TRUST LAW

# The law of trusts muddied

*By Anthony Grant, Trusts & Estates Litigator*

In *Vervoort v Forrest* [2016] 3 NZLR 807, the Court of Appeal said that trusts in New Zealand "... must bend to the practical realities when one trustee is in absolute control of all trust activities and the other trustees have effectively abdicated their trustee responsibilities" (para [62]).

In *Blumenthal v Stewart & Others* [2017] NZCA 181, a differently constituted panel of judges of the Court of Appeal expressly confirmed the validity of that proposition (para [56]).

In accordance with these rulings such trusts are to be treated as valid. What are these judges actually saying about our law?

I believe they are saying that many conventional family trusts in New Zealand are structured so that in substance one person can exercise complete control over them. The form of the trust is different. In its form, the trust will typically have two or three trustees and, in accordance with long-established principles of trust law, no decisions of the trustees will be effective unless their decisions are unanimous.

The Court of Appeal is saying that it is commonplace in this country for one trustee to operate a trust autocratically and independently of the other trustees and the courts should recognise that reality.

Now, in general, I believe that most lawyers would agree that the courts should prefer substance over form. We all know that a transaction can be structured in Form A, while its true structure is Form B. Form A is simply a disguise and our courts should never be fooled by a disguise.

But should the courts treat as valid, a trust which is under the "absolute control" of one of a number of trustees?

Going back to first principles, for a trust to be valid, a settlor must give both the legal and beneficial interests in an asset to a trustee. This is one of the three certainties required of a valid trust.

I suspect that most lawyers have formed at least one family trust to hold "their" domestic assets. Typically, the family home and perhaps a holiday home will have been settled on it. The lawyer and his/her spouse may be the trustees, often with a lawyer or accountant who is commonly described as an "independent" trustee.

As the trust does not generate taxable income, there will be no annual financial statements and the trustees may seldom, if ever, meet to discuss the workings of the trust.

The spouse who settled the trust will typically have structured the trust so that with appropriate powers of appointment and removal of both beneficiaries and trustees, he/she can take the asset back if he or she wants to do so.

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The trust may have been structured so that the asset cannot be got back except with the co-operation of the "independent" trustee, but that person will in many cases be a cypher who can be expected to do whatever he or she is asked.

The Court of Appeal appears to be saying that such trusts are valid. Are they?

If a trust is under the "absolute control" of a person there may be a good case for saying that it is invalid on the grounds that there was never an intention to cede control of the beneficial interest in the assets that were settled on the trust. In jurisprudential terms, one of the three certainties required of a valid trust was missing.

Alternatively, the trust may be a sham.

If such trusts are to be treated as valid – as the Court of Appeal appears to say that we should – what is the future of these important mechanisms for invalidating trusts?

They would appear to be lost, yet they are mechanisms of critical importance in the courts' toolkit of devices to ensure the proper operation of the law of trusts.

One of the difficulties that the courts have encountered in this area of the law is a theory that, in determining whether a trust is a sham, they are confined to a consideration of the evidence that exists at the time of a trust's formation. More particularly, they are confined to a consideration of the trustees' subjective intentions on the day when the trust was formed. This is an exercise in futility since the trustees will inevitably declare that they intended the trust to be genuine and medical science has not given judges a device that will enable them to learn a trustee's true intentions.

The courts should not be confined in this way and they should be able to consider evidence of subsequent conduct and circumstantial evidence – as they do in other areas of the law.

And what about the law of sham? If a trust which is nominally under the control of three trustees is in truth under the "absolute control" of one of them, being a person who always surreptitiously intended to retain the beneficial interest in the trust's assets, and the power to take them, might it not be a sham? And, if it is a sham, do the decisions in *Vervoort* and *Blumenthal* – which approve one trustee having absolute control over trust assets – prevent a court from making such a finding?

This area of the law is ripe for a reappraisal and I commend readers to the following three articles from the 2016 volume of the journal *Trusts & Trustees*, in which good reasons are given for saying that the courts' current approach to the law of sham is both timid and wrong: "Sham", by the Hon Donald G H Bowman QC (pages 490-496); "Sham and Remedial Doctrines", by Alexander Boni-Saenz & Reid Weisbord (pages 850-858); and "Sham Revisited: has Snook passed its sell-by date?" by Toby Graham (pages 859-863).

**CORRECTION**

My last article ("Assessing testamentary capacity – an important new development" (*LawNews* Issue 15, 19 May 2017) was written in haste and at a time of some distraction as I was about to fly out for a two week cruise on the eastern Mediterranean. I said that the will that was under consideration in *Farn v Loosley* was that of Mrs Farn (who died during the course of the litigation and whose will has featured in communications between the parties). This was an error. The will that was under consideration in *Farn v Loosley* was that of Mrs Farn's daughter, Allison Slater. The late Mrs Farn's solicitor has asked that I should inform readers of this error and I willingly do so.