



**EXAMINING THE ROLE OF ASSET PROTECTION IN ESTATE PLANNING AND  
HOW IT IMPACTS ON THE FAMILY LAW JURISDICTION**

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**By Phillip E. Sorensen LLB, Accredited Family Law Specialist<sup>1</sup>**

*'When, in disgrace with Fortune and men's eyes,  
I all alone beweeep my outcast state,  
And trouble deaf heaven with my bootless cries,  
And look upon myself, and curse my Fate  
...'*

William Shakespeare, *Sonnets*

Groom & Lavers Solicitors of Toowoomba & Oakey

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<sup>1</sup> Partner, Groom & Lavers Solicitors of Toowoomba & Oakey

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## Overview

Part 1 - Understanding when asset protection strategies are most commonly employed

Part 2 - Looking at the different means of sheltering assets from future personal and financial difficulties

Part 3 - Assessing how asset protection may disadvantage a party to a marriage

Part 4 - To what extent can asset protection strategies remove assets from the jurisdiction of the Family Court?

Part 5 - Examining whether the *Bankruptcy and Family Law Legislation Act 2005* will have any significant impact on family law cases

Part 6 - Considering pre-nuptial agreements as a form of asset protection

## PART 1 - UNDERSTANDING WHEN ASSET PROTECTION STRATEGIES ARE MOST COMMONLY EMPLOYED

### Chapter 1

#### Introduction

- [ 1 ] There may be only one person lonelier than a person separated from their spouse, and that is a person both separated from their spouse and facing bankruptcy or the threat of it by virtue of action from creditors.
- [ 2 ] It is prudent for clients to develop and deploy strategies to protect their assets against the buffeting they may face in the event of a breakdown of their relationship, and/ or that they may suffer in the turbulence of financial difficulty.

#### The Scenario

- [ 3 ] Your mission ... should you choose to accept it:

One of your favourite local business clients (Mr. D. Quixote<sup>2</sup>) comes to you and tells you he is thinking of getting married soon, next weekend actually. His intended is a lovely lady you have never heard of as your client only met her in the last couple of months.

Your client has been to a seminar conducted by one of the local accountants on asset planning. Your clients says they used a computer presentation and kept on about protecting assets for the future. Don reckons that sounds like a great idea.

He also mentions he has a project in mind (he is a bit of a dreamer and schemer your Don) which he would like to tell you about when he has some more details, but it could be big. It could also be a bit high risk. Your client tells you he has heard on the radio that the Government has changed the law after some big case down south involving some rich bloke but he knows nothing more than that. He would like to know more.

Don say he would hate to lose everything, 'If it all went south'.

He tells you that what he does know is that, if he could, he would like one of those impenetrable 'Massey Pre - Nups'<sup>3</sup>, he saw on a DVD<sup>4</sup> (*Mr Quixote has issues distinguishing fantasy from reality*).

Don said the accountants mentioned that putting assets in his future wife's name could be for good business planning, you know to keep his assets away from creditors if things go

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<sup>2</sup> A man full of romantic ideals.

<sup>3</sup> An ironclad, air tight, 'Impenetrable' Pre- Nuptial or Binding Financial Agreement. See [http://www.legalzoom.com/articles/article\\_content/article14056.html](http://www.legalzoom.com/articles/article_content/article14056.html)

<sup>4</sup> 'Intolerable Cruelty' Rated PG-13 - Running Time: 1:40 - Released 10/10/03 <http://www.intolerablecruelty.com/index.php> a documentary for Family Lawyers or 'Romantic comedy' for normal people, starring George Clooney and Catherine Zeta - Jones. George Clooney plays a lawyer who becomes famous for his hermetic ('impenetrable!') pre-nuptial agreement, dubbed the 'Massey Pre-nup', after his character in the film, Miles Massey a divorce lawyer to the wealthy, fabulous, and comical. 'The Massey Pre-nup is sought after as the ultimate problem solver, the uncontestable contract, all in all, the billionaire's best friend.' Recommended viewing for all those interested in the strategic use of Binding Financial agreements, in the Hollywood context of course. See the web site for a 'Pre - Nup' generator.

pear shaped, but he is a bit nervous also about his wife getting everything if they split up  
...As he leaves your office client asks again, if you can get him one of those 'Impenetrable'  
Pre Nups, or something like it.

You grab a coffee, turn on your computer screen, check the cricket score  
<http://www.cricinfo.com/> then ...

You go to <http://www.lexisnexis.com.au/aus/default.asp> to look up your Family Law Service  
to see what you can find out...

### **The good old days**

- [ 4 ] Well of course in the old days if you wanted to do some asset planning you would simply get secretary to bring you a hard copy of your precedent trust deed because being a Solicitor ( sorry 'Lawyer' ) you couldn't use a computer. You would pencil in the changes to insert the details for your current client in the place of the previous one. Then you would fax off an order for a shelf company to act as trustee. Estate planning 101 was as simple and uncomplicated as life on the farm used to be when people didn't worry about climate change and before the dollar was floated. And of course people used to stay married.

### **The threat horizon**

- [ 5 ] Your client<sup>5</sup> may face the challenge of bankruptcy from foreseen and unforeseen forces coming over many different horizons, and at different times. Are creditors his only worry?

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<sup>5</sup> Throughout the paper I have used the device of referring to the Husband as the 'business' owner who is in need of asset protection. This is for convenience only.

## Chapter 2

### Main purpose

- [ 6 ] The main purpose of any estate planning strategy is to make sure the right people receive the most of your assets in the most tax effective manner whilst protecting assets from ending up in the wrong hands<sup>6</sup>. For some the strategy is mainly about tax minimization. The focus in this paper however concerns Don's quest for asset protection.

### Reasons for asset planning

- [ 7 ] The reasons for asset planning may be many fold.  
For example your client may be a principal of, or employed in an occupation or business which is at some litigation risk ('high risk occupations') :
- Accounting practitioner particularly auditors
  - Company director or senior executive
  - Engineer
  - Insurance or Investment advisor
  - Legal practitioner particularly specialists
  - Medical practitioner particularly specialists
  - Property developer or Real estate agent
- These are only some examples. I am sure you can think of many others in your practice.
- [ 8 ] Your client may have been previously married and therefore separation 'shy'.
- [ 9 ] Alternatively, your client may be an investor in a high risk area, and wish to quarantine his personal assets from his investment activities. Or simply your client may be a parent or indeed spouse of any of the above.
- [ 10 ] For the client involved in each of the above examples an asset planning or estate planning strategy is prudent to protect wealth built up in many cases from a lifetime of work. The purpose is to protect the wealth for the benefit of the client and those he holds near and dear, for now and retirement, against future personal and financial difficulties.

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<sup>6</sup> 'Keeping it in the Family', Wealth Magazine, *The Australian* 15.03.06, p 6.



## **PART 2 - LOOKING AT THE DIFFERENT MEANS OF SHELTERING ASSETS FROM FUTURE PERSONAL AND FINANCIAL DIFFICULTIES**

### **Chapter 1- Asset protection strategies used**

#### **Introduction**

- [ 11 ] In order to shelter ones assets from future personal and financial difficulties, those assets need to be placed on the one hand, out of reach of one's spouse, or on the other hand, out of reach of one's creditors. These are of course threats which have different interests but similar objectives i.e. claiming some or all of your clients assets for division.
- [ 12 ] Sheltering assets in a company or trust structure has been a commonly deployed device throughout history.
- [ 13 ] The utility of the device will depend whether it can achieve the main purpose.

## Chapter 2 - Trusts <sup>7</sup>

### Introduction

[ 14 ] A Trust is one form of entity<sup>8</sup> used to hold assets. The three main reasons<sup>9</sup> why trust is often favoured entity (compare to other entity) as part of the business or investment structure are:

- flexibility
- asset protection
- taxation advantages.

In this paper we will only consider the second namely asset protection.

[ 15 ] We will later in this chapter discuss some of the common forms, but now recap on some trust basics.

### Some trust basics

[ 16 ] A trust may be defined as an equitable **obligation** binding a person (who is called 'the **trustee**') to deal with property over which he/she has control (which is called the '**trust property**') for the benefit of persons (who are called the '**beneficiaries**') of whom he/she may be one, and any one of whom may enforce the obligation. (Underhill -" Law of Trusts.")<sup>10</sup>

[ 17 ] The four elements of the trust are<sup>11</sup>:

- The trustee
- The trust property
- The beneficiaries
- A personal obligation annexed to the property (i.e. the obligation imposed on the trustee to deal with the trust property for the benefit of the beneficiaries)

[ 18 ] The main obligation of a trustee is to account in respect of the trust property. For a trust to exist the owner (the Trustee) must have become subject to a minimum obligation to act honestly and in good faith in relation to the trust

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7 I acknowledge the assistance of my colleague Robert Gunningham, MBA, Partner, Groom & Lavers for use of parts of his paper 'Asset Protection And Succession Strategy', delivered September 2005, upon which I have drawn for this paper.

8 A trust is not a legal entity in its own right, but may be treated as one for tax purposes. '*Lock Stock & Barrel*', NTAA Seminar Trusts 2006, National Tax & Accountants Association Ltd. (NTAA), p3

9 *ibid*

10 <http://www.publictrustee.sa.on.net/productsAndServices/estateServices/trusts.htm>

11 NTAA, p3

property for the benefit of a beneficiary or the purpose. The obligation to account is enforceable by legal proceedings.<sup>12</sup>

[ 19 ] Trustees are only one kind of person obliged to act for the benefit of another. Others similarly obliged include directors of companies acting for their company, agents acting for their principal and guardians acting for their ward. The feature distinguishing a trustee from these other persons is that title to property has been vested in the trustee so that it can be held for the benefit of the beneficiary.<sup>13</sup>

[ 20 ] A key to an understanding of this area is the concept that pursuant to a trust, property is held in such a way that one person (the trustee) has complete control of the property while another person gets the benefit of that property (the beneficiary). This is why, in the creation of a trust no decision is more crucial than that of the selection of the trustee.<sup>14</sup> From the asset planning perspective the most important decision is the selection of the appointor.

[ 21 ] The obligations of a trustee may be voluntarily assumed by the acquisition of property from another person (the Settlor) under a disposition inter vivos (made by someone during their lifetime), or under the Will of a testator, where the terms of the disposition show an intention to impose the obligations of trusteeship. The obligations of a trustee may also be voluntarily assumed by a beneficial owner of some specific property declaring a present intention to hold that property henceforth subject to a trust for a certain person or purpose.

[ 22 ] The essential feature of every trust is that one person is an owner who is bound to use the legal position as owner for the benefit of another person or for the advancement of some purpose.

[ 23 ] A Trust can be created by:

- a Will: this is known as a testamentary trust and becomes effective from the death of the testator;
- a deed or declaration made in the lifetime of the creator the trust.

In both cases, the assets are put in the control of the Trustee.<sup>15</sup>

### **Common types of Trusts**

[ 24 ] Common types of trusts<sup>16</sup> encountered in practice include:-

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<sup>12</sup> Ford & Lee, *Principles of the Law of Trusts*, Thomson Lawbook Co., 3<sup>rd</sup> ed, 1996, para [1000]

<sup>13</sup> *ibid*

<sup>14</sup> *op.cit*, para [8000]

<sup>15</sup> <http://www.pt.nsw.gov.au/Content+Menus/Trusts/Trust+FAQs/default.aspx>

- fixed trusts
- discretionary trusts
- restricted or hybrid trusts
- unit trusts
- testamentary trusts

### Fixed Trusts

- [ 25 ] A fixed trust is one created requiring the trustee to distribute the property among beneficiaries without the trustee having any discretion as to who is to be a distributee or as to the amount which each is to be given. The effect is to give each beneficiary a fixed interest under those provisions.

### Discretionary Trust

- [ 26 ] Family Trusts<sup>17</sup> which operate for a duration of up to 80 years are the most common form of discretionary trust. The minimization of tax is the usual primary reason a family trust is established, as tax can be distributed to lower income earners and therefore attract a lower incident of tax.
- [ 27 ] A Discretionary trust is one which is expressly created in which there may be provisions under which the acquisition by a beneficiary of an interest in property pursuant to the trust, of the amount to be received, is made dependent on the exercise of the trustee's discretion.<sup>18</sup> The expression 'discretionary trust' refers to the directions of the creator of the trust which confer the discretion rather than the instrument in which those directions are contained. Because of this flexibility for taxation purposes discretionary trusts are the most common type of trust employed by estate planners.

### Example – Discretionary trust

- [ 28 ] The following is an example of a provision from a discretionary trust deed providing for distribution of income:

***Income***<sup>19</sup>

4.1 *Discretionary distribution*

The Trustee holds the income of a financial year which is available for distribution upon trust **to pay, apply or set aside the income**, or any part of the income, to or for the benefit of the beneficiaries, other than a default beneficiary who is not otherwise a

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<sup>16</sup> This list is not exclusive. Other types include: Charitable trusts, trusts established by operation of law.

<sup>17</sup> A Family trust is a discretionary trust in which the beneficiaries are members of one family. (NTAA, p 4.)

<sup>18</sup> Ford & Lee, 'Principles of the Law of Trusts', Thomson Lawbook Co., 3<sup>rd</sup> ed, 1996, para [1130]

<sup>19</sup> Source *Lexis-Nexis Butterworths Encyclopedia of Forms and precedents*

beneficiary, or any one or more of them exclusive of the other or others who are living or which are in existence at the time payment, application or setting aside of such income is made in such shares or proportions and from such category of income **as the Trustee may in its discretion determine.** [PES Emphasis]

- [ 29 ] It is the discretionary nature of the trust and therefore lack of control over the trust by a beneficiary that makes the discretionary trust preferred for estate planning. Any trust that is a sham or alter ego i.e. controlled by a spouse is exposed in Family court proceedings. Later we consider the treatment of trusts in Family law proceedings.

### **Restricted or hybrid trust**

- [ 30 ] A restricted or hybrid trust is one where the trustee has a limited discretion as to the allocation or accumulation of nett income, capital and other benefits. This is to be compared with the discretionary trust where the trustee has an absolute discretion as to who (if any) out of a defined class of beneficiaries, is to be allocated the nett income, capital and other benefits.

### **Unit trust**

- [ 31 ] A Unit Trust is somewhat different from the trusts already mentioned, in that specific beneficiaries obtain 'units' in the trust, which holds the assets, which is represented in the value of the units. There could be a number of separate unit holders, and a Unit Trust is a common trust for use in businesses, as it allows various unit holders (or partners) to take units in the trust, thereby obtaining an ownership in the business which would be owned by the trustee of the trust. If you like, you can think of the 'units' as being similar to shares in a company.

### **Example - Unit trust**

- [ 32 ] The following is an example of a provision from a unit trust deed providing for distribution of income:

#### **Income**<sup>20</sup>

Forthwith after The Trustee shall have decided the amount of the proportion (if any) of the net income available for distribution the Trustee **shall distribute** such amounts amongst The Unit holders **in proportion to their respective holdings.**

[PES emphasis]

### **Testamentary Trusts**

- [ 33 ] A Testamentary trust is another way trusts can be established for estate, tax and asset protection planning purposes. A lifetime trust, in the manner referred to above, is achieved by preparation of a 'deed' of trust. A testamentary trust is contained in someone's Will.
- [ 34 ] While testamentary trusts can be invaluable, there are two major preconditions:-

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<sup>20</sup> Source: Groom & Lavers

- (a) Suitable Will: the will maker must have died having made a suitable Will i.e., a Will containing all the appropriate provisions for a testamentary trust; and
- (b) 'Estate' assets: the will maker must hold, or arrange asset ownership so that the will maker's estate will hold sufficient 'estate' assets to make it worthwhile to establish the trust (because of tax and other planning considerations) during a will maker's lifetime. The 'wealth' of a great many apparently high net worth will makers is often not owned by the will maker personally. Examples of these 'non-estate assets' can include discretionary trusts, joint tenancies, life insurance, superannuation and pensions.

### **Asset protection benefits of testamentary trusts**

- [ 35 ] Unless assets have been allocated to a particular beneficiary personally, the assets of a discretionary trust (as contained in the testamentary trust) do not form part of the estate of the beneficiary. This attribute is why discretionary trusts are so often the vehicle for owning investment assets and the shares or other interests in trading businesses. This attribute is also one of the reasons why people in 'high risk occupations' referred to earlier are, or should be, so keen to have Wills of their parents and spouses establish testamentary trusts for them, rather than those relatives leave assets to them personally.
- [ 36 ] The effect of the assets being 'non-estate' assets is that if a beneficiary becomes insolvent, the creditors of that beneficiary usually cannot access any of the trust funds. In earlier times discretionary trusts were more often used to safeguard a trust fund from the claims of creditors. This is because a discretionary trust confers on an object no interest in the property held by the trustee. If such an object becomes bankrupt, no interest in any property subject to the discretionary trust vests in the trustee in bankruptcy.<sup>21</sup>
- [ 37 ] If a trustee becomes insolvent there is no possibility of a bankrupt's trustee succeeding to the bankrupt's responsibilities under the trust since title to assets held upon a trust by a bankrupt does not vest in a trustee in bankruptcy.<sup>22</sup>
- [ 38 ] <sup>23</sup>The asset protection offered by a testamentary discretionary trust is not absolute; e.g., it does not apply:
- if the trust assets were security for the debt, e.g., the trustee had provided a guarantee;
  - to the extent the trustee is indebted or has allocated yet to be claimed income to the beneficiary;

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<sup>21</sup> Ford & Lee, para [7190]

<sup>22</sup> The property is not divisible amongst creditors under section 116 of the Bankruptcy Act. Cf Section 116 (2) which provides that the definition of 'property divisible amongst creditors' does not extend to property held by a bankrupt on trust for another person.

<sup>23</sup> See Ford & Lee, at para [7130] et seq generally on the effect on Trusts as a consequence of insolvency.

- if the bankruptcy “claw back” provisions apply: e.g., in respect of recently made gifts by the now bankrupt person to the trust.<sup>24</sup>

### Trusts encountered in family law

[ 39 ] M. Taussig Q.C & P. Trimbos, in their excellent paper ‘*Trust Busters: Does the Family Court Ignore Trusts*’,<sup>25</sup> explore trusts in the Family law context. According to the authors, trusts commonly encountered by family law practitioners can generally be characterised into two types; fixed interest and discretionary trusts. Under fixed interest trusts beneficiaries are entitled to a fixed share of the trust property. Examples of fixed interest trusts include investment trusts (such as managed funds), listed and unlisted property trusts and testamentary trusts.

### Future risks

- [ 40 ] Ever since the *Statute of Uses*<sup>26</sup> governments have tried at one time or another to abolish trusts or reduce the utility because of their effect on the revenue.<sup>27</sup>
- [ 41 ] Governments have tried their level best for centuries to abolish or reduce the efficacy of trusts. Proposals have been advanced to tax trusts as companies.<sup>28</sup> For political reasons the federal government has declined to act in this area. But governments can and do change. In future the utility of trusts may diminish.

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<sup>24</sup> cf. Section 120 of the Bankruptcy Act as to undervalued transfers made for the period of up to 5 years prior to the date of bankruptcy. See also Section 121 for the effect re trusts created with the main purpose of defeating creditors, and Ford & Lee, para [7110]

<sup>25</sup> M. Taussig Q.C & P. Trimbos, ‘*Trust Busters: Does the Family Court Ignore Trusts*’, paper presented to the 11<sup>th</sup> National Family Law Conference, September 2004, p43

<sup>26</sup> The Statute of Uses (1535) is a statute passed by Henry VIII which converted all English equitable estates that were created through "use" ( or Trusts) into legal estates. Thus, a grant of property to A under common law with the equitable title going to B would result in A losing title and B possessing the full title to the land. The purpose of the rule was to eliminate loopholes in property law that allowed possessors of land to avoid paying taxes on their property by holding it in equity. Source [http://en.wikipedia.org/wiki/Statute\\_of\\_Uses](http://en.wikipedia.org/wiki/Statute_of_Uses)

<sup>27</sup> The relevant section of the *Statute of Uses* reads as follows;

**2** Where any person stands or is seized of and in lands, tenements, rents, services, reversions, remainders, or other hereditaments, to the use, confidence or trust, of any other person, or of any body politic, by reason of any bargain, sale, feoffment, covenant, contract, agreement, will, or otherwise, by any means whatsoever it be, in every such case such person or body politic that shall have any such use, confidence or trust, in fee simple, fee tail, for a term of life, or for years, or otherwise, or any use, confidence or trust, in remainder or reversion, shall from henceforth stand and be seized, deemed and adjudged in lawful seizin, estate and possession of and in the same lands, tenements, rents, services, reversions, remainders, and hereditaments, with their appurtenances, to all intents, constructions and purposes in the law, of and in such estates as they had, in use, trust or confidence, of or in the same. And the estate, right, title, and possession, that was in such person that was, or shall hereafter be seized, of any lands, tenements, or hereditaments, to the use, confidence or trust, of any such person, or of any body politic, shall be from henceforth deemed and adjudged to be in him that hath such use, confidence or trust, after such quality, manner, form and condition, as he had before in use or to the use, confidence or trust, that was in him.

<sup>28</sup> Ralph Report, 1999

## Chapter 3 – Companies

### Introduction

- [ 42 ] A central feature of a company is that it is a distinct legal entity<sup>29</sup>, a separate artificial legal person. A company is separate from its controllers<sup>30</sup> (its members/shareholders) and the persons who run it (its directors) (the separate entity doctrine). For example the property of a company is not property of its members.<sup>31</sup>
- [ 43 ] The separate entity doctrine means that the rights, duties and liabilities attaching to the company are not those of the company's shareholders. Shareholders in the limited company receive the benefit of limited liability in the sense that their liabilities are limited to the amount (if any) unpaid on shares held by them.<sup>32</sup>
- [ 44 ] The use 'straight' company i.e. without a trust is not as popular a vehicle as the trust for holding assets. It may be deployed for example where for asset planning CGT is not an issue, or where multiple unrelated owners are involved.

### Disadvantages of a company

- [ 45 ] One main disadvantage of incorporation is the subjection of the companies directors and management to regulation under the *Corporations Act*.<sup>33</sup>
- [ 46 ] Having assets sheltered in a company brings with it many responsibilities. Not the least of these are of course the duties of directors at law and in particular under the *Corporations Act 2001*.<sup>34</sup> Directors of Australian companies are subject to general law duties based on their fiduciary relationship with the company and their general duties of care.
- [ 47 ] Directors' fiduciary duties are generally said to be owed to the company as a whole, not to individual shareholders, employees or the community. As well as general law duties, directors have certain statutory duties under the *Corporations Act*. These statutory duties are in addition to, not in derogation of, general law duties.<sup>35</sup>
- [ 48 ] A directors responsibilities may be both civil and criminal. Any civil penalty against a director personally, may place that directors personal assets at risk.
- [ 49 ] As an asset protection device simply holding assets in a company (without any trust) is not as effective in property settlement proceedings, as the

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<sup>29</sup> Ford, Austin & Ramsay, *Ford's Principles of Corporations Law*, 10<sup>th</sup> ed. Butterworths, p100

<sup>30</sup> op.cit,p112

<sup>31</sup> op.cit,p116

<sup>32</sup> See definition in sec 9 *Corporations Act*: '**company limited by shares** means a company formed on the principle of having the liability of its members limited to the amount (if any) unpaid on the shares respectively held by them.'

<sup>33</sup> Ford, Austin & Ramsay, *Ford's Principles of Corporations Law*, 10<sup>th</sup> ed. Butterworths, p 7

<sup>34</sup> See Part 2D.1 *Corporations Act*

<sup>35</sup> <http://www.aar.com.au/corpgov/iss/corp/corpdair.htm>



shares in the company are clearly assets. One device to further remove the shares may be to deploy a trust to hold the shares.

- [ 50 ] A company is not as flexible a structure as the trust for asset planning purposes. Income can be retained in a company, but a company is assessed at a 30% <sup>36</sup>tax rate, on every dollar of income earned i.e. a flat tax. Retained profits may be paid out fully franked dividends to shareholders. Companies do not have the same advantages for capital gains tax.<sup>37</sup>

### Loss of Control

- [ 51 ] If a person becomes a bankrupt, or becomes subject to a personal insolvency agreement under the *Bankruptcy Act* they cease to be an officeholder in their company.<sup>38</sup> They are automatically disqualified from managing corporations and cease to be a director, alternate director or secretary of the company (unless given leave by the court to manage corporations.) If the bankrupt is the only officeholder and member of the company, their trustee in bankruptcy may appoint another director in their place.<sup>39</sup> This has interesting ramifications for asset protection strategies.
- [ 52 ] If the company in question is the trustee of the family trust your client may be dispossessed of control of the trustee, and therefore the trust. Could that trustee then for example exercise a discretion to repay some of those long overdue beneficiary loan accounts? This could be an achilles heel.<sup>40</sup>
- [ 53 ] Further under the *Corporations Act*, a trustee of the estate of the bankrupt acquires rights in respect of a share held in a company. The trustee has the same rights to transfer a share as a bankrupt would have had were he or she were not bankrupt.<sup>41</sup>
- [ 54 ] In that circumstance any asset protection plan whereby you cease to have control of the trustee of your family trust may not seem like such a bad idea.

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<sup>36</sup> Subject to any changes in the Federal budget

<sup>37</sup> This is a general comment only. Please seek specific advice for your situation from a competent qualified tax professional.

<sup>38</sup> Source:

[http://www.asic.gov.au/asic/asic\\_infocore.nsf/byheadline/Bankruptcy+and+Personal+Insolvency+Agreements?openDocument](http://www.asic.gov.au/asic/asic_infocore.nsf/byheadline/Bankruptcy+and+Personal+Insolvency+Agreements?openDocument)

<sup>39</sup> Section 201F of the Corporations Act

<sup>40</sup> cf, The Hon. Justice J. V. Kay, 'Trusts, Setting one up in the light of the Family Court's powers', Paper presented to 2<sup>nd</sup> National Family Law Conference, 26 - 29 June 1986, @ p 14.

<sup>41</sup> Section 1072C of the Corporations Act

**Tip**

If Don's plan really will be the next thing you may need to give consideration to the structure of the shareholdings in his company.

Also Don may need to give consideration to having a number of directors perhaps relatives in any company with him to conduct his business enterprise. A difficulty that may arise is selecting directors willing to undertake those responsibilities under the Corporations Act. This may be especially relevant for any company which is undertaking the role as trustee for a family trust.

**Future risks**

- [ 55 ] It is conceivable a bankruptcy trustee may seek to apply at a future time to either join proceedings and seek orders for asset transfers pursuant to s79A – and utilising Part VIII AA to seek orders against a company.

### PART 3 - ASSESSING HOW ASSET PROTECTION MAY DISADVANTAGE A PARTY TO A MARRIAGE

[ 56 ] A party may be disadvantaged following the deployment of an asset protection strategy in the following ways:

- assets may be, or have been placed out of the hands of your client spouse party for the purpose of Section 79 proceedings under the *Family Law Act 1975*, and:
- additionally, assets may be, or have been placed out of the hands of the respondent spouse party for the purpose of section 79 proceedings under the *Family Law Act 1975* (i.e. out of both parties hands and in to some third party entity).

[ 57 ] Before section 79 can operate there must be some 'property' of the parties or either of them.<sup>42</sup>

#### **Assets placed in spouse's name**

[ 58 ] The simplest of asset protection strategies may for a Husband to place all his assets in his Wife's name to try and keep the matrimonial estate out of the hands of the Husband's creditors.

[ 59 ] The definition of 'property' in section 4 of the *Family Law Act 1975* is in the following terms:

**property**, in relation to the parties to a marriage or either of them, means property to which those parties are, or that party is, as the case may be, entitled, whether in possession or reversion.

[ 60 ] By virtue of the definition of 'property' the simple asset protection strategy presents no difficulty to an application by the wife for property settlement under Section 79<sup>43</sup>.

#### **Assets placed in name of third party entity**

[ 61 ] A more complex asset protection arrangement may be established as a result of assets being held for example in a trust or company arrangement.

[ 62 ] Later, on the breakdown of the marriage an applicant party may seek to include those assets in the matrimonial pool for division under *Section 79* of the *Family Law Act 1975*. Access to property for the purpose of lump sum maintenance by settlement of property application for spousal maintenance under *Section 72 (Spousal Maintenance)* or *Section 77 (Urgent Spousal*

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<sup>42</sup> Taussig & Trimbos p48

<sup>43</sup> of the *Family Law Act*.

*maintenance*) of the *Family Law Act 1975*<sup>44</sup> may prove more difficult. The respondent will seek no doubt to repel such an application on the grounds the assets held in the third party entity are not part of the matrimonial estate.

- [ 63 ] Practical difficulties may arise in the accessing of information such as company records, particularly where the applicant spouse is not an officeholder of the company. Ideally, pre-action disclosure resolves this<sup>45</sup>. However, the respondent spouse may drag the chain or provide incomplete disclosure. Doubts may arise about the credibility or the good faith of the disclosure.
- [ 64 ] In order for a successful application under Section 79 it may also be necessary to apply for orders under Section 78.<sup>46</sup>

### **TIP - Testamentary trusts in wills**

In the last part we discussed briefly Testamentary Trusts. One of the reasons for establishing a testamentary discretionary trust is to try to ensure that only your clients family members (usually descendants) have access to family wealth upon inter-generational transfer. For this reason a parent of a person in the 'high risk occupation' group we refer to earlier may consider the use of a testamentary trust as a useful estate planning tool. This would be an example of asset protection of a generation above affecting a party to a marriage i.e. Husbands parents ensuring assets do not come into their sons hands.

The topic of whether an inheritance can be taken into account in Family law proceedings is of course a subject wide enough for a paper in its own right.<sup>47</sup>

### **BFA as a claw back tool**

- [ 65 ] A party such as a husband may pursuant to a simple asset protection strategy place some or all his assets in the name of his wife. While this may be useful as a device for asset protection of course it brings disadvantages if that marriage breaks down. Of course if the husband has deployed an even more complex strategy, and for example does not have control of third-party entities, any section 79 claim by either party may face some difficulties.

### **TIP**

Consideration may be given to the execution of a binding financial agreement. This agreement could provide that in exchange for placing assets

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<sup>44</sup> Cf Section 80(1)( ba) for powers of Court in maintenance proceedings

<sup>45</sup> See also r 13.04(1)(f) and (g) of the Family Law Rules

<sup>46</sup> **Family Law Act 1975**

#### **'78 Declaration of interests in property**

(1) In proceedings between the parties to a marriage with respect to existing title or rights in respect of property, the court may declare the title or rights, if any, that a party has in respect of the property.'

<sup>47</sup> See *White Tulloch and White* (1995) FLC ¶92-640, *De Angelis and De Angelis* (2003) FLC ¶193-133 :

out of the husband's name there will be a claw back if the relationship breaks down. This will be especially relevant if at the breakdown of the relationship there are no financial risks over the threat horizon especially risk of insolvency.

However, there are special considerations if there is a risk a party may become insolvent or indeed is bankrupt at the date of the breakdown of the relationship. As we see in the next part there is a catch, and the binding financial agreement particularly the recitals will need to be very carefully drawn.

## **PART 4 - TO WHAT EXTENT CAN ASSET PROTECTION STRATEGIES REMOVE ASSETS FROM THE JURISDICTION OF THE FAMILY COURT?**

### **Introduction**

- [ 66 ] An asset protection strategy fundamentally seeks to protect assets by placing them relevantly out of a creditors hands so as to not be divisible amongst those creditors in the advent of an attack by creditors or on the bankruptcy or insolvency of a spouse. It is not necessarily for the same purpose as seeking to defeat or frustrate section 79 proceedings of a spouse. The strategy may however either advertently or inadvertently achieve that purpose.
- [ 67 ] Asset protection can be achieved for example by separating the assets of at risk trading entities, from assets held by the family. A party may conduct the business enterprise in the name of a company or trust, and separately hold assets such as the family home in a spouse's name. This is so that if the business assets are placed in jeopardy, the family assets are safe. It is as a consequence of assets not being held in the name of a party to the marriage, that concerns about jurisdiction of the court to make orders affecting those assets arise.

### **Court powers under sections 78 & 79 Family Law Act**

- [ 68 ] If as was referred to in Part 3, assets are placed out of both parties hands and into the hands of a third-party entity it needs to be considered what powers a Court exercising family law jurisdiction<sup>48</sup> has to deal with those assets. Under Part VIII of the *Family Law Act 1975* the Family Court and Federal Magistrates Court have jurisdiction in proceedings with respect to property of the parties to a marriage.
- [ 69 ] The main powers the court may utilise to make orders concerning the property Law parties to a marriage are set out in sections 78 and 79 of the *Family Law Act 1975*. The court must take into account the matters in section 75(2) and make an order that is just and equitable in all the circumstances of the case.<sup>49</sup>
- [ 70 ] Section 79 is the source of the commonly used power to make orders for settlement of property. While section 78 is the source of power to make orders for declarations as to existing title or rights of property i.e. including whether property is an asset of a party thereby subjecting it to Section 79.

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<sup>48</sup> 'a Family court'

<sup>49</sup> Section 79(2) FLA

### What is '*property of the parties*' ?

[ 71 ] It is clear from the definition of **property**<sup>50</sup> in the *Family Law Act 1975* that orders may be made in relation to the property **of the parties to a marriage or either of them**.

[ 72 ] In *Duff (1977) FLC 90-217*, the Full Court (Watson, Murray and Wood JJ) said at 76,132-76,133:

' It seems unnecessary to attempt to set out a catalogue of what 'property' may include in the context of sec. 79. It is sufficient for the purposes of this case to say that 'property' means property both real and personal and includes choses in action. The word 'property' has been the subject of a very large volume of judicial interpretation. A compendious description of it is to be found in Asbury, 3rd ed., Vol. 3, para. 541 with multiple references to cases. It is sufficient for our purposes to refer to that definition which states: —

'Property is that which belongs to a person exclusive of others and can be the subject of bargain and sale. It includes goodwill, trademarks, licences to use a patent, book debts, options to purchase, life policies and the rights under a contract.<sup>51</sup>

[ 73 ] 'Property' therefore has the widest possible meaning under the *Family Law Act 1975*.

### 'with respect to'

[ 74 ] The placing of an asset in the name of any entity other than a spouse may (superficially) at first sight place assets outside the jurisdiction of the Family court, because matrimonial proceedings must be '**with respect to property of the parties or either of them**'. This key phrase is contained in the definition of **matrimonial cause - (ca)**.<sup>52</sup> in the *Family Law Act 1975*

[ 75 ] This raises questions:

- Does it simply mean that if an asset is not in the names of the parties or either of them that asset is outside the remit of a Court exercising Family Law jurisdiction?
- To what extent then can placing assets in the names of non parties affect the jurisdiction of the family Court?

### Can assets be removed from the court's jurisdiction?

[ 76 ] We now explore how asset protection strategies can remove assets from the jurisdiction of a Family court by examining some of the different structures that may be used to hold assets.

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<sup>50</sup> Section 4 FLA

<sup>51</sup> Referred to in Harris (1991) FLC 92-254

<sup>52</sup> Section 4 FLA

## Company

- [ 77 ] Simply placing an asset in the name of a company will be ineffective against a Section 79 application, if ownership of the shares in that same company is still vested in the name of a party to the marriage. The shares will still be an asset and thereby subject to section 79.
- [ 78 ] If those shares in the company were then placed in the name of a trust this may have the effect of removing the 'ownership' one step further way. An applicant party may then seek to argue that the shares in the company were held by the third party for the benefit of a party to the marriage, in order to treat them as property of the parties.<sup>53</sup> There may be significant evidential hurdles in proving the existence of such a trust. The court may need to give consideration to whether such a trust is a sham, or puppet or alter ego of a party in order to reach a conclusion.<sup>54</sup> Next we consider the concepts of how a Family<sup>55</sup> court deals with trusts in more detail.

## Trusts

### Introduction

- [ 79 ] Fundamentally a trust is an effective device as to hold assets, as the parties have apparently divest themselves of the beneficial interest in the assets held by the trust.<sup>56</sup> The argument is of course that the assets are not those of parties but those of a third party namely the trustee.

### Approach of Family Court to trusts

- [ 80 ] In *Harris and Harris* (1991) FLC 92-254 at pp 78,706-78,708, the Full Court (consisting of Ellis, Strauss and Lindenmayer JJ) considered an appeal in which one of the appeal grounds was whether the trial judge had erred when treating the property of the family trust as the property of the parties. The Court held:

[78,706]

This ground raises issues which have been the subject of debate in a number of cases, including *Ashton* (1986) FLC ¶91-777 and the recent case of *Davidson* (1991) FLC ¶92-197. ...

**In order to determine the nature of the interest of a party under a trust deed, it is necessary to consider the trust deed in the light of the relevant factual circumstances.** For present purposes and having regard to some of the arguments, it suffices to say that neither the directors of the operating company, nor the operating company as such, have any beneficial interest in the trust property. As was pointed out in *Ashton*, a trust as such is not a legal person, although the trustee itself must be a legal person. The trust deed here is in one of the usual forms. It provides for an appointor who has the power to remove any trustee and to appoint another trustee or additional trustees. In the present case, the appointor is the husband. The trust deed also provides for a guardian who, again, is the husband. **For practical purposes as**

<sup>53</sup> For example under an application pursuant to Section 78 FLA

<sup>54</sup> See G and T [2003] FamCA 1076 , @ para 72 et seq in respect to the authorities concerning the differences between the concepts of 'sham', 'puppet' and 'alter ego'.

<sup>55</sup> Family Court of Australia, Federal Magistrates Court

<sup>56</sup> Taussig & Trimbos, p48



**regards disposition of trust property or trust income the trustee is under the complete control of the guardian.** The trustee with the consent of the guardian has power to pay all the income and all the capital of the trust fund to the husband. There is only one exception to this and that is that income which has been set aside for a beneficiary or which is held on trust for a specified beneficiary ceases to form part of the trust fund. Allocated income which has not been paid to the beneficiary is thereafter held on a separate trust for that beneficiary.

... It was argued on behalf of the husband that what he had in the trust was a chose in action as a beneficiary under the trust, and that such chose in action, although property, had no real or ascertainable value.

This submission might be appropriate if the position of the wife as a beneficiary under the trust had to be evaluated, for she had no right or power to require the payment to her of any part of the property or income of the trust. On the other hand, **the husband had the fullest power of disposition over the property and the income of the trust, including the power to cause to have distributed to himself all its income and all its corpus.** If he should choose to do so, no person could complain of any breach of trust. If the trustee were to be unwilling to carry out his wishes, he could replace the trustee with another company which was in his effective control or any other person who would do his bidding. **The very object of the trust, as appearing from the instrument, was to put the husband as appointor and guardian into the position of complete and unfettered control just as if he were the owner of the property. This arrangement was not a sham.** It was a genuine transaction intended to bring about legitimate income tax advantage and may have had other commercial motives.

...Reference was made in argument to *Ascot Investments Pty Ltd v Harper and Harper* (1981) FLC ¶91-000.

[78707]

... the present case we are not concerned with orders which seek to bind any third party.

The only orders which have been made are orders requiring the parties to do certain acts.

We, therefore, return to the question whether the husband's interest under the trust was "property", the interests in which could be altered under section 79.

[ Their Honours then extensively discuss the term 'Property' under the Family Law Act, and refer to Duff(1977)]

In our opinion, **the husband's interest as a beneficiary under the trust in combination with his rights and powers as appointor and guardian place him, for the purposes of section 79 of the Family Law Act 1975, into the position of an owner of property which property is constituted by his interest and his rights and powers under the trust.** This property is properly evaluated as equivalent to the value of the assets of the trust.

Under section 79 the court may make orders altering the interests of the parties in this property. If necessary, the court may require the husband to exercise his rights and powers under the trust deed so as to bring about a settlement of property out of the corpus or income of the trust for the benefit of the wife. See also section 80(1)(d), (e) and (k). In the present case, if the husband does not wish to dispose of trust property, his and the wife's other assets are sufficient to satisfy the orders which were in fact made.

...Accordingly, this ground of appeal fails.

[ **Emphasis PES**]

## Control

- [ 81 ] Consequently an examination of the facts surrounding the Trust and the extent to which it is under the control of a party to a marriage will be very relevant in the consideration of how the court will deal with the Trust.<sup>57</sup>
- [ 82 ] A party concerned about actions of creditors may seek to place assets out of the reach of creditors, safely in the hands of others they trust such as a spouse. On the other hand, however, from a family law perspective, they may not wish to place those assets completely out of their orbit of influence and solely in that of their spouse. If it could be said that sometimes a testator does not so much fear death, as losing control over his assets, could it also be said that a party to a marriage, similarly, does not so much fear separation as losing control over his assets.
- [ 83 ] In an extreme situation control of the sheltering entity may be in the hands of an associate. This may then raise an evidential obstacle to the spouse seeking to claw back the asset.

## Where control cannot be established

- [ 84 ] Where a party's control is limited to any significant extent then the Family court will be more reluctant to interfere with property. In a case where it cannot be established a trust is in the control of a party the Court may take into account the financial value derived from the asset as a financial resource.<sup>58</sup>
- [ 85 ] In a case where the trust is a mere expectancy neither party has an interest that can be brought to account in a property settlement.<sup>59</sup>

## The 'Unassailable Trust', does it exist?

- [ 86 ] It now falls to be considered, in contrast to Miles Massey<sup>60</sup> primary concerns, about whether a prenuptial is impenetrable, whether a trust can ever be unassailable in a Family court context.
- [ 87 ] Justice Kay considered this in his Paper delivered shortly after his appointment to the Court, *'Trusts, Setting one up in the light of the Family*

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<sup>57</sup> Taussig & Trimbos, p50. See also p50 and ff for an excellent review of the authorities on control

<sup>58</sup> *Kelly and Kelly (No 2)* (1981) FLC ¶91-108; See Also Section 75(2) (b) of the Family Law Act :

*'(b) the income, property and financial resources of each of the parties and the physical and mental capacity of each of them for appropriate gainful employment;'*

<sup>59</sup> However, see *Milankov* (2002) FLC 93 095, where the court took into account family trusts that the Husband would take control of upon his father death as an expectancy under subsection 75(2)(o) and not as a financial resource. In the Full Court *Kay J* considered the issue of the Husband's future control (of the family trusts) and in conclusion found little fault with the Trial Judges ultimate finding that the husband would receive trust assets after his fathers death (para 143).

<sup>60</sup> *George Clooney's character in 'Intolerable Cruelty'*

*Court's powers*,<sup>61</sup> Paper presented to 2<sup>nd</sup> National Family Law Conference, 26 - 29 June 1986. His Honour identified the salient features of an apparently unassailable trust:

- '1. There is no real control over the trustee and especially no power to appoint and remove the trustee which can be exercised solely or jointly by the parties to the marriage. It must be remembered that anything that either of the parties to the marriage can do the court can make them do (see Ascot Investments v Harper)
2. The class of beneficiaries of the trust is as wide as possible and as mixed as possible. Neither the parties to the marriage in are (sic) described as such i.e. "the spouse for the time being of X.". Several families are interwoven into the one trust document.
3. In the day to day administration of the affairs of the trust there is apparent and real independent control by the trustee who does not act simply as a puppet on behalf or one of the parties. If it can be shown for instance that the husband has made all of the managerial decisions, has signed all of the cheques and has treated the trust bank account as his own personal bank account then there is greater likelihood of a court being able to treat the trusts as a sham.

[ 88 ] In summary the factors are:

- no control in either spouse
- especially, no power of appointment or removal of trustee
- class of beneficiaries of the trust to be as wide as possible and as mixed as possible. Several families are interwoven into the one trust arrangement
- spouse who is not the operative of the trust should be referred to in terms of gender and not by name
- real and independent control by trustee who is not a 'puppet', almost as if it were on a 'commercial basis' [PES], or arms length basis
- day to day administration by a third party
- spouses ought not be appointed as takers in default.

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<sup>61</sup> The Hon. Justice J. V. Kay, '*Trusts, Setting one up in the light of the Family Court's powers*', Paper presented to 2<sup>nd</sup> National Family Law Conference, 26 - 29 June 1986.

## Legislative tools for clawback to the pool

### Sections 85 A & 106B

[ 89 ] Section 85A of the *Family Law Act 1975* is in the following terms:

#### 85A Ante-nuptial and post-nuptial settlements

(1) The court may, in proceedings under this Act, make such order as the court considers just and equitable with respect to the application, for the benefit of all or any of the parties to, and the children of, the marriage, of the whole or part of property dealt with by ante-nuptial or post-nuptial settlements made in relation to the marriage.

(2) In considering what order (if any) should be made under subsection (1), the court shall take into account the matters referred to in subsection 79(4) so far as they are relevant.

**(3) A court cannot make an order under this section in respect of matters that are included in a financial agreement. [PES emphasis].**

[ 90 ] The provisions of Section 85A (3) may serve to implement the asset protection strategy from an application by a spouse party if those provisions are contained in a binding financial agreement, except in the case of insolvency.

#### Section 106B - Transactions to defeat claims

[ 91 ] Section 106B of the *Family Law Act 1975* (which is worth revisiting in full), is in the following terms:

#### 106B Transactions to defeat claims

(1) In proceedings under this Act, the court may set aside or restrain the making of an instrument or disposition by or on behalf of, or by direction or in the interest of, a party, which is made or proposed to be made to defeat an existing or anticipated order in those proceedings or which, irrespective of intention, is likely to defeat any such order.

(1A) If:

- (a) a party to a marriage is a bankrupt; and
- (b) the bankruptcy trustee is a party to proceedings under this Act;

the court may set aside or restrain the making of an instrument or disposition:

- (c) which is made or proposed to be made by or on behalf of, or by direction or in the interest of, the bankrupt; and
- (d) which is made or proposed to be made to defeat an existing or anticipated order in those proceedings or which, irrespective of intention, is likely to defeat any such order.

(1B) If:

- (a) a party to a marriage is a debtor subject to a personal insolvency agreement; and
- (b) the trustee of the agreement is a party to proceedings under this Act;

the court may set aside or restrain the making of an instrument or disposition:

- (c) which is made or proposed to be made by or on behalf of, or by direction or in the interest of, the debtor; and
- (d) which is made or proposed to be made to defeat an existing or anticipated order in those proceedings or which, irrespective of intention, is likely to defeat any such order.

- (2) The court may order that any money or real or personal property dealt with by any instrument or disposition referred to in subsection (1), (1A) or (1B) may be taken in execution or charged with the payment of such sums for costs or maintenance as the court directs, or that the proceeds of a sale must be paid into court to abide its order.
- (3) The court must have regard to the interests of, and shall make any order proper for the protection of, a bona fide purchaser or other person interested.
- (4) A party or a person acting in collusion with a party may be ordered to pay the costs of any other party or of a bona fide purchaser or other person interested of and incidental to any such instrument or disposition and the setting aside or restraining of the instrument or disposition.
- (4AA) An application may be made to the court for an order under this section by:
  - (a) a party to the proceedings; or
  - (b) a creditor of a party to the proceedings if the creditor may not be able to recover his or her debt if the instrument or disposition were made; or
  - (c) any other person whose interests would be affected by the making of the instrument or disposition.
- (4A) In addition to the powers the court has under this section, the court may also do any or all of the things listed in subsection 80(1).
- (5) In this section:
  - disposition** includes:
    - (a) a sale or gift; and
    - (b) the issue, grant, creation, transfer or cancellation of, or a variation of the rights attaching to, an interest in a company or a trust.
  - interest:**
    - (a) in a company includes:
      - (i) a share in or debenture of the company; and
      - (ii) an option over a share in or debenture of the company (whether the share or debenture is issued or not); and
    - (b) in a trust includes:
      - (i) a beneficial interest in the trust; and
      - (ii) the interest of a settlor in property subject to the trust; and
      - (iii) a power of appointment under the trust; and
      - (iv) a power to rescind or vary a provision of, or to rescind or vary the effect of the exercise of a power under, the trust; and
      - (v) an interest that is conditional, contingent or deferred.

[ 92 ] It is clear that for the purposes an application of section 106 B that the intention behind the transfer or disposition is irrelevant. In these circumstances not only can a party apply, but importantly creditors may also apply in circumstances where by virtue of an order their debts might not be able to be paid. The legislation also provides for other interested persons to apply which, it is submitted permits an application by a bankruptcy trustee.<sup>62</sup>

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<sup>62</sup> See section 106 B (1A), (4AA). ss (4AA) was inserted by government amendment after the legislation was introduced into Parliament.

### Part VIII AA as an aid

[ 93 ] Part VIII AA<sup>63</sup> was included to overcome difficulties with doubts about the court's power to make orders against third parties.<sup>64</sup> There are ongoing concerns in the profession about the constitutional validity of the Part. The types of orders that can be made are limited to those as set out in the part.

[ 94 ] The objects are:

#### SECTION 90AA OBJECT OF THIS PART

90AA The object of this Part is to allow the court, in relation to the property of a party to a marriage, to:

(a) make an order under section 79 or 114; or

(b) grant an injunction under section 114;

**that is directed to, or alters the rights, liabilities or property interests of a third party.**

**[PES emphasis]**

[ 95 ] The powers given to the Court pursuant to Part VIII AA are to make ( the various types of orders) '***in proceedings under section 79***'. Whereas it is noted that for example the powers in section 85 A and 106 B are expressed to be '***in proceedings under this Act***'. It would appear that the powers under Part VIII AA are in furtherance of section 79 or 114 not an independent new head of power.

[ 96 ] The powers under section 114 include:

#### SECTION 114 INJUNCTIONS

114(1) **[Types of orders and injunctions]**

In proceedings of the kind referred to in paragraph (e) of the definition of 'matrimonial cause' in sub-section 4(1), the court may make such order or grant such injunction as it considers proper with respect to the matter to which the proceedings relate, including—

...

(e) an injunction in relation to the property of a party to the marriage; or

...

[ 97 ] As to an order against a third party to a marriage it is submitted as to the doubts whether this is within power notwithstanding the provisions of Part VIII AA such as Section 90 AE 2 (b), that it is helpful in the context of this

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63 Commenced 17th of December 2004

<sup>64</sup> As discussed by the Court in Harris 1991 : 'Reference was made in argument to *Ascot Investments Pty Ltd v Harper and Harper* (1981) FLC ¶91-000. There the question was whether the Family Court had power to order Ascot Investments Pty Ltd to register the transfer from the husband to wife of 7,000 'A' class shares. In other words, the problem was whether a third person who was not a party to the marriage could be bound by the orders of the Family Court. It was in this connection, that Gibbs J (as he then was) expressed the view that sham arrangements which had been brought into being, in appearance rather than reality, as a device to assist one party to evade his obligations under the Family Law Act may be disregarded. In this context also, his Honour referred to the somewhat difficult concept of companies which are mere puppets of a party to the marriage.'

debate to review in full some of the passages of the judgment of Gibbs J in Ascot Investments and Harper :

'19. The authorities to which I have referred [*Per PES i.e. Sanders v. Sanders: Antonarkis v. Delly; Re Dovey, Ex parte Ross; Re Ross Jones, Ex parte Beaumont*] establish that in some circumstances the Family Court has power to make an order or injunction which is directed to a third party or which will indirectly affect the position of a third party. They do not establish that any such order may be made if its effect will be to deprive a third party of an existing right or to impose on a third party a duty which the party would not otherwise be liable to perform. The general words of ss. 80 and 114 must be understood in the context of the Act, which confers jurisdiction on the Family Court in matrimonial causes and associated matters, and in that context it would be unreasonable to impute to the Parliament an intention to give power to the Family Court to extinguish the rights, and enlarge the obligations, of third parties, in the absence of clear and unambiguous words. It can safely be assumed that the Parliament intended that the powers of the Family Court should be wide enough to prevent either of the parties to a marriage from evading his or her obligations to the other party, but it does not follow that the Parliament intended that the legitimate interests of third parties should be subordinated to the interests of a party to a marriage, or that the Family Court should be able to make orders that would operate to the detriment of third parties. There is nothing in the words of the sections that suggests that the Family Court is intended to have power to defeat or prejudice the rights, or nullify the powers, of third parties, or to require them to perform duties which they were not previously liable to perform. It is one thing to order a party to a marriage to do whatever is within his power to comply with an order of the court, even if what he does may have some effect on the position of third parties, but it is quite another to order third parties to do what they are not legally bound to do. **If the sections had been intended to prejudice the interests of third parties in this way, it would have been necessary to consider their constitutional validity. (at p354) [PES emphasis]**

20. The position is, I think, different if the alleged rights, powers or privileges of the third party are only a sham and have been brought into being, in appearance rather than reality, as a device to assist one party to evade his or her obligations under the Act. Sham transactions may always be disregarded. Similarly, if a company is completely controlled by one party to a marriage, so that in reality an order against the company is an order against the party, the fact that in form the order appears to affect the rights of the company may not necessarily invalidate it. (at p355)

21. Except in the case of shams, and companies that are mere puppets of a party to the marriage, the Family Court must take the property of a party to the marriage as it finds it. The Family Court cannot ignore the interests of third parties in the property, nor the existence of conditions or covenants that limit the rights of the party who owns it. To take two obvious examples, the Family Court could not compel a husband to assign to his wife a lease without obtaining the necessary consent of the lessor, and could not order the transfer to a wife of land owned by a husband free of mortgage, when in fact the land was mortgaged to a third party. Thus, in the present case, the Court must deal with the husband's shares in Ascot Investments as they in fact are, that is, as shares in a company whose memorandum and articles contain a restriction on transfer.(at p355)

[ 98 ] Now that Parliament has expressed the powers of the Family courts in clear and unambiguous terms it is only a matter of time before a disgruntled litigant challenges the validity of Part VIIIAA in the High Court. To again quote Gibbs J in Ascot Investments:

It is one thing to order a party to a marriage to do whatever is within his power to comply with an order of the court, even if what he does may have some effect on the

position of third parties, but it is quite another to order third parties to do what they are not legally bound to do.

It is submitted for example the power should not be used to divest third parties of legitimately held proprietary interests.

- [ 99 ] Pending resolution of the matter in the High Court, it must be it is submitted that the powers under Part VIII A could be used to aid an application made under sections 85 A and 106 B.

### **Orders against companies**

- [ 100 ] It is not too hard to conceive orders being sought against a company to transfer to a spouse party, assets such as a house held in a company name. It is submitted that Ascot investments is authority for a proposition that any transfer of an asset to a company the purpose of evading responsibility under section 79 is liable to be set aside as a sham.
- [ 101 ] Caution must be taken with regard to the taxation effect of such orders.<sup>65</sup> Advice from a competent qualified tax practitioners must always be sought when contemplating such a proposal.

### **Orders against trusts**

- [ 102 ] An asset held in a trust may seem out of reach but Part VIII A may be a useful tool for 'trust busting'. A trust could be ordered to include a spouse as a beneficiary, if that trust had excluded them. Orders for example could also be made restraining an exercise such as a change of trustee, or amendment to a trust deed to remove a party as appointor. A declaration may be sought under section 78 to have trust assets declared an asset of the parties in order that it be subject to the provisions of section 79.

### **Catch 22**<sup>66</sup>

- [ 103 ] The catch is that if a party under risk of attack from a creditor and or facing bankruptcy separates from a spouse (having previously hidden assets away under an asset protection cloak) they may have no alternative but to seek to retrieve assets under section 78 and section 79 for themselves. Such action thereby makes the asset available to a creditor or bankruptcy trustee. This may not be a gambit worth opening.

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<sup>65</sup> 90AE (4) *Family Law Act 1975*. See also Division 7A of the Income Tax Assessment Act 1936, although since PS LA 2006/2 (GA) advised that statute barred private company and trustee loans made prior to the enactment of Division 7A will not be treated as giving rise to a deemed dividend under Division 7A, practitioners and their clients may breathe a little easier

<http://law.ato.gov.au/atolaw/view.htm?docid=PSR/GA20062/NAT/ATO/00001>

<sup>66</sup> From Joseph Hellers novel of the name. Catch 22 is a no - win situation, whichever alternative you chose, you will lose or be in trouble. Source *Brewers Dictionary of Phrase and Fable 17 ed.*



## PART 5 - EXAMINING WHETHER THE *BANKRUPTCY AND FAMILY LAW LEGISLATION ACT 2005* WILL HAVE ANY SIGNIFICANT IMPACT ON FAMILY LAW CASES

### Chapter 1- What's new since *Bankruptcy and Family Law Legislation Act 2005*?<sup>67</sup>

[ 104 ] Three big changes<sup>68</sup> in the relationship between creditors and the Family Court introduced in recent years are:

- The Family court now has exclusive jurisdiction to hear bankruptcy and Family Law matters at the same time if one of the spouses in a matrimonial property settlement is insolvent.<sup>69</sup> A new definition to **matrimonial cause cb** has been introduced to provide for proceedings between party to marriage and bankruptcy trustee.<sup>70</sup>
- A trustee in bankruptcy<sup>71</sup> and creditors<sup>72</sup> can apply to set aside binding financial agreements<sup>73</sup> and Consent orders.<sup>74</sup>
- The Family court can under Part VIII A make order binding third parties.<sup>75</sup>

#### Changes now needed to strategies

[ 105 ] The asset protection strategies you may have previously considered to advise for your clients up to now will need reconsideration change in light the raft of changes by this new legislation. Suddenly the world as we knew it looks a lot less secure.

#### Section 121 Bankruptcy Act

[ 106 ] Transfers of property to defeat creditors are void against a trustee in bankruptcy.

[ 107 ] The Bankruptcy Act provides:

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<sup>67</sup> The *Bankruptcy Act* as referred to in this paper is the version of the legislation current as at 27 March 2006.

<sup>68</sup> 'Split Decisions', BRW February 9-15, 2006, p 36.

<sup>69</sup> Section 35 of the Bankruptcy Act as amended by *Bankruptcy and Family Law Legislation Amendment Act 2005*

<sup>70</sup> Amends Section 4 FLA, as inserted by *Bankruptcy and Family Law Legislation Amendment Act 2005*

<sup>71</sup> Section 79A (10) as inserted by *Bankruptcy and Family Law Legislation Amendment Act 2005 commencing 15 April 2005*

<sup>72</sup> Section 79A (4) as amended by *Bankruptcy and Family Law Legislation Amendment Act 2005*

<sup>73</sup> Introduced by the *Family Law Amendment Act 2003*: Section 90K:

A court may make an order setting aside a financial agreement or a termination agreement if, and only if, the court is satisfied that:

...(aa) either party to the agreement entered into the agreement:

- (i) for the purpose, or for purposes that included the purpose, of defrauding or defeating a creditor or creditors of the party; or
- (ii) with reckless disregard of the interests of a creditor or creditors of the party; or

<sup>74</sup> Sections 79 A (4), (5), (6),(7).

<sup>75</sup> Commenced 17<sup>th</sup> of December 2004

## 121 Transfers to defeat creditors

### *Transfers that are void*

(1) A transfer of property by a person who later becomes a bankrupt (the *transferor*) to another person (the *transferee*) is void against the trustee in the transferor's bankruptcy if:

- (a) the property would probably have become part of the transferor's estate or would probably have been available to creditors if the property had not been transferred; and
- (b) the transferor's main purpose in making the transfer was:
  - (i) to prevent the transferred property from becoming divisible among the transferor's creditors; or
  - (ii) to hinder or delay the process of making property available for division among the transferor's creditors.

### ***Bankruptcy and Family Law Legislation Amendment Act 2005***

[ 108 ] The *Bankruptcy and Family Law Legislation Act 2005* has made significant changes to the provisions which relate to financial agreements, and property settlement provisions under section 79 of the Family Law Act.

[ 109 ] According to the explanatory memoranda, the objects of the Bill are to:

- (a) address longstanding issues concerning the interaction between family law and bankruptcy;
- (b) prevent the misuse of financial agreements as a means of avoiding payment to creditors; and

...

### **Amendments relating to financial agreements under the Family Law Act 1975**

[ 110 ] We now consider the amendments designed to prevent parties using financial agreements under Part VIIIA of the Family Law Act to defeat the claims of creditors.

[ 111 ] A new act of bankruptcy has been introduced namely where a person becomes insolvent as a result of a transfer pursuant to a (binding) financial agreement made under the Family Law Act.<sup>76</sup>

[ 112 ] From the explanatory memorandum :

166. The new act of bankruptcy will apply only where the transfer under the financial agreement has the effect of rendering the person insolvent. **This would apply only to transfers pursuant to financial agreements and not to other property distributions (for example, property settlements under section 79 of the Family Law Act).**  
[PES emphasis]

[ 113 ] The amendments will now allow a trustee in bankruptcy to claim property transferred pursuant to a financial agreement as divisible property in the

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<sup>76</sup> Section 40 Bankruptcy Act : '(o) if the debtor becomes insolvent as a result of one or more transfers of property in accordance with a financial agreement (within the meaning of the Family Law Act 1975) to which the debtor is a party.'

bankrupts estate. If a person becomes a bankrupt on a creditor's petition, the bankruptcy of the person relates back to, and is deemed to have commenced at, the time of the commission of the earliest act of bankruptcy within a period of six months before the presentation of the petition leading to the person's bankruptcy.<sup>77</sup>

[ 114 ] By virtue of the legislation these changes apply in relation to financial agreements entered into after the commencement of the amendment namely 15 Apr 2005.

[ 115 ] However as can be seen from the explanatory memorandum an order for property settlement pursuant to section 79 will not be of itself an act of bankruptcy. Although as we will see later this does not mean that an order pursuant to section 79 is not affected by this new legislation as creditors have now been given standing to apply has a person affected by an order if they can show that they may be unable to recover their debts if an order were made.

[ 116 ] Interestingly the grounds set out for setting aside binding financial agreements are different to those for setting aside a consent order. In section 90K for example referring to the setting aside of binding financial agreements, a court may set aside an agreement if it were entered into for a purpose of defrauding or defeating creditors.

### **Amendments relating to section 79 proceedings under the *Family Law Act 1975***

[ 117 ] By virtue of the amendments to *Bankruptcy and Family Law Legislation Act 2005*, significant changes have been made, in that Subsection 79 (1) of the Family Law Act was repealed and replaced as follows:

#### **Subsection 79(1)**

(1) In property settlement proceedings, the court may make such order as it considers appropriate:

- (a) **in the case of proceedings with respect to the property of the parties** to the marriage or either of them—altering the interests of the parties to the marriage in the property; or
- (b) **in the case of proceedings with respect to the vested bankruptcy property** in relation to a bankrupt party to the marriage—altering the interests of the bankruptcy trustee in the vested bankruptcy property;

including:

- (c) an order for a settlement of property in substitution for any interest in the property; and
- (d) **an order requiring:**
  - (i) either or both of the **parties to the marriage**; or
  - (ii) **the relevant bankruptcy trustee** (if any); **[PES emphasis]** to make, for the benefit of either or both of the parties to the marriage or a child of the marriage, such settlement or transfer of property as the court determines.

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<sup>77</sup> Section 115(1) Bankruptcy Act

[ 118 ] Of historical concern was whether the court could in any application before it balance the interests, of the spouse on the one hand, and creditors on the other. By virtue of the amendments to Section 79 the Court has power to make orders can be made including altering the interest of parties in property for the benefit of the parties or children, and altering the interesting vested bankruptcy property (of a bankrupt party) for the benefit of the parties or children.

[ 119 ] According to Stephen Bourke<sup>78</sup> the playing field has been levelled. When dividing a bankrupt's estate, the Family court can now consider such factors as the non-bankrupt spouses non-financial contributions to a marriage. The previous bankruptcy laws gave only limited consideration to any non-financial contributions of a non bankrupt spouse.<sup>79</sup>

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<sup>78</sup> BRW article – February 9-15, 2006

<sup>79</sup> *ibid*

## Chapter 2 - How then might a Court apply these new legislative provisions?

### Balancing of the contributions

[ 120 ] Previously an application pursuant to Section 79 was a matter of determining rights between parties to a marriage based on their contributions and an assessment of the section 75 (2) factors. That exercise of itself was difficult enough. Now under the new amendments in the case of an insolvent party to a marriage, the court will be faced with the balancing of the contributions between a party to a marriage, and the trustee of a bankrupt party to a marriage. How then does the court balance the rights of creditors who of course have not contributed to the property of the marriage, against those of a spouse and interests of the children? The rights of the creditor may only represent one of the liabilities in the property pool.

### Competing claims of spouse and creditor

[ 121 ] Of concern always were the competing public policy interests in a property settlement involving a bankrupt. Whose interests were supreme those of the creditors, or the non bankrupt spouse? The non - bankrupt spouse of course may have made significant contributions pursuant to section 79 to that very same property, which the creditors seek to claim and divide. What then of the interests of the children and their future. These are not easy considerations to reconcile.

[ 122 ] It will be an unenviable task for a Court exercising its discretion to balance up the rights between parties to the marriage and outsiders.

[ 123 ] This topic was considered as long ago as 1992 by The Honourable Justice Lindenmayer, in his paper, '*A Question of Priorities: Wives or Unsecured Creditors*<sup>80</sup>', appropriately under the heading:

#### Striking a Balance

Even the most cursory reading of the authorities in this area of the law makes patently obvious the fact that any attempt to impose a strict order of priorities, be it in favour of third party creditors or in favour of spouses, must inevitably come to be regarded as repugnant to the courts' ability to do justice to the individual circumstances of each case. Just as vexed a question as the one facing the courts in trying to balance the competing legal rights of the parties then, is the question of trying to strike the necessary social balance between the two.

The most important concepts here are those of necessity and balance. It would appear unfair that a spouse who has been employed over a long period in home duties should be arbitrarily relegated to a position of priority below that of the unsecured creditor to such an extent that his or her claim under s.79 of the Act is diminished or even extinguished altogether. Similarly, spouses who allow the property of the marriage to be maintained in the sole name of their partner often find themselves the victims of what has become known colloquially as 'sexually transmitted debt', and are left in a position far worse than those who hold joint legal title in the property. It seems unfortunate on the face of it then that mothers and wives should be forced to pay the price for what often are, "the sins of the fathers". But the public policy argument is by no means so simply stated or one-sided.

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<sup>80</sup> Paper presented to the 5<sup>th</sup> National Family Law Conference, September 1992.

Balanced against the rights of the spouse is the fact that the Family Court has in the application of the basic rule, already shown a preparedness to assign liabilities to one party alone or to discount a liability altogether where appropriate. Neither can it be said that spouses are by any stretch of the imagination always "innocent" victims of their partners dealings. Spouses have often enjoyed the pre-insolvency prosperity and lifestyle that their partner's business ventures have brought. Having previously received the benefits of such success, the so-called 'roller coaster ' principle dictates that they should thus be prepared to share in the 'down side' of such ventures.

While I would suggest that the needs of the spouse to be able to survive financially must in the end outweigh the rights of unsecured creditors the over-riding principle is that of balance. The individual circumstances must dictate the approach of the court. But to achieve that, the Family Court needs to have access to all of the circumstances of each case. Any attempt to achieve this, is at present hamstrung by the limited jurisdiction of the Family Court to deal with bankruptcy matters.

- [ 124 ] The concerns raised by His Honour as to the difficulties in balancing the rights of spouses against creditors are just as valid today as they were when the paper was delivered in 1992. We can only await developments of the jurisprudence in this area now that the court's jurisdiction to do with bankruptcy matters has been expanded. It will be interesting one day for example to see if it might be argued that financial misconduct of one party leading to the bankruptcy of the other spouse party ought be taken into consideration in a property settlement as a negative contribution.

### **Conclusion**

- [ 125 ] Depending on the timing and direction of the attack on your client's assets the best asset planning approach may just be an irresolvable dilemma. The changes to the *Family Law Act* wrought by this new legislation are significant. As a result of the changes introduced by *Bankruptcy and Family Law Legislation Act 2005* your clients may be able to safeguard their assets from either creditors or spouses but not both.

## **PART 6 - CONSIDERING PRE-NUPTIAL AGREEMENTS AS A FORM OF ASSET PROTECTION**

### **Introduction**

[ 126 ] For the purpose of this paper it is assumed that the binding financial agreement under consideration meets all the requirements of the Family Law Act as to validity.

### **Can a binding financial agreement serve two masters?**

[ 127 ] Fundamentally a binding financial agreement is an arrangement usually designed with a view to place assets out of the reach of a spouse in the event of a relationship breakdown, or divide them between spouses under some determined arrangement. That is the purpose is not usually to place the assets in the hands of the spouse, permanently, to keep them out of the reach of creditors. Can a binding financial agreement serve these two masters?

### **Chapter 1 - What is there to worry about?**

- What should the Wife ( Spouse of Potential Bankrupt ) worry about?
- What should the Husband ( Potential Bankrupt ) worry about? (Other than the friendly tradesman in the new King Gee shorts moving in after the wife moves him out.

[ 128 ] Of course all ex-wives are not as devious as the character played by Catherine Zeta - Jones in the movie 'Intolerable Cruelty', are they?

### **Spouse of potential bankrupt<sup>81</sup>**

[ 129 ] Is a simple solution to our client's estate planning concerns is to place his assets in the hands of his spouse (subject to the terms of well drawn a Pre-Nup). Will assets be safe from creditors? If anything happens in the marriage of Mr & Mrs Quixote, can Don can simply rely on the Binding Financial Agreement to seek the transfer back to him of those assets rightfully his, i.e. just as a Trustee in Bankruptcy will seek to 'claim back' assets to distribute assets amongst creditors. Of course he would only engage the provisions of the Pre Nup when the creditors were off the scent.

[ 130 ] Without a Pre - Nup, our Don would be left with the option of instituting proceedings pursuant to section 79 of the *Family Law Act* for settlement of property. Action may also have to be taken pursuant to Section 78 for a declaration about the ownership of property.

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<sup>81</sup> Who is not facing potential Bankruptcy themselves.

## Chapter 2 - Joint Task Force Report of January 2002

- [ 131 ] Unfortunately for Mr Quixote, as long ago as October 2003, alarm bells were ringing<sup>82</sup> because of the recommendations made in the *Joint Task Force Report the Use of Bankruptcy and Family Law Schemes to Avoid Payment of Tax*<sup>83</sup>.
- [ 132 ] In his paper<sup>84</sup>, '*Critical Strategies for Protecting Assets in the Advent of a Bankruptcy*', paper delivered in October 2003 Mr Ken Schurgott's indicated that the proposals should not be underestimated. Those proposals have now come to pass.
- [ 133 ] Mr Schurgott also noted<sup>85</sup> :

The bankruptcy of a person is deemed to have a relation back to, and have commenced at, the time of commission of the earliest act of bankruptcy committed by that person within the period of six months immediately preceding the date on which the bankruptcy petition was presented. The property which vests in the trustee and bankruptcy is that relevant property which is owned by the person at that earlier relation backdate. This relation back principle can be devastating because the bankrupts will often believe that transactions entered into prior to the lodgment of a debtors petition (or creditors) petition will be protected (subject of course, to the applications of Section 120 and 121 of the Bankruptcy Act)'.

In re Sabri, ex parte Brien (1997) FLC 92 – 732 provides an excellent example.

The Family Court made a Consent Order in respect of the settlement of the purchase by the wife of the husband's interest in the matrimonial home. The wife had borrowed funds from the bank and paid settlement monies to the husband. A creditor's petition was served shortly after settlement and a Sequestration Order made soon after that. A Bankruptcy Notice had been served on the husband prior to settlement and the husband had failed to comply with it. This failure to comply was an act of bankruptcy. It occurred within six months of the creditors position and thus became the operative date for the purposes of Section 115.

Notwithstanding the Consent Order of the Family Court and payment by the transferee, the husband's interest in property had vested in the trustee and bankruptcy prior to the transfer to the wife pursuant to the Family Court Order.

- [ 134 ] In issue for the purpose of the present paper is whether a pre-nuptial (or indeed any Binding Financial agreement within the meaning of that term in the *Family Law Act*) is useful as a form of asset protection.

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<sup>82</sup> Ken Schurgott, '*Critical Strategies for Protecting Assets in the Advent of a Bankruptcy*', paper delivered to Lexis - Nexis Conference 28, 29 October 2003 'Securing the Wealth of at Risk Individuals'

<sup>83</sup> January 2002

<sup>84</sup> Shurgott, p2

<sup>85</sup> Op cit



### **Section 120 of the *Bankruptcy Act***

- [ 135 ] Section 120 of the Bankruptcy Act provides for the time frames for transfers of property.<sup>86</sup> If an appropriate asset protection plan is to be established, then these time frames must be acutely observed.<sup>87</sup>

### **Section 121 of the *Bankruptcy Act***

- [ 136 ] Section 121 of the Bankruptcy Act<sup>88</sup> provides that if the main purpose of the making of a transfer was to avoid the transfer property becoming available to his creditors, then such transfer is void against the trustee.

- [ 137 ] Mr Schurgott in his paper raised this point<sup>89</sup> whether in the context of asset protection planning, if a transfer of property was made at a time when there were no existing creditors, no contingent liabilities and nothing threatened but the transfer is overtly made to avoid the property becoming available to creditors who may eventuate, is that sufficient to trigger an application of Section 121. As Mr Shurgott put it, **The question being simply, is good planning vulnerable?**

- [ 138 ] It appears that such planning is at some risk. See Sackville J in *Prentice –v- Cummins (No. 5)90*. As His Honour said:

It does not seem to me that ex-parte Mercer necessarily means that a Barrister who transfers assets in order to keep them out of the hands of clients or potential clients, who at some stage in the future might sue for professional negligence, is outside the scope of Section 121 (1) (b) of the Bankruptcy Act should the transfer be subsequently impugned. It must be borne in mind that Section 121 (1)(b) may be satisfied even if the transferor was solvent at the time of the transfer and even if the transferor had no creditors at that time. It seems to me that the answer to the question is likely to depend on the facts of the particular case.

### **Clawbacks under section 120 as amended**

- [ 139 ] Section 120 has been now amended and clarifies to some extent the situation concerning transfers void against trustees. Generally, under section 120, undervalue transfers such as those to a spouse are void if they occur in the 5 years leading up to a bankruptcy. A transfer however is not void if it occurred more than 2 years before the Bankruptcy, if at the time of the transfer it can be proved the bankrupt spouse was solvent.<sup>91</sup>

### **Bankruptcy Legislation Amendment (Anti-avoidance) Bill 2006**

- [ 140 ] At the time of writing this paper, a bill currently before Parliament would extend the time period under section 120 from 2 years to 4 years, where transfers are to related entities.<sup>92</sup> Section 121 is also to be amended to limit the circumstances under which transfers to related entities are protected. These changes are outside the scope of this paper.

<sup>86</sup> See Subsections 1 ( 5 yrs ) & 3 ( 2 yrs ).

<sup>87</sup> Mr Schurgott's paper, page 12.

<sup>88</sup> See legislation for full text.

<sup>89</sup> At Page 17

<sup>90</sup> [2002 FCR 1503 at Paras. 100-103]

<sup>91</sup> Section 120 (3) Bankruptcy Act

<sup>92</sup> Bankruptcy Legislation Amendment (Anti-avoidance) Bill 2006

### Chapter 3 - ASIC v John David Rich & Anor

#### Issues concerning a certain Binding Financial Agreement

- [ 141 ] Issue of transfers pursuant to a Binding Financial Agreement came to prominence in the case of ASIC<sup>93</sup> and Rich and Ors 2003 [FamCA] 1114, a judgment delivered on 15 October 2003.
- [ 142 ] In that case, an application was made by ASIC for an Order pursuant to Section 90K (1)(B) and 90KA of the Family Law Act to set aside a financial agreement entered into by John David Rich also known as 'Jodee Rich' and his wife.
- [ 143 ] The facts of that case were that the husband and wife married in 1987 and still lived together with their three children at the time of the proceedings. The husband was a founder of One.TEL Limited and occupied the position of joint managing director until 17 May 2001 when he resigned.
- [ 144 ] The chronology was then:
- On 29 May 2001, the board of directors of One.TEL resolved to place the company into administration.
  - Two days later, on 31 May 2001 the husband and wife entered into a financial agreement under Section 90C of the *Family Law Act 1975*.
  - On 31 May 2001, ASIC commenced an investigation of the husband in relation to suspected contravention of the Corporations Law.
  - On 24 July 2001, One.TEL was placed in liquidation.
- [ 145 ] ASIC then applied for Orders under Section 90K(1)(B) and Section 90KA of the Act, to set aside the financial agreement. It contended that in transferring the property the husband had the intention of defrauding ASIC.
- [ 146 ] ASIC's application was dismissed on jurisdictional grounds. It was held by the Court that no part of the definition of matrimonial cause authorized the institution of the proceedings by ASIC pursuant to Section 90K.
- [ 147 ] Clearly, each case will turn on its individual facts. In the Rich case, between 17 May 2001 and 4 June 2001, the husband had engaged in a series of acts and events for the purpose of transferring or otherwise altering the ownership of his assets or assets of his associates. On 21 May 2001, the husband

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<sup>93</sup> Mr Rich and others at the time this paper was being written were defending civil proceedings in the NSW Supreme Court brought by ASIC asserting that they breached their responsibilities to shareholders in One.TEL Limited

transferred his interest in a Porsche motor vehicle to his wife. On 21 May 2001 the husband resigned as the Director of Tasman Pacific Pty Ltd, the mortgagee of a property at Vaucluse owned by the husband and wife as joint tenants. This property is described in the Financial Agreement as 'the home'.

- [ 148 ] By the terms of the Agreement the husband also settled upon a discretionary trust, certain rights to receive monies in a company and requested the trustee supply the income produced by those funds and the capital of those funds for the maintenance, education and advancement in life for the children.
- [ 149 ] The husband also promised to pay the wife \$1,000.00 per week and indexed annually to enable her to meet the outgoings and expenses of the home, and for the maintenance of the home, and for the provision of the food and expenses of their joint shared life together. In order to secure this payment the husband agreed to a charge over his remaining share of the proceeds of sale of a property to secure the aggregate sum of \$500,000.00. The husband agreed to place those funds in a secure investment to ensure the promised maintenance was available.
- [ 150 ] By the terms of the Agreement, the husband also acknowledged that the furniture, furnishings and contents including artworks in the home are the sole property of the wife "*...having been acquired for her benefit and with the intention that they should be held to provide appropriate furnishings for the home of the wife and the children*". The artwork was extensive and valuable.
- [ 151 ] The Agreement is interesting in that it recited that:

"C...Jodee's financial affairs have taken a significant turn for the worse and his financial future is under a cloud. (The wife) is concerned that her professional career, as a lawyer, and public company director may be significantly compromised as a result of the adverse change in Jodee's circumstances.

Additionally, these pressures are likely to place the marriage under stress. (The wife) has been advised that by reasons of the years of their marriage and the birth of their children, she has an inchoate claim to a settlement of property under the Family Law Act, and in view of the financial uncertainty of both Jodee and (the wife), (the wife) has asked Jodee to provide financial security for her and the children. Jodee has been advised that (the wife) is entitled to security and that if (the wife) and he were to separate, there would be a significant award made for the benefit and security of (the wife) and the children by way of property settlement and maintenance.

L ... the purpose of this Agreement is to provide how, in the event of the breakdown of the marriage of (the wife) and Jodee, all of the property and financial resources of each of them at the time of this Agreement or any later time during the marriage, is to be dealt with and to provide for the maintenance of (the wife) during the marriage and/or should the marriage be dissolved in the event of that dissolution."

- [ 152 ] According to the Judgment, the Agreement did not specify why the husband's financial affairs had taken a significant turn for the worst and his financial future was under a cloud. Nor did it specify why or in what way the wife's professional career may be significantly compromised. What is interesting is

that these provisions were set out in the agreement at all. The drafter of the agreement left no doubt of the intention behind the agreement.

- [ 153 ] At Paragraph 56, His Honour noted that all assets transferred by a bankrupt during the relation back period being a period immediately commencing with the date of the earliest act of bankruptcy in the six months prior to the presentation of the petition, will automatically vest equity in the trustee. Section 123 of the Bankruptcy Act affords protection against the doctrine of relation back in respect of some transactions affected by a **maintenance agreement** but subject to sections 121 and Section 122.

#### **The old definition**

- [ 154 ] A Maintenance Agreement was defined in Section 5 of the Bankruptcy Act to mean a Maintenance Agreement that has been registered or approved by a Court in Australia or 'a Financial Agreement within the meaning of that Act'.<sup>94</sup>
- [ 155 ] The result being that subject to Section 121 of the Bankruptcy Act which deals with transfers to defeat creditors, a transfer pursuant to a Financial Agreement would be upheld. Thus disposition of property pursuant to the terms of a Financial Agreement were previously afforded considerable protection under the Bankruptcy Act. Prior to December 2000, this was subject to the powers of the Family Court to set aside agreements.

#### **The legislature intervenes**

- [ 156 ] The Family Law Amendment Act 2003, amended the Act by inserting a new provision in the definition of matrimonial cause namely, paragraph (eab), to include  
(eab) third party proceedings (as defined by Section 4A, to set aside a financial agreement;...
- [ 157 ] **Third party proceedings** is defined in the new Section 4A to include a creditor, the definition of which is set out in Section 4A(2). Section 90K(1)(aa) was also inserted to provide that an agreement can be set aside if either party entered into it with the purpose of defrauding or defeating a creditor or with reckless disregard of the interests of a creditor.
- [ 158 ] Jodee Rich of course was a high profile example of the use of a binding financial agreement in order to avoid creditors. However the clever drafting of that agreement highlights the tension between the legitimate rights of creditors and the legitimate rights of spouses to what may be the same estate. The same pie cannot be eaten twice.

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<sup>94</sup> Rich, para 58. Note this legislation now amended

**Is it all in the timing?**

- [ 159 ] Prudent business planning of course takes place well before the action of creditors, not in the immediate time after it. The Jodee Rich case because of its high profile nature brought a lot of attention. There was a very close relationship in time between the placing of his company into liquidation, and the transfers away of assets. Good planning it is submitted is done in the distant past.
- [ 160 ] Because of no doubt of Mr Rich's success in the application and the spectacular nature of his case, and despite the considerations which favour the interests of spouses, the legislative intervention followed hot on the heels of the decision and the Act was amended. The cross hairs on the sights of the legislators lined up on the financial agreement. Property transferred under financial agreements by bankrupts is now subject to recovery.

## Chapter 4 - Financial Agreements now

[ 161 ] An act of Bankruptcy can now be committed by virtue of a transfer pursuant to a Financial agreement:

### 40 Acts of bankruptcy

(1) A debtor commits an act of bankruptcy in each of the following cases:

(a) if in Australia or elsewhere he or she makes a conveyance or assignment of his or her property for the benefit of his or her creditors generally;

...

(o) if the debtor becomes insolvent as a result of one or more transfers of property in accordance with a financial agreement (within the meaning of the *Family Law Act 1975*) to which the debtor is a party.

[emphasis added PES]

[ 162 ] This can then make property previously protected divisible amongst creditors.

[ 163 ] According to the explanatory memoranda<sup>95</sup> because:

‘A financial agreement can be made before or during the marriage or following separation. It is a binding agreement dealing with the distribution of property in the event of the marriage breaking down. It may also provide for the maintenance of either party to the marriage or their children. Financial agreements do not require approval by a court. Nor do they have to be registered with the court. They can only be set aside by the court in circumstances similar to those applying in contract law (such a fraud and undue influence). **For these reasons, it is not appropriate that property transferred pursuant to such an agreement is excluded from the property available to pay creditors.**’

[ 164 ] This therefore has wide implications for the use of financial agreements as an estate planning tool. A financial agreement will be ineffective against a Trustee in Bankruptcy.

[ 165 ] This may be considered as business risk. The party with a stable marriage may consider the greater risk lies with their entrepreneurial business rather than with their spouse.

[ 166 ] With the introduction to the *Family Law Act* of the binding financial agreement greater certainty can be obtained by having an agreement in place. That agreement can provide for the arrangements to be affected upon separation and also deal with those business assets and structures.

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<sup>95</sup> See Para 163

**Chapter 5- Bankruptcy and Family Law Legislation Act 2005 - Amendments to Bankruptcy Act 1966 relating to 'maintenance agreements'**

[ 167 ] Younger practitioners, may of course never seen one, but there may possibly still be a few clients who have in place maintenance agreements made under section 87 or 86 of the *Family Law Act*.

[ 168 ] The definition of 'maintenance agreement' at subsection 5(1) of the *Bankruptcy Act 1966* has been amended to exclude financial agreements entered into under Part VIIIA of the *Family Law Act 1975* . This will allow trustees to use the provisions in Division 3 of Part VI of the Act to recover property transferred by the bankrupt prior to the commencement of bankruptcy.

[ 169 ] The definition is as follows:

**5 Interpretation**

In this Act, unless the contrary intention appears:

...

***maintenance agreement*** means:

- (a) a maintenance agreement (within the meaning of the *Family Law Act 1975*) that has been registered in, or approved by, a court in Australia or an external Territory; or
- (b) any other agreement with respect to the maintenance of a person that has been registered in, or approved by, a court in Australia or an external Territory;  
**but does not include a financial agreement within the meaning of the *Family Law Act 1975*.**

[ 170 ] It would appear therefore that the old forms of maintenance agreement is still a protected species, though of limited relevance.

## Chapter 6 - Where to now? Is the tried and true Consent order an effective tool still?

- [ 171 ] Given the difficulties faced with settling matters by way of financial agreement, if there is any risk of bankruptcy at first sight it would seem prudent to settle any section 79 matters by way of consent orders rather than a financial agreement. The explanatory memorandum to the amending act seems to give comfort to this proposition.
- [ 172 ] As noted in the explanatory memorandum to the 2005 Act, financial agreements do not require approval of a Court. They are a private ordering of the parties' financial affairs. The agreement does not even require any public form of registration for them to come into effect. This is in stark contrast to the process for approval of the old Section 87 agreement or the registration of a Section 86 agreement. For these reasons, legislature has determined that it is not appropriate that property transferred pursuant to such an agreement is excluded from the property available to pay creditors.
- [ 173 ] Now consider the circumstance where under a Consent Order a (later) bankrupt spouse was very generous to the (non bankrupt spouse) under the terms of the orders. A trustee in bankruptcy could apply to set aside a consent order if it were entered into to defraud creditors. Is no sphere safe? However, in order to be successful in an application, the applicant must still establish the grounds set out in Section 79A (1A)<sup>96</sup>. This may present an evidential hurdle to any applicant bankruptcy trustee.
- [ 174 ] However, according to the explanatory memorandum the new act of bankruptcy will apply only with the transfer under a financial agreement has the effect of rendering the person insolvent. This would apply only to transfers pursuant to financial agreements and not to other property distributions (for example, property settlements pursuant to section 79 of the family Law act). This would suggest that an act of bankruptcy is not

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<sup>96</sup> 79A Setting aside of orders altering property interests

- (1) Where, on application by a person affected by an order made by a court under section 79 in property settlement proceedings, the court is satisfied that:
- (a) there has been a miscarriage of justice by reason of fraud, duress, suppression of evidence (including failure to disclose relevant information), the giving of false evidence or any other circumstance; or
  - (b) in the circumstances that have arisen since the order was made it is impracticable for the order to be carried out or impracticable for a part of the order to be carried out; or
  - (c) a person has defaulted in carrying out an obligation imposed on the person by the order and, in the circumstances that have arisen as a result of that default, it is just and equitable to vary the order or to set the order aside and make another order in substitution for the order; or
  - (d) in the circumstances that have arisen since the making of the order, being circumstances of an exceptional nature relating to the care, welfare and development of a child of the marriage, the child or, where the applicant has caring responsibility for the child (as defined in subsection (1AA)), the applicant, will suffer hardship if the court does not vary the order or set the order aside and make another order in substitution for the order; or
  - (e) a proceeds of crime order has been made covering property of the parties to the marriage or either of them, or a proceeds of crime order has been made against a party to the marriage;
- the court may, in its discretion, vary the order or set the order aside and, if it considers appropriate, make another order under section 79 in substitution for the order so set aside.



committed by the mere transfer of property pursuant to section 79, including it is submitted [PES] by virtue of a consent order.<sup>97</sup>

[ 175 ] However, it is not all plain sailing. Pursuant to the *Bankruptcy and Family Law Legislation Amendment Act 2005*, Sections 79 and 79A were also amended.<sup>98</sup> Now, under Section 79A (5) a bankruptcy trustee is taken to be **a person interested in an order** for the purposes of the section, if at the time when the order was made either the person was bankrupt, or later became bankrupt. Pursuant to the provisions of Section 79A (1A), Court may make this setting aside an order on the application of person interested in an order.

[ 176 ] Pursuant to the provisions of Section 79A (4)<sup>99</sup> of the *Family Law Act 1975* creditor of person is deemed to be person interested in order if that person's debt is not able to be paid by virtue of an order. It is not too difficult to envisage then a situation where a husband (who is a debtor) transfer his entire interest in the family home to the wife then faces an application by a creditor to set aside that consent order.

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<sup>97</sup> EM para 166

<sup>98</sup> Commenced 18 September 2005.

<sup>99</sup> This was added to the legislation under the heading: 'Additional amendments relating to the interaction between family law and bankruptcy law'

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<<http://www.svpartners.com.au>>

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