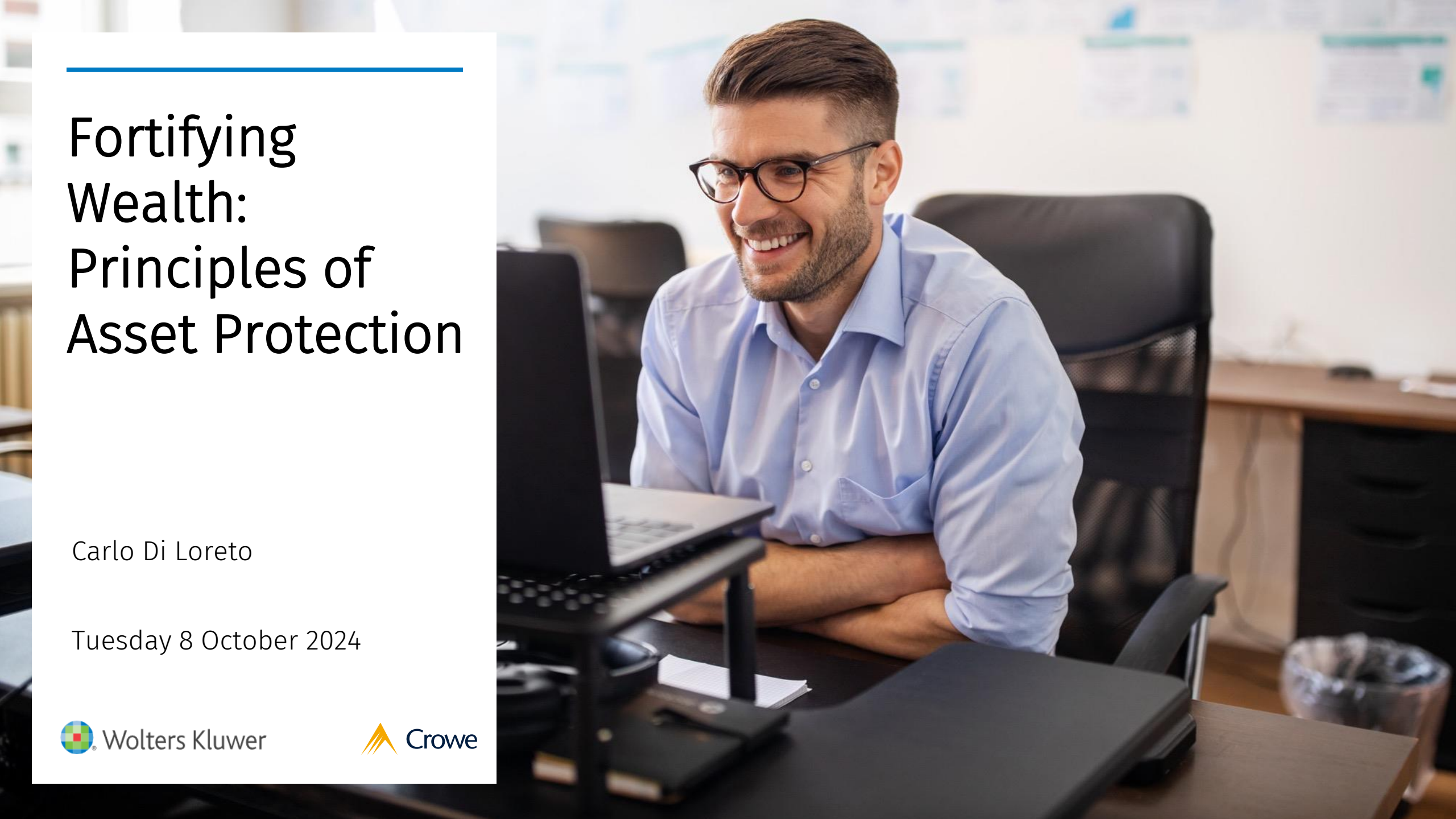
Fortifying Wealth: Principles of Asset Protection

Carlo Di Loreto

Tuesday 8 October 2024



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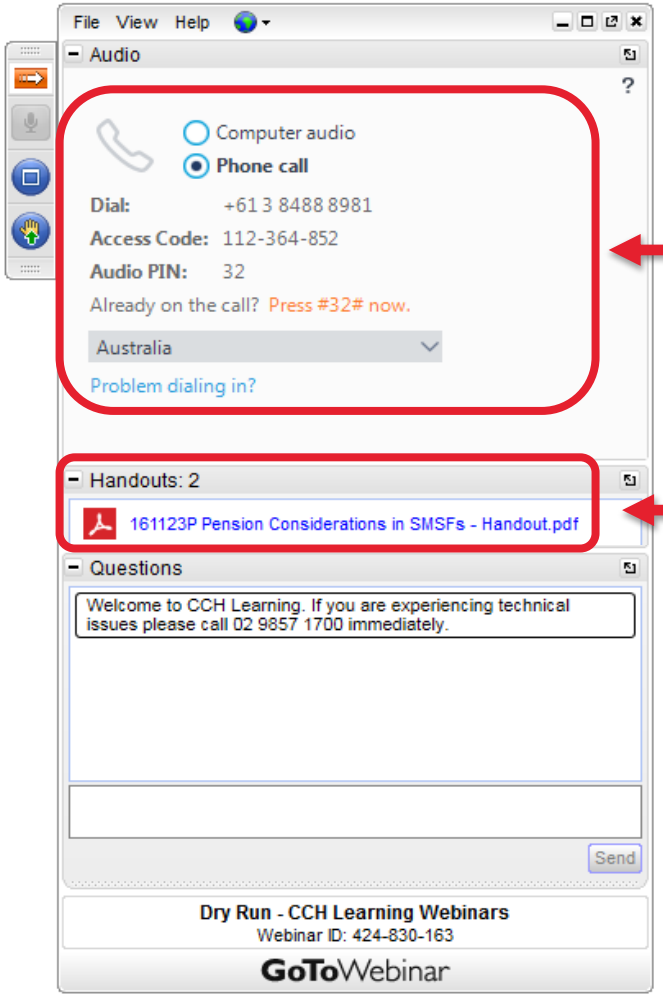

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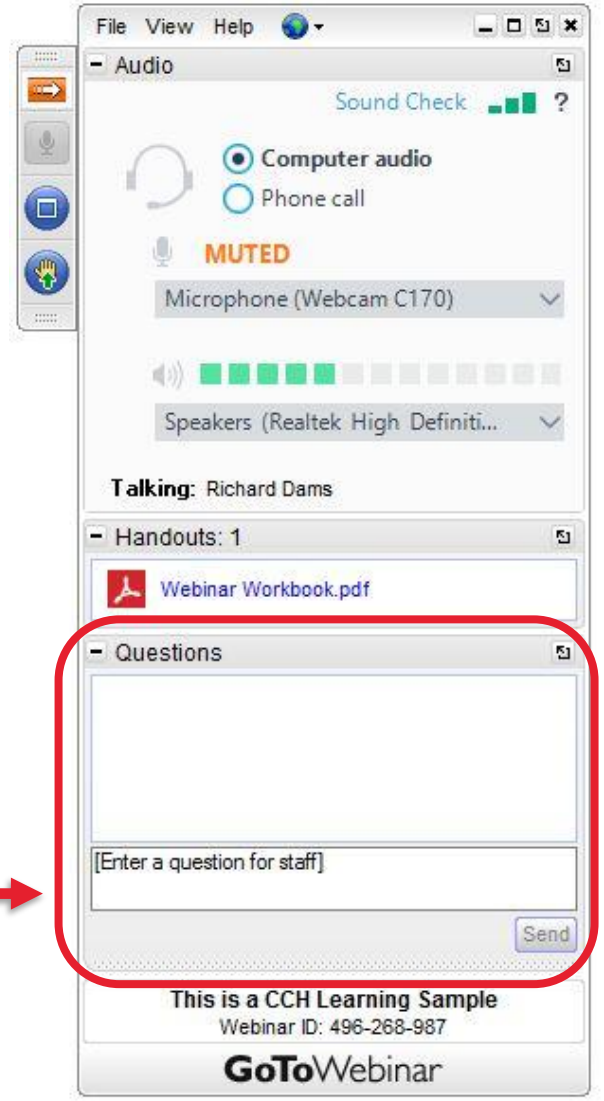

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Your Presenter

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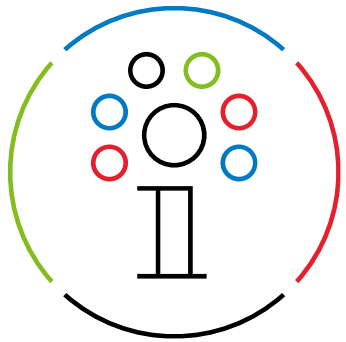
Today's session will cover



First Principles of Asset Protection

- bankruptcy rules
- appointor provisions in trusts
- debit & credit loan accounts
- retention of title
- assets which do not form part of a person's estate on death
- wills
- expression of wishes
- enduring power of attorney
- medical power of attorney

First Principles of Asset Protection

First principles in asset protection

- Three main objectives:
  1. Estate Growth (Wealth Creation)
  2. Estate Protection (Protecting Assets)
  3. Estate Transmission (Wealth Transfer)

Ten general rules of asset protection

1. Ensure family assets controlled by person not financially exposed (spouse)
2. Observe clawback / avoidance aspects of Bankruptcy Act 1966
3. Generate income in business entities quarantined from financial risk
4. Ensure secure funding extended to the risk exposed person or entity
5. Review wills, trusts, shareholdings & estate planning strategy
6. Use ‘layers’ of protection
7. Take adequate insurance cover
8. Own little or no assets
9. Always think two deaths ahead
10. Ensure risk mitigated by seeking & implementing expert advice

Bankruptcy Provisions

Bankruptcy Provisions

- 'Claw back' provisions of *Bankruptcy Act 1966* allow for recovery of property by trustee under certain circumstances
- Scope is wide & includes a range of transactions that can be 'reversed' for trustee to recover property
- Main focus to bring into property divisible amongst creditors, property transferred by bankrupt to defeat creditors

Bankruptcy Provisions - Commencement

- Bankruptcy begins when earliest act of bankruptcy occurred in the six months preceding presentation of debtors or creditors bankruptcy petition [s 115]
- Known as doctrine of relation back - property of bankrupt vests in trustee from a period preceding the actual date of bankruptcy
- All property that belonged to bankrupt at or after commencement is divisible property of bankrupt estate [s 116]

Bankruptcy Provisions – Claw backs

- s 120 – undervalued transactions
- s 121 – transfers to defeat creditors
- s 121A – transactions where consideration given to 3rd party
- s 122 – avoidance of preferences
- s 128B – superannuation contributions made by bankrupt to defeat creditors
- s 128C – superannuation contributions made by 3rd party to defeat creditors

s 120 Bankruptcy Act - Summary

Status of transferor on transfer	Time period for claw back
Insolvent	5 years from commencement of bankruptcy
Solvent - transfer to related party	4 years from commencement of bankruptcy
Solvent - transfer to unrelated party	2 years from commencement of bankruptcy

s 121 Bankruptcy Act

Transfers to defeat creditors:

- s 121 operates independently of s 120 - it has no time limits & applies to property transferred at any time
- If transferor's main purpose to avoid property becoming available to creditors or hinder/delay property being available, then trustee in bankruptcy can require property be transferred
- Onus of proof of transferor's main purpose rests with trustee in bankruptcy

Transfer to defeat creditors

- A transfer of property will not be void if:
  - transferee gives at least MV consideration; and
  - did not know or could not reasonably have inferred that transferor's main purpose in making the transfer was to avoid creditors; and
  - transferee could not reasonably have inferred at the time of the transfer that transferor was, or was about to become insolvent

s 122 Bankruptcy Act

Avoidance of Preferences:

- A transfer of property will be void against the trustee in bankruptcy if:
  - it is made by a person who is insolvent in favour of a creditor
  - it has the effect of giving the creditor a preference over other creditors; and
  - it was made within 6 months before the presentation of the creditor's petition of bankruptcy
- Purpose is to prevent people making preferential payments to some creditors just before they become bankrupt

s 128B Bankruptcy Act

Superannuation

- A transfer made by way of a contribution to a superannuation fund is void against the trustee if:
  - property would probably have become part of bankrupt's estate or would probably have been available to creditors if contribution had not been made; and
  - bankrupt's main purpose in making contribution was to prevent it from:
    - becoming divisible among their creditors or
    - to hinder or delay the process of making the property divisible

s 128B Bankruptcy Act

- Bankrupt is taken to have the requisite ‘main purpose’ if:
  - it can be reasonably inferred from all circumstances
  - at time of making contribution they were or were about to become insolvent
- In determining the ‘main purpose’ regard must be had to:
  - whether a pattern of making contribution had been established in the period before the contribution was made; and
  - if so, whether the contribution, when considered in light of the pattern, is ‘out of character

s 128C Bankruptcy Act

- A contribution made by a 3rd party (e.g. an employer) for benefit of a bankrupt can also be void against the trustee under s 128B
- Under s 128C, there is an additional requirement that 3rd party must make contribution under a ‘scheme’ to which bankrupt was party
- Concept of ‘scheme’ very wide & may include a salary sacrifice arrangement
- Main purpose of entering into scheme must be to prevent transferred property becoming divisible among their creditors

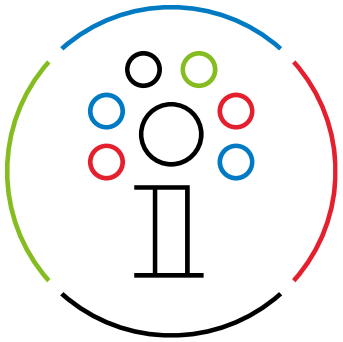
Division 4A Bankruptcy Act

- Separate ‘claw back’ provisions under Division 4A of Part VI of Bankruptcy Act, applies where:
  - interests in property are held by an entity that is not a natural person
  - the bankrupt provided personal services for less than MV consideration while controlling the entity
  - the bankrupt has also derived some (direct or indirect) benefit from the property
- Intended to prevent accumulation of wealth in lead up to bankruptcy in name of a 3rd party, while bankrupt continues to use & enjoy the assets

Poll Question #1

The doctrine of ‘relation back’ is an expression of the retrospective operation of bankruptcy law.

a) True
b) False



Asset Protection Structures

Asset protection structures

- Effectively, there are only three ‘safe havens’ to protect assets in event of bankruptcy:
  - position assets in a discretionary trust
  - insurance policies
  - superannuation

Trusts

- Importance of appointor provisions must be re-emphasised
- Issues relevant to asset protection & succession planning:
  - inter vivos trusts (trusts established during a person's life)
  - testamentary trusts (established under a person's will)

Role of appointor

- Persons named in the trust deed who have the power to remove an existing trustee, or nominate an additional or replacement trustee
- Appointors, in effect, control the trust property in their role of determining who the trustee is
- Where there is more than one appointor, the trust deed usually provides that the powers of the appointor are exercised jointly
- Worthwhile considering an additional independent appointor

Appointor

Bankruptcy Issues

- A trust deed may provide that upon an appointor being declared bankrupt they are automatically disqualified from continuing to act as an appointor:
  - in this case no longer have ability to control the trust
- If trust deed is silent regarding if appointor is declared bankrupt:
  - can trustee in bankruptcy exercise the power of appointment to appoint himself?

Appointor

Bankruptcy Issues

- Concern is - if power of appointment is asset of bankrupt - trustee in bankruptcy could appoint himself & distribute income & assets to the bankrupt's creditors
- Currently, the power of appointment has been held by the Courts not to be an asset of the bankrupt [Wily v Burton & Ors (1994) 126 ALR 557]

Note:

- There have previously been pronouncements by the Courts & by legislature to indicate in future the law may change to include it as an asset of the bankrupt.

Appointor

Bankruptcy Issues

- If trust deed disqualifies appointor if they are declared bankrupt, trustee in bankruptcy has no ability to treat as an asset of the bankrupt
  - downside bankrupt no longer controls the trust
- If trustee is a company & bankrupt holds shares, trustee in bankruptcy can use voting rights attaching to shares to appoint himself & his nominee as directors:
  - directors exercise their power to realise trust assets & distribute to the bankrupt beneficiary who would be required to provide them to trustee in bankruptcy

Appointor

Bankruptcy Issues

- An independent appointor overcomes these problems
- An independent appointor could act to appoint a new trustee to prevent trustee in bankruptcy seizing assets

Appointor

Family Law Issues

- An independent appointor is an advantage if the appointors are involved in a family court property dispute
- If two parties are appointors & involved in family court proceedings, family court can direct the appointors to act in a certain way
- Means Family Court then has access to trust assets that it would not otherwise have

Appointor

Family Law Issues

- Considering the case of Goodwin (1991) the use of an independent appointor should be considered
- In Goodwin, the Full Court of the Family Court held in considering the power that the husband had as the sole appointor of a trust:
  - “in particular the power of appointment in the present case is not a fiduciary power but a power which, by the terms of the deed, the husband may exercise for the purposes of controlling the trust for his own benefit if he so chooses”

Appointor

Family Law Issues

- The Court will consider trust deed & surrounding facts to determine degree of control exercised by a party to the marriage
- If a party controls trust completely either through deed or past conduct, then Court will ignore trust structure & include trust assets within asset pool of parties

Appointor

Family Law Issues

- A person who is not a party to the marriage cannot be subject to Family Court directions [Ascot Investments Pty Ltd v Harper (1981) 148 CLR 337]
- Amendments to s 90AE Family Law Act 1975 mean that independent parties may be subject to direction of FC, but only to extent direction relates to property of one or both of parties to the marriage
- Consider an independent appointor

Independent appointor – who to choose

- Someone whom the family has absolute faith & confidence to act in their best interests
- Should not be significantly older than existing appointors
- Child of existing appointors not recommended – can give a child an unfair advantage over other children
- Relative of either of the existing appointors i.e. Brother or sister
- Trusted friend
- Professional adviser i.e. accountant

Trust succession issues

- Trust property is not owned by any beneficiary therefore cannot be passed by a beneficiary's will
- Control of the trust can be passed on by the trust deed specifying, following the death of the original appointors, who will become the appointor
- Benefit of assets held in a trust is after death of original beneficiaries (protects assets for children from Family Court & Trustee in bankruptcy)

How to effect change to appointors

- Appointment of an independent appointor should be by a deed executed by the existing appointor
- Appointment of succeeding appointor can be made either by provision in existing appointor's Will or separate deed executed by him / her inter vivos
- Recommended appointment of succeeding appointor be included in deed (not Will) & it be included in same deed as deed appointing any additional independent appointor
- Need to only refer to one deed to determine existing and succeeding appointors

Example Provision

- H + W + X (independent) or H + X (independent)
- When survivor of H and W dies or becomes mentally incapable then the legal personal representative of the survivor becomes appointor
- When all children of H and W reach 18 or (21 or 25) then they become joint appointors
- When a child dies, that child's children can appoint one person to be a joint appointor in place of their deceased parent

Choice of Trustee

- Trustee can be a limited liability company or individual
- From an asset protection position individual should not be trustee (to save money often a temptation to appoint individual):
  - reason trustees are directly liable for the debts of the trust
  - trustee entitled to be indemnified out of trust assets

Boensch v Pascoe [2019] HCA 49

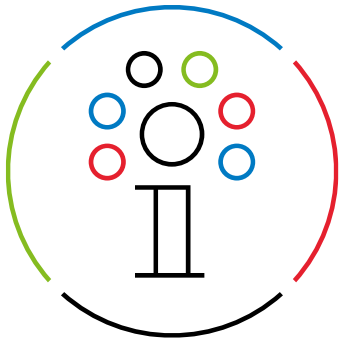
- Held that a right to be indemnified out of trust assets was a beneficial interest in a residential property held on trust for children a bankrupt trustee (individual) – bankruptcy trustee entitled to lodge and maintain a caveat over the property

Choice of Trustee

Reminder:

- s 197 Corporations Act 2001 amended in 2005 following the decision in Hanel v O'Neil (2003) SA SC 409
- s 197 now provides that a director of a corporate trustee will only be personally liable if the trustee is not entitled to be fully indemnified out of the trust assets because of:
  - deed denying trustee's right to be indemnified a breach of trust by the corporate trustee
  - corporate trustee acting outside scope of its powers
  - a term of the trust

Poll Question #2



Who should NOT be selected as an independent appointor of a trust?

a) Someone whom the family has confidence will act in their best interests
b) A relative of the existing appointors
c) A trusted friend
d) 87-year-old uncle of existing appointor, who has had long periods of ill-health
e) A professional advisor

Loan Accounts

Loan accounts

- Debit loans – amounts owed to the trust or company
- Credit loans – amounts owed by the trustee or company
- Where trust operates a business, it is undesirable for trust to have large sums owed to it by individuals or other private companies or trusts
- If trust's business falters, administrator could call upon debtor to repay loan & enforce repayment by attempting to access assets of the debtor

Loan accounts

- Debit loan accounts to operating entities should therefore be avoided or minimised
- Where debit loan accounts to operating entities exist consider ways to reduce or eliminate:
  - set-off against other inter group loans
  - sale of investment assets to fund repayment
  - commence regular repayment schedule

Debit loan accounts

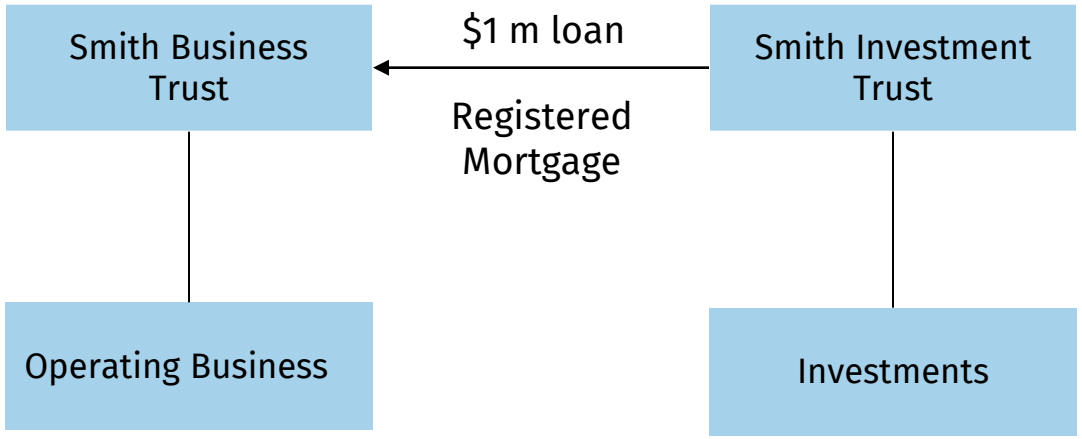
- Where trust does not trade & only has investments (investment trust) existence of debit loan accounts does not present a problem
- Unlikely trust would ever suffer financial problems
- Debit loan accounts in investment trusts in names of individuals are useful to provide the basis for mortgaging the individual's personal assets to secure repayment to the investment trust
- Debit loan accounts in investment trusts in name of trading entities provide useful asset protection if secured by registered mortgage, debenture charge over assets of trading entity

Credit loan accounts

- Credit loan accounts in companies or trusts & beneficiary entitlements in trusts to individuals who are commercially at risk should be avoided
- Assign loan to spouse or discretionary trust (if solvent possible clawback within 4 years - s 120 Bankruptcy Act 1966)
- Any future credit entitlements should be created in favour of a spouse or discretionary trust
- Where there is a significant credit loan in an operating entity to an investment entity, security should be taken over the credit loan

Example - Security

- Smith Investment Trust is owed $1 m from the Smith Business Trust (currently unsecured)
- A registered mortgage debenture over all the assets should be taken out to secure the Smith Investment Trust asset



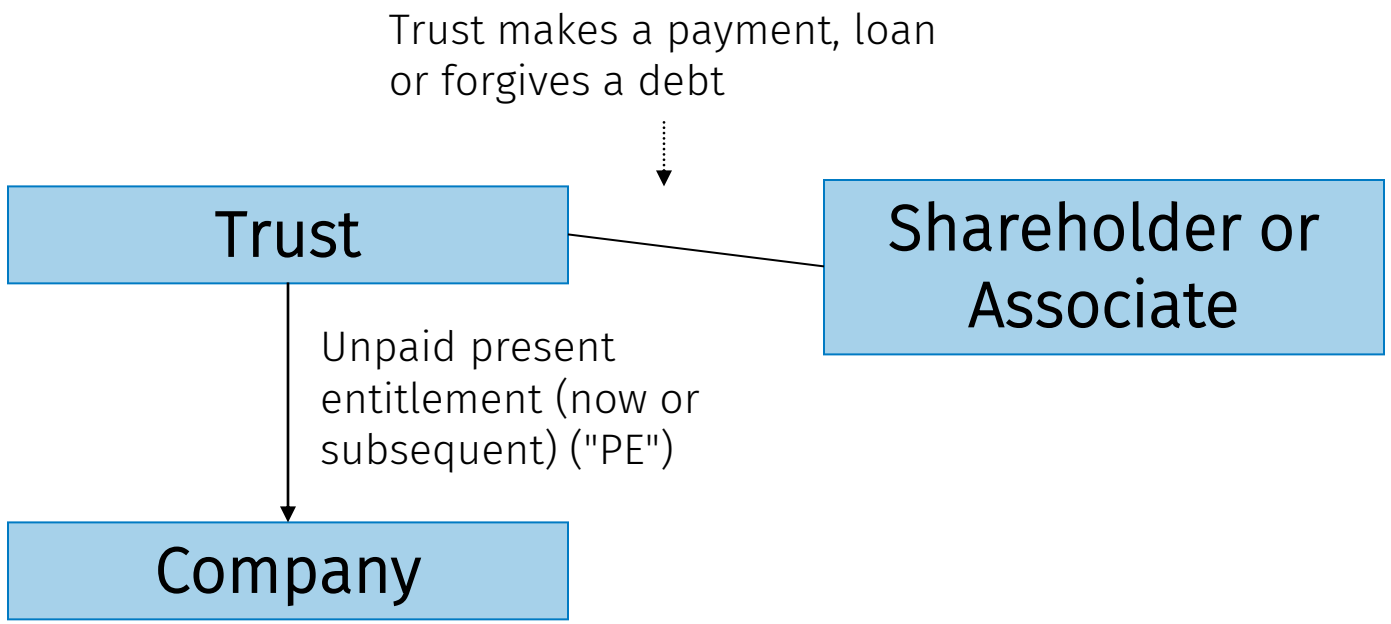
Credit loans

- Where a business trust has loaned money to the investment trust then consider strategies for reduction or elimination (see debit loan accounts)

Reminder:

- Division 7A ITAA 1936 applies to trusts with unpaid present entitlements to corporate beneficiaries
- ATO takes the view that a UPE is a loan as is a form of financial accommodation
- Subdiv EA is a specific provision that can also apply to trusts with an unpaid present entitlement to corporate beneficiaries

Credit loans – general application of Subdivision EA



Beneficiary balances

- Allowing large credit beneficiary balances to build up in favour of at-risk beneficiaries can negate asset protection benefits of accumulating assets in a trust
- One way to avoid or limit scope of problem is, once any additional distribution to the at-risk beneficiaries would be taxed at the top marginal rate, excess income can be accumulated in the trust
- If beneficiaries do need access to the cash, it can be loaned to them so that the trust is a creditor of the at-risk person

Retention of title

- To protect trading entities from clients who go into liquidation or become bankrupt consider ‘Romalpa Clauses’
- Clause or term inserted into contracts by which sellers of goods seek to retain ownership or title to those goods until the buyer has paid the price of those goods
- A number of issues arise in seeking to enforce these clauses including:
  - being able to properly identify the relevant goods from amongst other goods held by the buyer
  - combining of goods with other goods so as to lose their identity
  - whether a particular clause may constitute a charge registrable under the Corporations Act 2001

Estate Transmission

Estate transmission

- Advisers should not underestimate the importance of ensuring accumulated wealth that has been properly protected, can be transmitted effectively on death
- Our clients need to make important arrangements during their lifetime to ensure this smooth transmission and for their directions / wishes to be followed
- Should involve a multi-disciplinary approach and specialist advice should be sought, obtained and implemented where appropriate
- Better to address the estate planning process with clients sooner, rather than later to avoid common pitfalls

Estate transmission

- A package of documents are required:
  - Enduring Power of Attorney
  - Medical Power of Attorney
  - Will
  - Expression of Wishes
  - Business Succession Agreement

Assets which do not form part of the Estate

- Starting point with estate transmission is to identify assets regulated by the Will and assets regulated by other means.

Asset Type	Control	Document Regulating
Joint Tenancy (as opposed to tenants in common) Note: At common law, joint tenancy is presumed in the absence of a contrary intention.	Survivor	Position at Law
Superannuation (binding nomination)	Member within 3 years of death	Valid binding nomination
Superannuation (non-binding nomination)	Fund trustee post death	Trust Deed
Discretionary Trust	Appointor, Trustee	Trust Deed

Assets which do not form part of the Estate

Asset Type	Control	Document Regulating
Company	Directors subject to appoint by shareholders	Constitution or Shareholders Agreement. Transfer of shares if held by individual may be pursuant to Will depending on other documentation
Loan to Company or Trust	Lender or legal personal representative of lender	Loan agreement may override Will
Business Interests	Remaining business owners/trustee of Will	Business Succession Agreement / Partnership Act
Life Insurance	Policy owner or nominated beneficiary	Insurance Policy

Enduring power of attorney

- A power of attorney gives someone the authority to do things on your behalf
- A power of attorney is enduring if it operates when you are of unsound mind
- A power of attorney is cascading if it has other people acting if the attorney becomes of unsound mind (i.e. you appoint your spouse & then your children)

Enduring power of attorney

When does it take effect?

- Can make the power of attorney effective from date of signing; or
- Come into effect only when loss of mental capacity
- Can be revoked at any time while you have mental capacity

Medical power of attorney

- Where allowed under State/Territory law - legal document authorising a person to make health care decisions for you
- Object is to allow persons 18 years or older to make anticipatory decisions about medical treatment
- Person will have the authority to decide about your medical care in consultation with doctors and other relevant people
- Your attorney can only make decisions for you if you become mentally incompetent to make medical decisions
- Will last until you sign a new medical enduring power of attorney, you cancel it, you die or it is cancelled or suspended by appropriate Court/Tribunal.

Wills

- Simple is best, but the Will must be tailored to the individual's needs & circumstances
- Checklist should be used by accountant to ensure all testator's estate & wishes are considered
- Accountants should take on the responsibility that clients have an up to date Will
- Should be reviewed at least once every 3 years

Wills

- Any significant changes in circumstances should review Will:
  - death in family
  - birth, adoption
  - divorce
  - bankrupt family member
  - major change in asset position
  - establishment of new company or trust

Wills

- Obtain specialist legal advice
- Australia wide significant litigation regarding contesting Wills
- Common grounds for contesting Wills:
  - proving the last Will is valid/invalid
  - mental capacity
  - proving the deceased was not unduly influenced by someone

Expression of wishes

- A testator may have a specific idea how they would like the capital & income of discretionary trusts distributed after death
- The wishes do not bind the trustee
- Trustee continues to administer the trust pursuant to the trust deed
- Work by moral suasion only - provided control of the trustee & identity of succeeding appointors have been properly addressed, likely that statement of wishes will be followed

Changing a Will

- Wills can be changed at any time - two ways to alter a Will:
  - preparing a codicil - has effect of removing a clause of the Will and replacing it with an alternative clause
  - preparing a new Will

Note:

- Generally better to make a new Will rather than add a codicil.

Questions?

Alison Wood
CCH Learning Moderator

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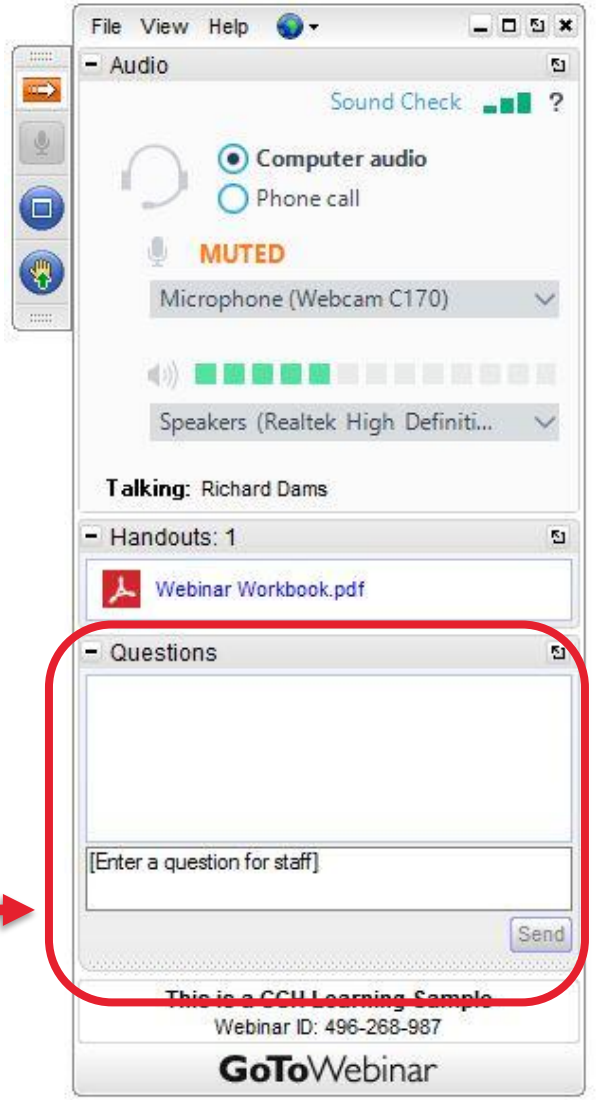

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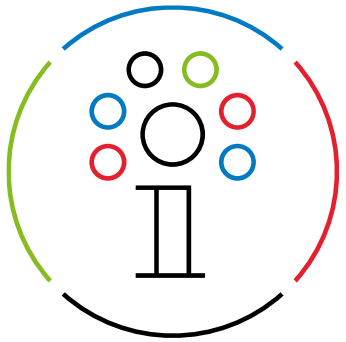

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