

Options for Limiting Liability and Protecting Assets with Business Structures

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1. Comparing Commonly Used Business Structures

1.1 Introduction

There are several business structures generally used to structure businesses. The most commonly used structures for businesses are:

- a) Sole trader
- b) Partnership (between individuals or entities such as trusts)
- c) Company (small/private or large/public)
- d) Trust (unit trust or discretionary) often with a corporate trustee
- e) Joint Venture – incorporated or unincorporated (usually used for projects and/or where a product is produced and shared e.g. mining joint ventures)

The most recent ABS survey (Counts of Australian Businesses, including Entries and Exits, Jun 2003 to Jun 2007) indicates that:

- 1) the types of legal organisations used in Australia as at June 2007 were as follows:
641,538 (32%) Companies
620,037 (31%) Sole proprietors
385,801 (19%) Partnerships
364,075 (18%) Trusts
(<1%) were operating in the Public sector
- 2) Over the past four years, there has been consistent growth across most organisational categories, except for Partnerships which have experienced decline each year.
- 3) Out of all private sector businesses in the period June 2006-07, entry rates were highest for Sole proprietors (22%) and Trusts (19%), followed by Companies (14%) and Partnerships (12%). Conversely, exit rates were highest for Sole proprietors (20%) and were noticeably lower across the other private sector categories. Across the past four financial years, both entry and exit rates have been relatively stable for all private sector categories.
- 4) For both the stock of businesses and for business entries, survival rates have been consistently higher for Trusts and Companies, while they have been lower for Sole Proprietors and Partnerships.

To determine the best structure for your client's business you should look at:-

- The purpose of the business, its likely duration and the types of assets the business will acquire
- taxation consequences (e.g. applicable tax rates, ability to defer tax, flexibility or rigidity on income and asset distribution, ability to carry forward or access losses, application of personal services income rules, ability to salary package etc)

- organisational and governance issues (e.g. number of controllers and their structure, whether controllers are also owners or entitled to income, whether control is by democratic vote or dictatorship etc.)
- liability issues (the focus of this presentation)
- establishment and maintenance costs
- funding issues i.e. how will initial capital be provided (i.e. by the business owners or by external means), ease of raising finance (and ability to return capital)
- ability to admit new investors or business owners (to allow for future growth)
- succession issues (exit strategies for owners, stability of structure in the event of disability or death of owner – e.g. might dissolve a partnership)
- simplicity of the structure (client's ability to understand and manage it, accountant's, financier's, investors' and suppliers' ability to understand it)

I have not covered franchising as a structure in this paper since it is effectively a contract between the franchisor and franchisee to operate a business in a certain way with a licence to use certain intellectual property rights for a period of time in a set territory. This contract is governed by the Franchising Code of Conduct prescribed by the *Trade Practices Act 1974 (Cth)*. The underlying structure of the franchisee will be one of the structures discussed in this paper.

I will also not cover Superannuation as a business structure (i.e. as an entity for holding assets or real property etc).

1.2 Limiting liability from what?

External attacks

When clients are asked what they consider to be the risk they might need protection from in a business context most will respond by listing off:

- Attack by creditors (i.e. bankruptcy / insolvency);
- Attack by employees (i.e. industrial action);
- Attack by clients or customers for negligence;
- Public risk; and
- Product liability.

Most do not consider the following equally important risks:

- Fraud (including employee fraud);
- Business Partner's actions;
- Failure or marriages / relationships; and
- Death or critical illness or incapacity of business owner or other key person.

Obviously there are practical ways to limit liability from the above risks by taking steps to minimise the risk of being sued (e.g. by implementing cash flow systems, safe workplace systems, undertaking continuing professional education or implementation of proper manufacturing processes, etc). Additionally all businesses should obtain adequate insurance cover such as WorkCover, Public Liability, Professional Indemnity etc

Business risk protection structuring is then done to:

- quarantine business owners from business risk (e.g. by structuring the stakeholders as separate legal entities from the at-risk individuals running the business)
- quarantine business assets from personal assets
- quarantine business assets from business risk (e.g. by having one entity own the business assets and another entity as the trading entity)
- quarantine the risk of one business from the risk of another business
- reducing assets (or equity in assets) held by at-risk individuals (e.g. by transferring them to a non-at-risk spouse or other entity (e.g. trust or superannuation), or by encumbering them or borrowing against them)
- minimise the impact of other risks such as marriage breakdown, fraud, workplace accidents, death or incapacity by taking out insurances or preparing other documentation such as Binding Financial Agreements, Buy Sell Option Deeds etc.

To undertake a thorough business risk structuring review it must be done in the context of each business owner's personal circumstances and personal assets, and should consider the consequences of the failure of marriages or relationships, death, critical illness or incapacity not just of the business owner, but also of the non-at-risk spouse or other third party who might be selected to own assets instead of the at-risk business owner.

Protecting clients from "friendly fire"

It is easy to conjure up scenarios for clients concerning risk protection when considering possible attacks from outside the camp (such as from creditors, or customers suing for negligence etc) but clients often forget that attacks can be "friendly fire" from banks or other financiers usually considered as working with the business until financial pressure comes to bear.

Limiting liability in this context means advising the client on:

- their exposure when giving personal or directors' guarantees; and
- the type of security which should be offered to banks or other financiers (e.g. charge over the company as opposed to mortgages over personal real property. The trade off might be a higher interest rate)

Protecting clients from themselves

It is important that clients understand at the outset that in order to effectively limit liability the business structuring must be done carefully and from inception (when there is no existing threat of bankruptcy or insolvency) and not when threats of attack upon their business are imminent because usually it is too late to undertake re-structuring at that point because of the "claw back" and "commencement" provisions in the bankruptcy and insolvency legislation.

The focus of this paper will be initial business structuring i.e. when there is no actual existing threat of bankruptcy or insolvency.

1.4 Structuring options

Sole Trader

An Individual carrying on business in their own name is the simplest and cheapest structuring option i.e. there are low establishment costs (limited to a business name (if any) and obtaining an ABN (if necessary) and any licences etc) and low ongoing administration costs,

with simple accounting (unless there is complexity in identifying what are business assets as opposed to personal assets e.g. for depreciation). The individual owns the assets of the business, and makes contracts with customers directly. Obviously this structure has a limited life i.e. of the sole trader dies or becomes incapacitated, the business may come to an end.

The sole trader will have limited access to finance if the business grows since he or she will not be able to raise finance from the public and is limited to everyday sources such as finance companies, mortgages of property etc.

This option is most often used by very small businesses that don't have employees (e.g. cleaners, or contractors etc).

This option is however the riskiest way to carry on business, since all of the individual's assets (regardless of whether or not they are personal or business assets) will be exposed to any claims made against the business. Similarly the business assets are also exposed to the risk of the individual's personal debts.

Liability can be limited by:

- obtaining insurances sufficient to cover them for the types of claims that might arise e.g. public liability, professional indemnity insurances etc.
- undertaking other asset protection structuring e.g. by having a non-at risk spouse, or other entity (such as trusts or superannuation) hold all substantial assets (giving due consideration to the other personal risk of marriage breakdown and making sure that poor succession planning or guarantees by the non-at-risk spouse or other entity does not undo that structuring)

Partnerships

A partnership is where two or more individuals or other legal entities carry on business together with a view to profit.

Partnerships are again relatively simple structures, with low establishment and administration costs. They can be informal partnerships (e.g. between a husband and a wife in business) which are then governed by the provisions in the relevant state or territory partnership legislation (in Queensland – the *Partnership Act 1891*) or can be formalised by a documented Partnership Agreement (which may override certain provisions in the partnership legislation). The partners will have full control of the business (although the larger the partnership the smaller control each partner will have) but generally must make decisions jointly (i.e. unanimously). All partners will need to sign any legal documents binding the partnership i.e. the partnership is not separate legal entity (even though in practice there are procedures in place to allow partnerships to be sued in their trading name). The partners each own a share of the business and its assets and generally have an entitlement to a share in the profit (unless they are salaried or fixed-draw partners). Note that the definition of partnership for tax purposes (i.e. under the *Income Tax Assessment Act 1997 section 995-1*) is different from the definition of partnership under the Partnership Act, so a tax law partnership can exist even if there is no partnership at law.

This option is commonly used by family businesses (e.g. husband and wife business) or where businesses are required by law to carry on business as individuals or partnerships.

Except in the case of a limited partnership (not discussed in this paper) partners face unlimited personal liability. Partners like individuals are personally liable for all liabilities and claims against the business and accordingly all assets owned by each partner personally (whether or not those assets are used by the business) are exposed to the business risks. In fact, the potential liability of a partner is even greater than the liability of a sole trader, since partners are jointly and severally liable for the debts of business, actions of other partners (except limited liability partnerships) and claims made against the business.

Liability can again be limited by:

- obtaining insurances sufficient to cover each partner for the types of claims that might arise
- each partner undertaking other asset protection structuring e.g. by having a non-at risk spouse, or other entity (such as trusts or superannuation) hold all substantial assets
- salaried partners obtaining indemnities from other equity partners (noting that the indemnities are only of value to the extent of the assets held by the partners giving the indemnities)

Private Company

Companies are (according to the ABS Survey as at June 2007) the most commonly used business structure.

The various types of company are as follows:

- 1) company limited by shares (proprietary company) – liability of members is limited to the amount (if any) unpaid on their shares.
- 2) company limited by guarantee (public company) – liability of members arises on winding up (not when they become members) i.e. the members guarantee to provide funds up to a specific limit (or set by a specific formula) per member, if the company is unable to meet its liabilities from the sale of its assets on winding up.
- 3) unlimited companies (proprietary or public company) – liability of members is for the amount (if any) unpaid on their shares and then to the full extent of their resources if the company is unable to meet its liabilities from the sale of its assets on winding up.
- 4) no-liability companies (public company) – developed especially for mining industry – members are not liable for calls made by the company during its lifetime or on winding up. If the call is not paid then the member forfeits the right to dividends and shares may then be sold.

Companies can either be proprietary companies or public (listed or unlisted) companies. A company (other than a no-liability company and a company limited by guarantee) may be incorporated as a proprietary company if it has share capital and its membership is no more than 50 members. A proprietary company can have only one director (public companies require a minimum of 3 directors) and are less regulated than public companies. A proprietary company is however prohibited from raising funding from the public.

The focus of this paper will be companies limited by shares since this is the most common structure used by most businesses.

A company is a separate legal structure that clients, financiers, customers and suppliers understand. A company structure provides limited liability to shareholders (provided they do not provide personal guarantees for finance or as part of supply contracts) however if the shareholder becomes bankrupt or insolvent the shares held by it will fall into the hands of the trustee in bankruptcy or administrator, liquidator or receiver.

Companies are generally governed by their Constitutions or the replaceable rules and Corporations Law (with some exclusions) and are subject to regulation by ASIC, with annual reporting (and possibly annual audit) requirements etc. Incorporation and ongoing administration costs can be expensive.

Directors have the day to day control but have a duty to act in interests of the shareholders. Any majority shareholder has ultimate control of company (because of the shareholders' right to remove and replace directors). It is possible set share classes with varying voting, capital

and income rights. Directors and shareholders can be the same people, or shareholders can be entities controlled by directors.

The company owns the assets of the company. Shareholders have no legal entitlement to assets of company except on winding up.

Directors have onerous duties and responsibilities and can be personally liable for debts incurred by their companies:

- 1) if they trade while insolvent,
- 2) if they have provided personal guarantees to financiers or suppliers; and
- 3) under the director penalty regime (amended and moved from the ITA to Division 269 of Schedule 1 of Taxation Administration Act 1953 (TAA) on 1 July 2010). A director can now be personally liable for the full amount of the liability the moment the company defaults on an instalment agreement with the ATO to pay its outstanding deducted taxes (e.g. PAYG withholding tax).

Liability can be limited by:

- obtaining insurances sufficient to cover directors and office holders for the types of claims that might arise
- each director undertaking other asset protection structuring e.g. by having a non-at risk spouse, or other entity (such as trusts or superannuation) hold all substantial assets
- ensuring that the shareholders are non-at risk individuals or entities (even if controlled by the directors), so that the shares do not fall into the hands of trustees in bankruptcy etc (taking care to advise clients on the risks of shareholders giving guarantees for business debt, and to be mindful of the impact that loan accounts can have – discussed in the paper below)
- Entering into Shareholders Agreements (the business pre-nup) (to document how the company is to be managed, how the company is to be valued on entry or exit of business owner, how the rights of minority shareholders are to be protected and to ensure proper dispute resolution procedures are documented)
- Entering into Buy Sell Option Deeds (insurance funded or otherwise) to document what is to happen in the event of death or disability of a business owner or controller
- Promoters may need to take additional steps to limit their liability under any pre-company-registration contracts i.e. ensure the company ratifies any such contracts after incorporation, obtain appropriate indemnities or securities from intending company directors for any pre-registration liability, and obtain written releases from personal liability from the contracting parties

Trusts

Trusts are often classified as express and non-express; private and public.

An express trust is a trust created by the express and intentional declaration of the settlor, usually documented in writing (but can be created by conduct).

A non-express trust covers implied, resulting, presumptive or constructive trusts.

Public trusts are charitable trusts (to benefit the public welfare) and non-charitable trusts (to benefit public purposes).

This paper will only consider express, private trusts for the benefit of private individuals.

Express, private trusts used for businesses are of three main types – discretionary trusts, unit trusts (i.e. fixed trusts) and hybrid trusts.

Discretionary trusts (where the trustee has complete discretion on how to distribute income and capital of the trust to various beneficiaries set out in the trust deed, as amended from time to time) are usually used for:

- 1) running a family business i.e. the assets of the business are held by the trust, the trust operates the business and the income earned by the business is distributed between the family member beneficiaries.
- 2) Holding shares or other investment assets, or as a non-at risk entity for holding “personal” assets in lieu of individuals holding them. Investment income can then also be “split” amongst the various beneficiaries of the trust.

Discretionary beneficiaries have no legal entitlement to the assets or income of the trust (unless they are default beneficiaries and trustee fails to exercise its discretion or the trust is wound up).

Fixed trusts are used where specific beneficiaries are to hold assets of the trust and have rights to capital and income of the trust in a pre-determined or fixed manner e.g. unit trusts.

Unit trusts are often used in lieu of a company structure where there is no need to “park” or accumulate income or where there are assets which could be subject to CGT (since discounts are available to unit trusts but not companies). Unit trusts give beneficiaries (unitholders) certainty regarding their rights (since they hold units in the trust, much like shares in a company) and ability to ultimately control the trust, since they generally have the power to remove and replace the trustee (just as shareholders have the right to remove and replace directors). Unitholders (unlike shareholders) have a proprietary interest in the trust property. Unit trust can be less expensive to establish than companies (if corporate trustees are not used) and are not subject to as much regulation as companies are.

Hybrid trusts combine the features of discretionary and unit trusts i.e. unit holders (instead of the settlor in the case of a discretionary trust) supply the initial settlement funds (thus allowing equity finance) and their interest in those funds and subsequent accumulations of assets of the trust are determined by their unit holding. However, the distribution of income and surplus capital to the unitholders is in the trustee’s discretion.

Trusts are governed by the terms of their trust deeds, the common law, equity and state or territory legislation (in Queensland, the *Trusts Act 1973*). The trust itself is not a legal entity, rather it is the trustee that has control and holds the property for the benefit of the beneficiaries or unitholders. It is the trustee and not the trust which is ultimately attacked or sued, however usually the trustee will have a right to an indemnity from the trust assets (provided the trustee has not acted fraudulently or in breach of its fiduciary duties etc) or from the beneficiaries of the trust if they have consented to the breach of trust. Unitholders in a unit trust may be liable jointly and personally for any shortfall on liquidation of the trust unless the unit trust deed contains a limitation of indemnity clause.

Trustee’s indemnity – blessing or curse?

While the indemnity available to the trustee, is usually in place to protect the trustee, this indemnity will allow creditors access to the trust assets by “subrogation” i.e. if a creditor obtains judgement against a trustee (who has not exceeded its rights as trustee or breached the terms of the trust), then the creditor will stand in the shoes of the trustee and be able to access the trust assets under the indemnity allowed to the trustee.

There has accordingly been consideration given to whether or not the trustee’s right to an indemnity can be excluded from the terms of the trust.

Ford, in his publication “Principles of the law of Trusts” states (at para 14.3930) that in Queensland it is not possible to exclude the right to indemnity out of the assets at least where the trust is created by an instrument. That is because s 65 of the *Trusts Act 1973* (Qld) has the effect that s 72 (the provision declaring that a trustee has a right of indemnity out of the trust property) operates whether or not a contrary intention is expressed in the instrument

creating the trust. The position where the trust is created otherwise than by an instrument and there is a term excluding the right of indemnity is not, however, provided for.

The courts in Queensland seem to be of the view that the right of indemnity cannot be excluded because it is an incident of the office of trustee and is inseparable from it [*Kempton Industries Pty Ltd v CSD (Qld)* [1984] 1 Qd R 576 at 585].

The legislation of other jurisdictions is less explicit on the matter of exclusion than that of Queensland and the Victorian Supreme Court has taken the view that the right to indemnity can be excluded [*RWG Management Ltd v Commissioner for Corporate Affairs* [1985] VR 385; (1984) 9 ACLR 739 at 395 (VR)]

Ford points out (at para 14.3930 and 14.4210) that even if it is possible to exclude a trustee's right of indemnity so as to impede creditors, creditors will not be without a remedy where the trustee is a corporation. Since under the Corporations Act 2001 (Cth), s 197(1) if a trustee-corporation cannot discharge a liability incurred by it while acting, or purporting to act, as trustee and "is not entitled to be fully indemnified" against the liability out of trust assets, each person who was a director when the liability was incurred is liable to discharge the liability.

Ford points out in his article "*Trading trusts and creditor's rights*" (1981) 13 MULR 1 at pp1-2 that a creditor will not get payment out of trust assets unless the entity, incurring the debt, was acting within the trust powers and unless the trustees have avoided committing any breach of their duties to the trust (even if unrelated to the creditor's transaction). Ford also states that a creditor will not get payment out of the assets of the trust, if the trust instrument "denies access by creditors to trust assets". This means that it could be possible to have a trust deed which allows the trustee an indemnity from the assets of the trust, but denies any creditors the right to access the trust assets by subrogation.

Trusts are one of the more complex structures used in business structuring. They are often not properly understood by clients, financiers, suppliers or even accountants.

Liability can be limited by:

- Establishing corporate trustees of any trust (to add another layer of protection / hurdle for anyone suing the business) – care must be taken to structure even this corporate trustee carefully (see more detailed discussion regarding discretionary trusts and the impact of the *Richstar* decision below). Note s 197 of the *Corporations Act* places joint and several personal liability on directors of a corporate trustee if the corporate trustee incurs a debt which it cannot pay and for which it is not entitled to be indemnified out of the assets of the trust.

An often overlooked (or undervalued) issue in establishing a corporate trustee is the identity of the shareholder/s in the corporate trustee. Often corporate trustees are only \$2 companies which will only ever act as trustees (i.e. never own assets in their own right) and accordingly it is often the case that the directors of the company are also the shareholders in the company.

Apart from the considerations that need to be taken into account in light of the *Richstar* decision (discussed below) it is important to note that if the director/s of the corporate trustees are to be the individual shareholders of that company, then if the directors are sued and made bankrupt those shares will fall into the hands of the trustee in bankruptcy. If there is no independent (or automatic) power of appointment (to remove and replace the trustee in this circumstance) then the trustee in bankruptcy in the case of a sole director shareholder corporate trustee may end up controlling the trust and making distributions from the trust property to the bankrupt's estate; and in the case where 50% of the shares are held by the bankrupt, may end up deadlocking the trust.

Even where there is a power of appointment in place to remove and replace the corporate trustee it may ultimately be "cheaper" commercially to negotiate with the trustee in bankruptcy concerning purchase of the bankrupt shareholder's share rather

than exercising the power of appointment to remove and replace the trustee (since it might save the costs of setting up a new corporate trustee and then undertaking all of the relevant transfers to note the new trustee's ownership of assets, business names etc). It is however, not the usual case that a trustee in bankruptcy would be willing to accept the \$1 share value as consideration for such a transfer (since the trustee in bankruptcy will be aware of the types of costs involved in changing a trustee).

This is another reason (apart from the "*Richstar* reason") why it may be prudent to have a non-at-risk person or entity hold the shares in the corporate trustee.

- Ensuring that the trustees have indemnity from the trust assets (specified in the trust deed) to protect trustees (but can allow creditors to have access to trust assets by subrogation).
- In the case of discretionary trusts, structuring the trust carefully e.g. if the trust is being used to hold the assets of an at-risk individual, care must be taken to ensure that individual does not have ultimate control of the trust (i.e. ensure that the person is not the sole trustee, or sole appointor etc) This is dealt with in further detail below. Further care should be taken to draft appointor succession clauses carefully to ensure that the at-risk individual is not appointor of the trust if he or she commits an act of bankruptcy. Obviously this type of succession should also be considered upon other triggering events such as incapacity or death of the first named appointor to ensure the control of the trust passes appropriately.
- In the case of unit trusts ensuring that the unitholders' liability is limited in the terms of the trust.
- Including a clause in the trust deed denying access to the trust assets by creditors. [Ford, HAJ, "*Trading trusts and creditor's rights*" (1981) 13 MULR 1 at pp1-2].
- obtaining insurances sufficient to cover the trustee for the types of claims that might arise.
- the trustee (or in the case of a corporate trustee each director of that company) undertaking other asset protection structuring e.g. by having a non-at risk spouse, or other entity hold all substantial assets.
- ensuring that the unitholders (in the case of fixed trusts, unit trusts or hybrid trusts) are non-at risk individuals or entities, so that the units do not fall into the hands of trustees in bankruptcy etc (taking care to advise clients on the risks of unitholders giving guarantees for business debt, and to be mindful of the impact that loan accounts can have – discussed in the paper below).
- In the case of unit trusts, fixed trusts or hybrid trusts, entering into Unitholders Agreements (the business pre-nup) (to document how the trust is to be managed, how the trust assets are to be valued on entry or exit of business owner, and to ensure proper dispute resolution procedures are documented).
- In the case of unit trusts, fixed trusts or hybrid trusts, entering into Buy Sell Option Deeds (insurance funded or otherwise) to document what is to happen in the event of death or disability of a business owner or controller.

Joint Venture

A joint venture is a contract between parties (persons or entities) to conduct a business, which involves the sharing of the product of their joint venture (rather than sharing the profit). Control is joint between the joint venturers (i.e. the joint venture agreement will usually specify which party can make decisions about which aspects but will usually require unanimous consent on key issues). The parties can agree to delegate management of the joint venture to a third party. There is no agency between joint venturers so one joint venturer

cannot bind the others. Where assets are acquired by the joint venturers they are owned as tenants in common in specific proportions (not as joint tenants).

Many structures are described as joint ventures, but are not actually at law joint ventures.

The joint venture can be unincorporated (i.e. governed by a joint venture agreement) or incorporated (i.e. where a company is incorporated, and the joint venturers are shareholders with a specifically drafted shareholder's agreement – noting that this may not be a "true" joint venture if profits are shared). It is easy to see how a structure named a joint venture could be either a partnership or a company at law if a careful analysis is not done of the parties' intentions.

The legal classification of the structure could have considerable consequences e.g. if the joint venture is actually a partnership at law then the joint venturers will be jointly and severally liable. Even if there is not a partnership at law, there may be a partnership for tax law purposes which could produce tax outcomes not intended by the parties.

Joint ventures are usually used for businesses or projects with a limited life span e.g. minerals exploration or mining (where e.g. coal is produced and sold), biotech research and development projects or entertainment arrangements but can also be seen in property development (where one party will contribute land and the other construction expertise – to produce e.g. units for sale) or sharefarming arrangements (where one party provides the labour, while other parties provide the funding) etc.

Of all the structures discussed so far this is the most complex and possibly the most expensive as very specific drafting will be needed to document the parties' intentions.

The risks that the joint venture might be exposed to will depend on the type of project or business to be undertaken, and so limiting liability must be considered on a case by case basis. If the joint venture is a true joint venture and not a partnership then the joint venturers will be liable for their own debts and a discrete portion of the liabilities of the joint venture (unless the other joint venturers have held themselves out to the public as being involved in the business or project together).

Liability can be limited by:

- Structuring the joint venture carefully to make sure that the structure will not be classed as a partnership at law or pursuant to tax law
- Ensuring that the joint venture agreement clearly sets out what is to occur to the joint venture project if one or more of the joint venturers wish to exit the project or if a joint venturer becomes bankrupt, incapacitated or dies (i.e. is the joint venture to come to an end, or can replacement parties be sourced? Is the former member liable for contracts of the joint venture made when that member was a joint venture member, or not?)
- obtaining insurances sufficient to cover the joint venture and each joint venturer for the types of claims that might arise
- each joint venturer taking steps to limit its own liability (depending on the type of entity it is)
- in the case of incorporated joint ventures, each director of the company taking steps to limit their liability (as discussed for company directors above)

Associations

Associations can chose between one of four structures:

- unincorporated association (whether or not for profit)

- Partnership (unincorporated association for profit)
- Company limited by guarantee (whether or not for profit)
- Incorporated Association (not for profit) (governed by the Associations Incorporation legislation – in Qld the *Associations Incorporation Act 1981*)

An association (or partnership) with more than 20 members, if for profit, must pursuant to s115 of the *Corporations Act* incorporate as a company (unless exempted by regulation).

Associations are usually used for social, sporting and recreational clubs, community, religious, educational or political groups, artistic, musical or literary societies, environmental or heritage organisations, charitable organisations, trade, professional, industry and alumni associations etc. However, associations can also be used for trade or commerce, credit unions, friendly societies and co-operatives etc set up for profit-making.

The focus of this paper will be the liability of unincorporated associations since they can be formed for profit (whereas incorporated associations must be not-for-profit).

The liability of unincorporated associations is complicated since this structure is not an independent legal entity. This means that the members of the association can be sued personally, however their liability is limited to the amount of the subscription required by the rules of association (unless there is an express provision to the contrary). If however the property of the association is held by trustees for the association, the trustees may be sued with the right of indemnity from the property of the trust (i.e. the association property).

Committee members of an unincorporated association will usually be personally liable in contract to third parties, however the committee members usually also have an equitable lien against the common fund (but not against the members of the association personally).

Liability can be limited by:

- Structuring the unincorporated association rules carefully to ensure liability of members is limited and to ensure committee members have a lien or indemnity from the assets of the association including the common fund
- obtaining insurances sufficient to cover the members, committee members and any trustees for the types of claims that might arise
- the committee members and any trustees undertaking other asset protection structuring e.g. by having a non-at risk spouse, or other entity hold all substantial assets

2. Quarantining Risk using Layered Structures

Layered structures to quarantine business assets from business risk

When structuring businesses with a view to limiting liability it is important to consider quarantining the business assets from the business risk, which might involve setting up not one but two (or more entities).

The two main ways of doing this is by establishing:

- 1) two or more separate entities e.g. one to own the assets of the business and one to be the trading entity, so that if the trading business is attacked the assets are safe from such attack; or one to own the Intellectual Property of the business (such as it's branding etc) and one to be the trading entity, so that if the operating entity is attacked, the business name, and its public face can continue free from the attack. (another advantage of this option is that the leasing fee for the use of the assets or

a licence fee payable to the entity owning the IP could allow additional scope for taxation planning).

- 2) a service trust to enter into all employment contracts, leases, equipment finance etc so that the operating business is quarantined from those “liabilities” (another advantage of this option is that a degree of “income splitting” can be achieved where the service trust charges the operating business for the costs incurred in providing its services pursuant to a service agreement). Note that strict taxation requirements now exist regarding the commercial reasonableness and legitimacy of the fees so charged and the formalities regarding the service entity and the service agreement. The ATO has provided a Service Arrangements Users Guide “Your Service Entity Arrangements” to assist businesses using service entities to ensure they comply with these requirements, this guide is based on Taxation rulings IT 276 and TR 2006/2.

In both instances the arrangements need to be formally documented between the entities and rigidly followed e.g. invoices for leasing or licensing or service trust fees must be regularly issued and paid.

Obviously the more structures are involved, the greater the complexity and the greater the initial and ongoing costs.

3. Initial Structure and Consequences of Re-Structuring

3.1 Choice of initial structure

Which structure or structures to use will depend on each client’s very specific circumstances.

Practitioners must be careful to balance the key drivers for clients setting up businesses (i.e. keeping establishment costs low, while implementing the most tax effective structure) with longer term objectives such as ensuring the structure will accommodate the growth of the business and provide the business controllers with some protection from liability.

Often risk protection strategies do not allow for optimum tax structuring, so clients will often need to decide what is more important to them. Some clients are willing to sacrifice risk protection for tax advantage others want protection above all else. It is for this reason that it is recommended that business structuring advice be provided in a collaborative way involving accountants and other financial advisers so that the client’s priorities are understood and key structuring factors are not overlooked.

1.3 Business Re-structuring

Clients often want to minimise cost and start business with a small or simple structure and then amend that structure later when the business has grown.

Practitioners need to advise clients of potential stamp duty and capital gains tax costs that can arise on business re-structures, and encourage clients to consider the likely future needs of the business and establish a structure capable of accommodating that growth which could be more cost-effective in the long term.

It may be the case that clients will come to us with existing business structures in place often because they commenced a business with a simple structure which is now not coping with the growth of the business.

This paper will not cover the various strategies for business re-structures. I refer you to a recent paper written by Matthew Burgess and Patrick Ellwood of McCullough Robertson presented at the Legalwise “Asset protection for Baby Boomers and Others” Seminar on 24 March 2009 entitled “How Can Business Owners Protect Themselves?” for further discussion on business re-structuring.

4. Beware the “sleeping dogs”

Internal Arrangements

When clients come to you to seek advice about structuring their exciting new business, one of the last things they will want to focus on or spend money on, is documenting the internal arrangements for the business.

The types of documents that new businesses should consider preparing at the outset are:

- Shareholders, Unitholders, Partnership or Joint Venture Agreements to document how the business will be managed (i.e. how decisions are to be made, how the business is to be funded, and what is to happen if a business owner dies, becomes incapacitated or decides to voluntarily exit the business). Company Constitutions or Trust Deeds are not sufficient to deal with these matters, or contain clauses in direct contradiction to the clients' wishes in these matters.
- Buy-Sell Option Deeds (Insurance funded or otherwise) to cover involuntary exits of a business owner.
- Executive Agreements setting out the terms of which business owners are to be employed in the business.

The benefit of having these types of agreements in place from a risk protection point of view is:

- i) clarity on the rights as between business owners inter-se concerning requirements to contribute to the liabilities of the business
- ii) clarity on the rights of the stakeholders on winding up
- iii) having a fence at the top of the cliff (by way of insurance funded buy-sell agreements etc) can avoid the need for the ambulance at the bottom of the cliff i.e. business failure can result not merely from external attack but can arise simply as a result of a key business owner dying or becoming incapacitated
- iv) clarity on the roles played by each business owner and stakeholder i.e. if there is a dispute about whether or not someone was a mere employee or a quasi-director etc.

Loan Accounts, unpaid present entitlements & Inter-entity loans

The other sleeping dog for many businesses from a liability perspective is inter-entity loans and internal loan accounts (in trusts and sometimes in companies) or unpaid present entitlements (of beneficiaries in trusts). This issue is not something that arises when setting up a business but often comes into being as the business is being run, so it is an issue often overlooked by solicitors when advising their clients at the structuring stage.

The problem with loan accounts and unpaid present entitlements is that they can undo much of the risk protection implemented by lawyers for their clients and can expose the entity (and indirectly passive investors / stakeholders) to liability if the loans are called upon by an administrator or receiver etc. e.g. if a director of a company takes steps to ensure that there are no assets in his or her personal name but has loan accounts in their name in associated trust entities (which might be the “passive shareholder” in the company) or in the company directly, those loan accounts can be called upon by a trustee in bankruptcy if the director declares bankruptcy. This would obviously be a significant burden upon the entity owing the money to the bankrupt director and could allow the trustee in bankruptcy access to assets of the company or trust structure to the extent of the loan or entitlement.

Inter-entity loans can cause similar problems for example if a layered structure is selected to quarantine the business assets from the business risk but the business operating entity lends

the asset holding entity funds to purchase additional assets, then if the business operating entity is attacked and eventually wound up, the liquidator can call up the loan made to the asset holding entity. The asset holding entity will then have to either borrow money to repay the loan or sell the assets it was protecting from the trading risk to pay out the loan.

It is accordingly important to advise both clients and their accountants about this potentially sleeping dog and to deal with those loan accounts on a regular (preferably annual) basis (e.g. by deed of forgiveness or by adjustments against funds paid out – noting that deeds of forgiveness can be scrutinised by trustees in bankruptcy and be voidable if they fall within sections 120 (Undervalued Transactions) or 121 (Transfers to defeat Creditors) of the Bankruptcy Act and can also have tax consequences for loan accounts in companies.

It is also important for business owners or controllers who lend money to their business either at the initial stage or when the business starts to experience financial difficulty to consider obtaining security for these loans (even if only second in priority to other external finance security), so that if the business entity ultimately fails but the business controllers are not personally liable (e.g. for insolvent trading) then the business owners or controllers can recoup the funds lent as secured creditors in priority to other creditors.

Undoing the protection by giving securities and guarantees

Business lenders will usually seek security for any loans made to businesses (so that they have enforceable rights over the property secured and priority over other unsecured creditors for repayment).

Security is commonly taken as a:

- registered charge (usually fixed and floating) over company assets
- registered mortgage over real property
- registered bill of sale over chattels
- bank guarantee

However often banks and other financial institutions will usually require personal guarantees to be given by partners, directors of a company (or corporate trustee) or by trustees of a trust and in some cases by unitholders in unit trusts. These are usually part of the “standard conditions” of finance approval and as such are often overlooked by business controllers as something innocuous, however the giving of this additional form of security can undo much of the risk reduction strategies undertaken at the initial business structuring and risk minimisation structuring stage.

Practitioners therefore need to warn business controllers of this future potential risk when undertaking initial business structuring.

5. Discretionary Trusts and Richstar

One of the main ways in which to limit liability is to undertake asset structuring strategies to ensure that the “at-risk” person (i.e. sole trader, partner, director, trustee etc) does not own assets in their own name.

One of the simplest solutions often used is to transfer assets to or purchase assets in the name of a non-at-risk spouse.

This strategy has come under attack (at least in relation to the matrimonial home) in Cummins case [*The Trustees of the Bankrupt Estate of John Daniel Cummins v Cummins* [2006] HCA 6] where the court held that unless there is clear evidence to the contrary, it should be inferred that each spouse has a one-half interest in the matrimonial property (regardless of who paid for the property or in whose name it is held).

In the Cummins case the matrimonial property was purchased as vacant land in 1970 as joint tenants. The mortgage was in joint names. In 1987 the husband transferred his half share to his wife. Mr Cummins had not filed tax returns and had not paid tax for the whole time he was working as a barrister in Sydney. In 2000 Mr Cummins went bankrupt. The trustee in bankruptcy brought proceedings to require the wife to transfer back her husband's half share pursuant to s 121 of the Bankruptcy Act (i.e. as a transfer intended to defeat creditors). The court was of the view that (because there was no evidence to the contrary) Mr Cummins' main purpose in making the transfer in 1987 was for the purpose to prevent the matrimonial property from becoming available to meet his liabilities to the ATO.

The wife argued that since she had contributed 76.3 percent to the purchase price of the property she should only have to transfer back 23.7 percent. In the Cummins case consideration was specified in the transfer document dated 1987 (being 50% of the valuation of the property at the time i.e. not 23.7%). While there was evidence to show that Mrs. Cummins had paid the stamp duty and the valuation fee it was clear that Mrs Cummins had not paid any consideration to Mr. Cummins. This meant that Mrs Cummins could not claim the "protection" of s121(4) which then stated that the transfer was not void if market value consideration had been paid by a transferee who did not know that the transferor's main purpose was to defeat creditors or that the transferee could not reasonably have inferred that, at the time of the transfer, the transferor was, or was about to become, insolvent.

The court noted that there was no evidence provided on behalf of Mrs Cummins subsequent to her contribution to the purchase price of the vacant land, to show that the ownership on the register as joint tenants was at odds with, and subjected to, the beneficial ownership established by trust law (i.e. that she held a greater interest in the property because of her greater contribution to the purchase price).

The high court held that "where husband and wife purchase a matrimonial property, each contributing to the purchase price, and the title is taken in the name of one of them, it may be inferred that it was intended that each of the spouses should have a one-half interest in the property regardless of the amounts contributed by them". The court ordered the wife to transfer 50% of the net proceeds of sale to the trustee in bankruptcy.

In the context of asset protection structuring where there is no imminent or likely threat of bankruptcy there are, however, in the writer's view strategies that can be implemented to limit the effect of Cummins case and the subsequent amendments to the Bankruptcy Act, where "at-risk" spouses wish to transfer their interest in property to their non-at-risk spouse.

Assets held by Discretionary Trusts

Another solution often implemented is to hold property and assets in more independent structures such as superannuation funds or discretionary family trusts.

However the Federal Court in the *Richstar* case [*Australian Securities and Investments Commission, Re Richstar Enterprises Pty Ltd v Carey (No 6) (2006) FCA 814*] recently set another precedent when it allowed ASIC to place a "freeze order" over the property of a discretionary trust where the relevant individuals were beneficiaries who effectively controlled the trustee's power of selection because they were the trustee or one of them and/or because they had the power to appoint a new trustee (i.e. the trustee was effectively the alter ego of the relevant beneficiary) because in the court's view those individuals had something approaching a general power and the effective ownership of the trust property.

This was the first time (outside the family law context) that a beneficiary's interest in a discretionary trust has been equated to a form of property. In fact the decision has been criticised for its application of family law cases (where the courts are considering what assets should be taken into account in making an order for the adjustment of property in a family law dispute) in a commercial insolvency context.

In *Richstar* (one of many cases in the Westpoint litigation) ASIC was seeking to extend the definition of "property" to which the receivers had been appointed. In prior orders the four directors of Richstar Enterprises and their associated entities were ordered to make

disclosure of their assets and liabilities. Presumably as a result of the disclosures so made, ASIC then sought to amend the receiver orders in relation to three of the four directors and all of the related entities to bring into the scope of receiver orders property held by a third party as trustee for any trust in which the relevant individuals were beneficiaries. Consent orders (in the terms sought by ASIC) had already been agreed to by the fourth director prior to the hearing of the case.

It is important to bear in mind that the receiver orders sought by ASIC were “freeze orders” over certain property to allow further investigations concerning that property to take place without that property being dissipated i.e. the orders made by the court in *Richstar* were not orders to vest any interest in that property in the receivers.

The power to appoint a receiver for such “freeze orders” is contained in s1323(1)(h) of the Corporations Act 2001, which provides that:

The Court, may upon application by ASIC or by the aggrieved person, make one or more of the following orders....

- (h) an order appointing:
 - (i) if the relevant person is a natural person – a receiver or trustee, having such powers as the Court orders, of the property or part of the property of that person...

“Property” is defined in s 9 of the Corporations Act 2001 as:

any legal, equitable estate or interest (whether present or future and whether vested or contingent) in real or personal property of any description and includes a thing in action.

The question for the court then was whether the property of the trusts (of which the individuals were beneficiaries) could be classed as “property” of the individuals; or if the beneficiaries had an interest in the assets of those trusts sufficient to constitute “property” so that those interests could be the subject of appointment of receivers.

French J acknowledged that in the “ordinary case” the beneficiary of a discretionary trust does not have an equitable interest in the trust income or property which would fall within the definition of s9 because a beneficiary (at arm’s length from the trustee) does not have a contingent interest but rather a mere expectancy or mere possibility of distribution.

However, French J distinguished from the “ordinary case” the case where the beneficiary effectively controls the trustee’s power of selection (or discretionary power).

Ford & Lee – Principles of the Law of Trusts at paragraph [5210] analyses the decision as follows:

French J in 58 ACSR 141 at [36] considered that “where a discretionary trust is controlled by a trustee who is in truth the alter ego of a beneficiary, then at the very least a contingent interest may be identified”. His Honour said that in those circumstances the beneficiary has something more than a mere expectancy because “it is as good as certain” that the beneficiary will receive the benefits of distributions either of income or capital or both. He adopted the phrase “it is as good as certain” from what was said by Nourse J at first instance in *Inland Revenue Commissioners v Trustees of Sir John Airds Settlement* [1982] 2 All ER 929 at 940 reversed on appeal *Inland Revenue Commissioners v Trustees of Sir John Airds Settlement* [1984] Ch 382 without affecting the relevant statement of Nourse J. Nourse J said:

A contingency is an event that may or may not happen. If there is no real possibility that it will not happen, so that it is as good as certain that it will, it is a contingency without reality and substance and no contingency at all.

French J also referred to decisions in the family law jurisdiction which have accepted that for the purposes of s 79 of the Family Law Act 1975 (Cth) a person with wide powers of control over property in a family trust can be regarded as having ownership

of the trust property. At 58 ACSR 141 at [41] French J concluded that the beneficiary, through his trustee company, appeared to have effective control of the assets of the trust and that at the very least he had a contingent interest. He went on to say that the beneficiary's interest would appear to amount to "effective ownership of the trust property".

French J in his judgement highlighted the factors contained in a few of the discretionary trusts in question which in his view indicated that the relevant individuals had what amounted to effective ownership of the trust property in those trusts. Those factors were as follows:

First trust:

- 1) the individual was the director and secretary of the corporate trustee;
- 2) the individual was the original appointor (although the appointor had changed to the individual's wife); and
- 3) the trustee had wide discretion including the power to prefer one or other beneficiary to the total exclusion of any other beneficiary.

French J was of the view that in this case the individual had a contingent interest which amounted to effective ownership of the trust property.

Second trust:

- 1) the individual was the trustee
- 2) the individual, his family members, other entities and charities were beneficiaries of an open class of beneficiaries
- 3) no more than 39% of the income and capital could be distributed without a unanimous resolution from the appointor
- 4) the appointor was the individual's wife

French J was of the view that the individual in this case had a contingent interest in the whole of the trust property and effective ownership of at least 39% of the trust property.

Third trust:

- 1) the individual was the appointor of the trust
- 2) the individual was a member of an open class of beneficiaries
- 3) the trustee had every power as if it were the absolute owner of the trust fund.

French J was of the view that the individual in this case had a contingent interest in the trust property and possibly a general power which approaches ownership.

It is interesting to note that there was no analysis by French J about whether or not any of the beneficiaries were also default beneficiaries of the trust.

None of the above examples detailed fully the identity of the trustees, directors or shareholders of corporate trustees and appointors, or considered in any detail the terms of the trust deeds or how the trusts had been operated in the past (i.e. did the fact that the individual have the potential for effective control of the trustee mean that the individual always received 100% of the distributions from the trust historically. Namely, could it really be said that it was "as good as certain" that the individual with effective control of the trust would necessarily receive distributions from the trust).

French J did however make orders under s 23 of the Federal Court Act authorising the receivers to require the defendants to provide information relating to the trust documents and the management of the trusts, including their distribution history so that a decision could be made whether to extend the receiver orders to the property of that trust.

Has Richstar been followed?

To date the decision in *Richstar* has only been cited and considered (mainly for the less controversial parts of the judgement or in the context of family law cases) but the case has not yet been followed or applied.

Public Trustee v Smith

The most instructive judicial comment of the *Richstar* case was given by White J in *Public Trustee v Smith* [2008] NSWSC 397.

Public Trustee v Smith was a case concerning the gift of a property by will, where the property was not owned by the willmaker but by a discretionary trust of which the willmaker was the beneficial owner of all of the shares in and director of the corporate trustee of the trust but not a named beneficiary of the trust. The court concluded that the willmaker was not the beneficial owner of the trust assets. In coming to that conclusion White J referred to the *Richstar* case and made the following comments:

“French J did not say that it followed from the defendants’ positions as beneficiaries of discretionary trusts and their control of the trustees that this amounted to actual ownership as distinct from “effective ownership”. As with the reference to “de facto ownership” I take the phrase “effective ownership” to mean that the defendants had such control of the affairs of the trust that they were in as good a position as if they were the beneficial owners, but not to mean that they were the beneficial owners of the trust property. In my view, there is very sound reason for construing the expression in s 1323(1)(h)(i) “an order appointing a receiver or trustee of the property of [the relevant person]” as extending not only to property actually owned by the relevant person but property effectively owned by him or her, for the same reasons as discussed in the family law cases concerning s 79 of the Family Law Act. However, I do not understand ASIC v Carey (No 6) to establish that because a beneficiary of a discretionary trust controls the appointment or removal of the trustee, or controls the exercise of the trustee’s powers and can appoint trust property to himself or herself, that the holder of such a power is the beneficial owner of the trust property irrespective of the terms of the trust deed. In the construction of statutory powers such trust property might be regarded as the property “of” such a person (depending of course upon the statute in question) if something short of ownership provides the necessary connection between the person and the property denoted by the word “of.” (my emphasis)

Farr v Hardy

The above reasoning in *Public Trustee v Smith* was applied in the decision of *Farr v Hardy* [2008] NSWSC 996 (albeit by the same judge – White J) In that case White J decided a claim for family provision and for the same reasoning set out in *Public Trustee v Smith* White J refused to include assets of the “Farr Better trust” in the estate of Mr. Farr who exercised control over that trust during his lifetime.

Interestingly counsel for the applicant in that case relied on the *Richstar* case for the proposition that the trust assets should be included in the estate assets (which proposition was rejected by the judge) but did not seek to have those assets designated as part of the “notional estate” under the NSW succession legislation.

Rafferty v Time 2000 West Pty Ltd (no 2)

The *Richstar* case was cited by Besanko J of the SA Federal Court in *Rafferty v Time 2000 West Pty Ltd (no 2)* [2008] FCA 1931 which was an application for Mareva orders (or freezing orders) over several third party entities including a discretionary trust effectively controlled by Mr Donovan. Mr Donovan was one of the respondents in a claim made against him (and several other companies controlled by Mr Donovan) for repayment of \$1.7million paid by the applicants under a complex series of Joint Venture and Shareholders agreements. The applicants sought freeze orders over the proceeds of sale of several properties owned (or ultimately owned as sole unitholder of another unit trust) by the Stephen Donovan Family

Trust. Mr. Donovan was the sole director and shareholder of the corporate trustee of that trust, he was one of several beneficiaries and was the sole appointor.

Within a few days of the applicant making the application for the freeze orders Mr. Donovan appointed his fiancée as director of the corporate trustee and appointed her as the sole appointor of the trust. The fiancée swore an affidavit to say that she would act independently of Mr Donovan and that she had obtained independent legal advice about her obligations.

Besanko J made the freezing order against Mr. Donovan's trusts. Little weight was given to the last minute transactions undertaken by Mr. Donovan in the shadow of the application.

Besanko J agreed that Mr. Donovan as a member of a class of possible objects of appointment had no proprietary interest in the trust assets however he determined that it was enough (under the principals for making the Mareva order) that Mr. Donovan might receive an interest under the trust which then might ultimately be recovered by a trustee in bankruptcy from Mr. Donovan (if the applicants succeeded against Mr. Donovan and he was unable to satisfy a judgement).

Besanko J then went on to "identify" (apparently without submissions by counsel) two other possible bases for making the freezing orders. To justify one of these grounds Besanko J pointed to the *Richstar* case which he said allowed the court "to look behind the trust structure and determine that, in reality, the property of the trust is effectively Mr Donovan's property because he effectively controls the power of selection".

It is again important to note that both the *Richstar* case and this case were "freeze order" cases and did not contain orders to allow creditors access to the assets of the relevant "third party" trusts.

ASIC v Groves and Others; Re ABC Learning Centres Ltd

The *Richstar* case was most recently cited in *ASIC v Groves and Others; Re ABC Learning Centres Ltd (admins apptd) (recs and mgrs apptd) [2009] FCA 915*. On 24 June 2009 ASIC commenced proceedings under s1323 Corporations Act 2001 against Mr. Groves, his then wife and his brother-in-law to carry out investigations into suspected contraventions of the Act (relating to transfers of real estate properties held by "Mr. Grove's" family trust to Mr. Grove's brother-in-law and wife).

Ultimately the decision related only to the question of costs between the parties and there was no determination on the legal question of whether or not the property of "Perfection Too" as trustee of "Mr. Groves" discretionary family trust constituted property "of" Mr Groves for the purposes of s 1323 Corporations Act 2001. This was put in issue because ASIC had indicated it intended to rely on the reasoning in *Richstar* to contend that Perfection Too and the trust were the "alter ego" of Mr. Groves. However, Lindgren J did outline the structure of the trust, how it was changed by Mr. Groves during the course of adjourned hearings and the effect of that change on the trust.

When proceedings were commenced by ASIC, the trust was structured with a corporate trustee "Perfection Too". The sole shareholder of the company was Mr. Groves and the sole director of the company was Ms Collins-Rubie (Mr. Grove's then wife). The potential beneficiaries of the trust were Mr. Groves, Ms. Collins-Rubie and Mr. Grove's two daughters. Mr. Groves was also the sole appointor of the trust.

Between adjourned hearing dates (on 16 July 2009) Ms. Collins-Rubie resigned as director of Perfection Too and Mr. Groves appointed two directors (being two accountants from Vincents Chartered Accountants) independent of himself and his wife. Lindgren J noted that "this meant that whatever the position may have been previously, at least from 16 July 2009 it could no longer be said that Perfection Too was the "alter ego" of Mr. Groves". Lindgren J did however require amendment of undertakings given by Mr. Groves to ensure he would not appoint or remove directors of "Perfection Too" or remove that company as trustee of the trust.

Trusts post Richstar

In the writer's view the *Richstar* case does not necessarily mean that trust property will now be available to creditors on the bankruptcy of a beneficiary because s 116 of the Bankruptcy Act requires that the property be vested in the bankrupt at the commencement of the bankruptcy before it can be divisible amongst the creditors of the bankrupt.

Despite the views expressed by White J in *Public Trustee v Smith*, care should now be taken when structuring discretionary trusts to ensure the following issues are considered:

- 1) should an "at-risk" person be the trustee, director or shareholder of a corporate trustee or the appointor of the trust or should a third party be appointed in those roles?
- 2) should an "at-risk" person be excluded as a beneficiary (or default beneficiary)?
- 3) Should the terms of the trust deed restrict distributions of income and/or capital to an "at-risk" person if they are the sole trustee, sole director or shareholder of a corporate trustee or the sole appointor? Or should the trustee's decision to make a distribution to an "at-risk" person require the consent of another third party?
- 4) the combination of these appointments should also be considered for example:
 - if the "at-risk" person is to be the director of a corporate trustee, should third parties be the shareholders of the corporate trustee, and should the "at-risk" person be excluded as a beneficiary or a default beneficiary?
 - If the "at-risk" person is to be an appointor of the trust, should that person be excluded as a beneficiary or a default beneficiary, or should a joint appointor be included with a requirement that decisions be made unanimously?

6. Conclusion

Business Structuring with a view to limiting liability is a complex area of law which requires consideration of the client's present requirements and likely future requirements.

The issue of liability should not be considered in isolation but should be balanced with other requirements such as ease of operation, taxation issues, funding issues and succession issues. Ultimately the client may be required to make a decision about which of those factors are more important.

It is an area in which practitioners should consider joint consultation with experts in other areas such as accountants, superannuation experts, succession practitioners, insolvency practitioners and family law practitioners.

The fact that steps taken by the business owners or controllers in the future could impact the effectiveness of the structure implemented, gives practitioners the opportunity to build lasting relationships with these clients as part of their ongoing advisory team.

7. Disclaimer

This paper covers general legal issues and is not designed to provide specific advice. This paper is intended for information purposes only and should not be regarded as legal advice. Further specific legal advice should be obtained before taking action on any issue dealt with in this paper.

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Other sources are referenced within the body of this paper.