing on an objective criterion of law.[190] Her Honour stated that: [191]

> The issue in this case is therefore whether, in light of the provisions of the trust deeds, it is arguable that Mr Hotchin retains such control that the proper construction is that he did not intend to give or part with control over the property sufficient to constitute a trust.

The judge cited *Hughes v Stubb* as supporting this analysis.[192] While *TMSF v Merrill Lynch Bank and Trust Co Ltd* was cited as authority for the power of revocation as being tantamount to ownership, the case is irrelevant as Hotchin did not have the power of revocation, nor did he have the ability to wind up the trust by distributing the trust property to himself due to the self-dealing clause.[193] The Judge also held that even if the prevention of self-dealing

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[185] *Financial Markets Authority v Hotchin*, above n 16.
[186] At [32].
[187] At [33].
[188] At [35].
[189] *Welsh Development Agency v Export Finance* Co *Ltd*, above n 132, at 160.
[190] At 160; *Financial Markets Authority v Hotchin*, above n 16, at [29].
[191] At [30].
[192] At [38].
[193] *TSMF v Merrill Lynch Bank and Trust Co Ltd* [2011] UKPC 17.

constituted as part of the administration part of the trust, the removal of it would not be for the purposes of carrying out the trust deed into effect but would be for the benefit of Mr Hotchin. It would therefore be self-dealing and ergo prohibited.[194]

It appears that but for the self-dealing clause, Winkelmann J would have considered that the lack of existence of the trusts was at least arguable. Justice Winkelmann held that the claim that the trust lacked certainty of intention could not succeed.[195] Coupled with the reference to *Welsh Development Agency* it implies that whether a settlor has intended to part with control over the trust property sufficient to constitute a trust is a matter of certainty of intention. This is different to the High Court in *Clayton*, which postulated whether control invalidated a trust after the certainty of intention had been found. Therefore the self-dealing clause can be seen as evidence that Hotchin intended to divest his interest and dominion over the property.

On appeal, the Court implied that the sham trust threshold could actually be lower than in *Wilson.*[196] In the context of trusts possessing only a settlor-trustee, the Court stated that merely intending to retain control of the property (not the intention to mislead) would be sufficient to constitute a sham trust and that evidence of this can be manifested from post-settlement actions.[197] The Court recognised that "when sham is alleged, the Court may look at the substance of the transaction and not just its form."[198] Here the Court is practically following the substantive intention approach, in that the appearance of a wide range of powers and control over a trust may show that the "settlor" did not substantively intend to divest their interest and dominion in the property, despite the perhaps formal intention of the deed.

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[194] *Financial Markets Authority v Hotchin*, above n 16, at [41].
[195] At [42].
[196] *KA No 4 Trustee Ltd and KA No 3 Trustee Ltd v Financial Markets Authority* [2012] NZCA 370.
[197] At [46].
[198] At [52].

Chapter VI: Problems, Solutions and Effects

A. Proposed Theory

As demonstrated by early cases, certainty of intention is to be found substantively; not just a formal approach that stops at the trust deed and only departs to find an intention to mislead. With respect, the Court in *Wilson* and *Clayton* were wrong. I propose that an "illusory" trust is when someone attempts to settle a trust, but it is void ab initio on the grounds of lacking certainty of intention. While it may seem to be a "trust", it is in fact an illusion, a mirage; the settlor did not substantively intend to create one. There will be many different ways that a "settlor" could lack certainty of intention and sham intent is therefore subsumed under it. Since only the intent of the "settlor" is relevant,[199] the analysis for an illusory trust should be:

1) Is there evidence of the settlor's substantive intent to create a trust i.e. to divest their interest and dominion over the property, for the benefit of others? The formal intent of a deed/words will be strong evidence of this.
2) If the deed reserves an exceptional amount of power to the settlor potentially coupled with the exclusion of excludable duties, the Court may infer that they never intended to divest their dominion and interest and therefore did not substantively intend a trust.
3) If the deed (including powers) appears to be a trust, this will be heavily weighted evidence that will create a presumption of trust.
4) A party could bring objectively manifested evidence to show that the "settlor" lacked substantive intention to create a trust, as long as the evidence shows they lacked substantive intention at "settlement".
5) Evidence contrary to the deed must be strong to rebut the presumption of substantive intent inferred from it. A few breaches of trust or someone merely claiming there was no intention will not be enough.
6) If there is enough evidence to rebut the presumption of trust (i.e. lack of substantive intention), the "trust" will be void ab initio. If there is not enough contrary evidence, it is valid and enforceable.

[199] Palmer "Dealing with the Emerging Popularity of Sham Trusts", above n 9, at ; *Fletcher v Fletcher*, above n 81.

While not a fraud threshold, it will be found on the balance of probabilities. However, the formal intent of the deed will be strong evidence of the substantive intention to create a trust and it will take stronger evidence to rebut that presumption. The Law Commission itself has recommended that it is best to approach sham trusts by looking at whether the settlor possessed the certainty of intention, and that it could be possible to bring evidence to show that what is written in the deed is not what was intended.[200] I simply prefer the term "illusory" as "sham" is a misnomer.

If the powers strip the trustees of all accountability, there will be no trust.[201] While the "irreducible core" is necessary for a trust, it is not solely sufficient. Palmer argues that if the powers do not do strip all accountability, the trust must stand and that the presence of the irreducible core means a valid trust exists.[202] I am arguing that the vast amount of powers show that the "settlor" did not intend to divest their interest and dominion over the property, therefore do not possess the requisite substantive intention to create a trust. Therefore the existence of an "irreducible core" in the deed remains largely irrelevant for this intention analysis. The fact that all fiduciary duties are not excluded by a deed will not automatically preclude the "trust" from being illusory.

B. Evidence of Illusory Trusts

There are two types of conduct that will occur in connection to a trust. Firstly, breach of trust: where a settlor or trustee acts against the deed or law (including omissions like failing to act honestly). Secondly, authorised conduct: where a settlor or trustee exercises a power or action that the deed or law has expressly authorised (including omissions like not considering beneficiaries' interests)

i) Breach of Trust

If someone breaches the deed (or duties imposed by Equity/law not excluded by the deed), it will clearly be a breach of trust. As correctly stated in *Wilson*, breaches of trust can be valuable evidence in finding a sham (or as I am arguing, lack of intention to create a trust).[203]

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[200] Law Commission *Some Issues with the Use of Trusts in New Zealand* (NZLC IP20, 2010) at 59; GE Dal Pont and DRC Chalmers *Equity and Trusts in Australia* (4th ed, Lawbook Co, Pyrmont, NSW, 2007) at 459.
[201] Palmer "Controlling the Trust", above n 135, at 480.
[202] Jessica Palmer "Equity and Trusts" [2015] NZ L Rev 141 at 146.
[203] *Official Assignee v Wilson & Clyma*, above n 7, at [77].

As in *Bublitz*, trust accounts were used to pay for the day-to-day expenses of the bankrupt and trust payments were made directly to his wife. These post-settlement actions were clearly breaches of trust.

Breaches of trust can be used as evidence for the lack of intent to create a trust at its "settlement". Actions such as breaches of trust by the settlor-trustee, the settlor having effective control over the trustees (alter ego trust) and dishonest assistance by the settlor may allow for an inference that the settlor lacked the substantive intention to create a trust when it was "settled". A single or a few breaches of trust will likely not be sufficient to justify the inference that the settlor did not possess the requisite intent at "settlement". It cannot be quantified mathematically, so every case will have to be judged on its facts. If there are continuous breaches (perhaps in conjunction with other evidence), it may be justifiable to find that the settlor lacked the substantive intent to create a trust at the time of "settlement".

ii) Authorised conduct

Equity looks to the intent/substance rather than the form. Therefore a situation could arise where there is a objectively valid trust deed in form, but it is argued that there is no trust as the settlor has so much control due to the large combination of (individually valid) powers, and therefore did not have the requisite substantive intention to create a trust as they did not intend to divest their interest and dominion.[204]

The question is therefore: what combination of powers that, by themselves, are considered valid under a deed but show that a "settlor" never had the intention to divest themselves of their interest and dominion over the property? This question is very different to the one proposed by the Family and High Courts in *Clayton*. The Courts proposed whether, after intention to create a trust had been found, was there so much control that the trust was invalid. The former goes to certainty of intention and will find a trust void ab initio, while the later appears to invalidate a valid trust. I agree with the Court of Appeal that the latter is a contradictory position and is untenable.[205] A valid trust cannot be invalidated by the amount of control a trustee or settlor has. I am arguing that the amount of control shows that the trust is void ab initio due to lack of *substantive intention* to create a trust.

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[204] *Hughes v Stubbs*, above n 21, at 478-479.
[205] *Clayton v Clayton* (CA), above n 5, at [85].

Palmer has stated in the context of control, as long as the powers in the trust do not impinge on a trustee's duty and ability to act in honesty and good faith, the trust is valid and the "beneficial interest in the property cannot be stripped from the beneficiaries in favour of the controlling party."[206] I agree with this, in that control does not strip a beneficiary of their beneficial interest. My argument is that due to the vast control reserved, the settlor never substantively intended a trust and therefore the beneficiaries never acquired that interest. In *Hotchin*, the clause in the deed prevented him from any form of self-dealing. While Hotchin did have vast powers, he still could not use the trust to benefit himself. Therefore it seems that under *Hughes v Stubbs*, he had divested himself of his interest and dominion as he could no longer use it in his favour.

My argument is not that the powers are individually inconsistent with a trust or that they strip the trust to the irreducible core, yet it is still void because of the significant control reserved. My argument is that the settlor has reserved such wide powers and excluded so many duties that they never substantively intended to create a trust (divesting themselves of their interest and dominion over the property). You can "intend" to enter a contract, but if there is no consideration, there is no contract.[207] I agree with Palmer that control in of itself is not a ground to invalidate a trust, but that it is relevant as to whether the "settlor" lacked the intention to create a trust.[208] There would also be a lack of substantive intent if the "settlor" had no conception of what a trust is (but this would have to be proven through communications, actions and potential documents).

It will be hard to definitively rule on what combination of powers could allow a court to infer that a "settlor" never intended to create a trust. It will be best to weigh the formal intent of a deed with the powers, actions and knowledge to show whether the "settlor" had the requisite substantive intent. To me it seems that if a "trust" has some of following characteristics, it may be inferred that the "settlor" did not have the substantive intention to create a trust at the time of settlement:

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[206] Palmer "Controlling the Trust", above n 135, at 479.
[207] *National Bank of New Zealand Ltd v Waitaki International Processing (NI) Ltd* [1997] 1 NZLR 724.
[208] Palmer "Controlling the Trust", above n 135, at 486; *Antle v Canada* [2010] FCA 280, 61 ETR (3d) 13.

1. There are few duties, or none other than the irreducible core (if there is no irreducible core, there is simply no trust);[209]
2. there are no other trustees than the settlor-trustee at settlement and they are also a beneficiary;
3. the settlor holds wide (general) powers, unconstrained by Equity;
4. there is no prohibition on self-dealing if the settlor is the only trustee;
5. the ability of a settlor to wind up the trust by distributing the property to themselves without considering the interests of other beneficiaries;
6. the settlor treats the property as their own;
7. the settlor has no conception of what a trust is;
8. continuous and/or egregious breaches of trust by a settlor;
9. the settlor has factual control over the trust/trustees (i.e. alter ego trust).[210]

It is not that these characteristics are individually invalid, their combination merely shows that the "settlor' lacked the substantive intent to divest their interest and dominion over the property. Certain characteristics will have more weight than others; breaches of trust will not necessarily be decisive, but will be of evidential value in finding a trust illusory. It is important to note that the lack of substantive intention has to exist at "settlement" for the trust to be void. A valid trust cannot be invalidated by these factors. They only provide evidence that the "settlor" lacked the substantive intention to create a trust at "settlement".

While the existence of another trustee at settlement may imply the "settlor" intended to divest their dominion, it actually might not if it is coupled with a general power to remove trustees. Since the power is general it does not need to be exercised in good faith and therefore the settlor could remove a trustee that does not agree with them on any point,[211] showing that they did not intend to give up their control, and therefore lack substantive intention to create a trust.

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[209] *Armitage v Nurse*, above n 2.
[210] See the discussion on *Official Assignee v Wilson & Clyma* in Chapter III for more information on this point.
[211] Since it is held personally it cannot be constrained by the fraud on a power doctrine; *Clayton v Clayton* (CA), above n 5, at [89].

C. VRPT analysis

Was the VRPT void ab initio for lack of intention and therefore, under my formulation, an illusory trust"? Mr Clayton was the settlor-trustee, and a discretionary beneficiary. He could apply all the trust income and capital to himself at any time, and could use this power contrary to the interests of other beneficiaries, he did not need to consider their interests at all. The trustees were relieved from any potential conflict of interest and could not be held to account by the beneficiaries when using their discretion. Under the deed, the beneficiaries could only really hold the trustee to account for the "irreducible core" of obligations.

One factor pointing towards Clayton intending to divest his interest in the property is the inability to remove his children as the final beneficiaries. The power to add and remove beneficiaries only enabled the removal of *discretionary* beneficiaries, not final beneficiaries. This could imply that Mr Clayton did intend for the "trust" property to end up in their hands to a degree, as there was no way to remove them as final beneficiaries. However, as settlor-trustee he was able to wind up the trust at any time by appointing himself all the capital/income without considering their interests as long as he did not breach the remaining duties of the "irreducible core".

The power to add and remove beneficiaries was granted to Mr Clayton as "Principal Family Member"; it was a general power of appointment. One argument is that the powers of the settlor ought to be constrained by the duties given the objective intention to create a trust.[212] While one can interpret the fiduciary powers as constrained by Equity, this power was completed unfettered; he owed no fiduciary duties in relation to it, and he could not be constrained by the "fraud on a power" doctrine as he had given the power to himself.[213] Therefore Mr Clayton had intended this unfettered dominion and control over the "trust" to not be subject to any obligations. If a trustee were to disagree with an intended distribution, Clayton had the unfettered power to remove them to enact his decision.

On the face of the deed it appears that, due to the wide range of powers and exclusions, Clayton never substantively intended to divest his interest, control and dominion over the property and therefore did not have requisite substantive intention to create a trust. Analysing

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[212] Palmer "Equity and Trusts", above n 202, at 146.
[213] Tucket and others, above n 14, at [30-003]-[30-011]; *Clayton v Clayton* (CA), above n 5, at [89]; *Kain v Hutton* [2008] NZSC 61, [2008] 3 NZLR 589.

the powers in the deed along with the release from numerous duties, it is my conclusion that Clayton intended continue to act like the property was his own. While he may have genuinely intended to create a "trust", he did not substantively intend one. Therefore I would hold the VRPT as illusory and void ab initio. The critical points for me are that there were no other trustees, express relief from the prevention of self-interest and that the powers to appoint and remove trustees and beneficiaries were both general powers, unconstrained by Equity. Therefore the Court in Clayton was incorrect in its analysis of sham and illusory trusts.

If the general powers were vested in another person, perhaps I would find that there was a trust as it would show that Clayton had intended to divest his interest and dominion over the property. His dominion over the property would have been divested to another person and that person would be subject to the fraud on a power doctrine. This would be different to *BQ V DQ*, as the trust should have been found void due to the removal of all duties meaning there was no trust, not who possessed certain powers.[214]

D. Estoppel and resulting trust

If the trust is found void ab initio, the property will be held on resulting trust for the settlor by the trustees.[215] If any dispositions of property had been made to the "beneficiaries", the settlor would be estopped from making any personal or proprietary claims against the trustee if they had acted in good faith, believed they were to make such distributions by the deed or words, relied upon it and it would be unconscionable for the settlor to deny it.[216]

Under substantive certainty of intention, a "settlor" may argue that he never actually intended a trust in order to get the property back. This could be solved by estoppel. Since a shammer cannot rely on their sham intent against innocent third parties,[217] this can be extended to "settlors" that lack substantive intent. However, since the trust is void ab initio, there is no trust. By preventing the settlor stating that there is no trust, the trustee is left in limbo, being caretaker of property that a court is yet to declare as held on a resulting trust. The problem facing trusts is that people are attempting to settle "trusts" but they do not have the substantive intention to create a trust, for whatever reason. Preventing a settlor from claiming

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[214] Peart "Trusts and Relationship Property", above n 165.
[215] *Clayton v Clayton* (CA), above n 5, at [63].
[216] *Waltons Stores (Interstate) Ltd v Maher* (1988) 164 CLR 387, 34; *Wilson Parking New Zealand Ltd v Fanshawe 136 Ltd* [2014] NZCA 407, [2014] 3 NZLR 567.
[217] Tucker and others, above n 14, at [4-028]; *Carman v Yates* [2004] EWHC 3448 (Ch).

that they lacked this substantive intent would not solve this problem as it would protect a "trust" that is in substance and fact not a trust. While a settlor may intend a trust at the time and then change their mind later, settlor's claim of lack of subjective intent would on its own would never be strong enough to rebut the presumption.[218]

As a valid deed is strong evidence of intention to create a trust, there must be stronger evidence to rebut the presumption it creates. This would prevent a settlor that had not reserved a power of revocation (making the trust valid and irrevocable)[219] from claiming that trust did not exist to merely get their property back in an opportune way. While this may seem odd, it is conceptually coherent. Practically speaking, a settlor is rarely going to claim that there is no trust as it would put the property back in his hands; the main point of the modern trust is to remove the property from your estate to avoid liability. On the rare occasion that it is made, a simple claim of lack of substantive intent without objectively manifested evidence would never justify a finding of an illusory trust.

[218] As in situations such as *Paterson v Murphy,* above n 94.
[219] Tucker and others, above n 14, at [30-085]; *Paul v Paul* (1882) 20 Ch D 742.

Chapter VII: Conclusion

While the conceptual basis for the sham doctrine may apply to bilateral transactions such as contracts, it cannot apply to trusts. The early trust cases clearly show that a trust is a unilateral transaction that creates a relationship.[220] While this may seem like a contradiction, it is not. Trusts will not fail for want of a trustee,[221] they continue to exist if a person disclaims the role of trustee,[222] and the trustees do not even need to know that they are trustees for the trust to exist.[223] A trust will not be a trust if the "settlor" did not substantively intend to create a trust. They therefore must substantively intend to divest their interest and dominion in property, for the benefit of others The formal intent of a deed will be strong evidence of this, but it can be rebutted if the extent of the terms in the deed show they did not intend to divest their interest and dominion, or if they lack substantive intent proven by other objectively manifested evidence

The Family and High Courts in *Clayton* were both incorrect in their analysis of trust law. A valid trust cannot become invalid due to control or mismanagement.[224] A trust will be "illusory" when it is an illusion; where there appears to be a trust (due to a deed or words), but in reality there is no trust due to the settlor lacking the substantive certainty of intention to create one. The courts have already established that the sham doctrine voids the trust ab initio for lack of intention, but they conflate lack of intention with intention to mislead. Sham intent is only one way someone can lack certainty of intention, and to restrict the test to only that (along with the need for a common intention) is unprincipled and conceptually incorrect and incoherent.

One cannot simply limit the analysis of trust intention to formal intent, only departing for a subjective common intention to mislead. From a practical stand point, anyone challenging the validity of a trust will make a sham claim. Therefore, unless the claim is so untenable that it is stuck out instantly, the Court will have to indulge in the analysis of subjective/substantive intent outside the trust deed. Therefore in most instances the substantive intentions of the

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[220] *Fletcher v Fletcher*, above n 81.
[221] McGhee, above n 15, at [27-007]; *Re Lysaght*, above n 150.
[222] Tucker and others, above n 14, at [12-019]; *Mallott v Wilson* [1903] 2 Ch 495.
[223] *Fletcher v Fletcher*, above n 81.
[224] *Official Assignee v Wilson & Clyma*, above n 7, at [71], [92].

"settlor" will be relevant, even if it is very unlikely that the trust will be found void ab initio. It is simply not good enough for a court to cry "commercial certainty" as its only justification and then ignore centuries of equitable and trust principles.[225] The Court of Appeal in *Clayton* was worried about the unintended consequences that might occur to New Zealand trusts if a subjective approach was taken.[226] Essentially, the Court was worried that many trusts would be found void, especially since there are many large farming trusts and the fact that New Zealand is seen as an overseas trust haven.

These worries are unfounded. My approach is not a purely subjective approach. My approach merely includes the entire substance of the transaction, which includes objectively manifested evidence other than the deed. The Court in *Wilson* set a high threshold for shams, and this would continue under my illusory trust approach. A valid deed will be strong evidence of the intention to create a trust, and creates a presumption of one. It will be onerous to rebut this presumption. Unless there are serious continuous breaches (*Bublitz*), a complete disregard of the trust (*Star v Star*), so much control that the "settlor" never intended to give up dominion over the property, actual evidence showing no knowledge of what a trust is by the "settlor", or other strong evidence, it seems highly unlikely that a trust will be found void ab initio due to lack of substantive intention.

A finding of my illusory trust will still be a "high threshold" and it will still be a severe finding that the trust is void ab initio.[227] It will take significant evidence to show that a "settlor" had a different substantive intent to the formal intent of the deed. My theory does not open the floodgates to voiding trusts, but makes trust law conceptually coherent with trust principles.

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[225] *Official Assignee v Wilson & Clyma*, above n 7, at [53].
[226] *Clayton v Clayton* (CA), above n 5, at [83].
[227] *Official Assignee v Wilson & Clyma*, above n 7, at [53].

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