

- Sham Trusts
  - There is an appearance or pretence – usually in documentation – to create one set of legal arrangements, but the actual legal relationship intended is something different.
  - Trust as a sham, a legal relationship between trustee and beneficiary which is counterfeit
  - One pretends to set up a trust by writing down new legal obligations in the trust deed but is not genuine to hide what settlor really wanted to do with the property.
  - If a court found a sham trust, then the court gives effect to the real situation which the parties really intended
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- Official Assignee v Wilson
  - Official Assignee distributes a bankrupt's remaining property to each creditor.
  - Reynolds was a bankrupt before and later on.
  - OA: trust was a sham belonging to Reynolds as parties never intended to give effect to the trust deed. From the start, its hiding the real intention which was that the property would be held on bare trust for Reynold's benefit as he does not have legal ownership. If it was a sham, then the property can then be divided to creditors
  - Trust property in Queenstown owned by trustees Wilson and Mrs Harvey (Reynold's mother in law). Beneficiaries were Reynold's children and grandchildren
  - Trust property came from mainly from a mortgage as a liability to BNZ and another Invercargill property which was later sold back to Reynolds for 5000 equity. Reynolds personally guaranteed mortgage to BNZ but contributed little money into the trust.
  - Reynolds, partner Clyma and children were living in the trust property, paying for the mortgage as renting from the trust. Fine for trustees to exploit the trust property by renting it to benefit the beneficiaries, coincidental that it was rented to settlor and beneficiaries
  - OA: sham as settlor uses trust property as if they were the beneficial owners by living in it which showed it was Reynold's property. Burden of proof on OA to make the claim. House was for the benefit of Reynolds, trustees were doing what Reynolds wanted them to do and Reynolds was really owner of the property while representing the house to be trust property so it cannot be taken to satisfy his liabilities
  - Reynolds had no claim in trust property as not one of the beneficiaries. Not strong argument as Reynolds was not living rent free, he was paying mortgage, unclear what way is the trustee not giving effect to the trust by renting property to the settlor and paying the rent to the trust.
  - HC: no sham
  - Reynolds wanted to renovate the Invercargill house but the trustees did not want to take on the risk of renovation, so Reynolds purchased the house back from the trust. Unclear if it was acting in the best interests of the beneficiaries or doing what Reynolds wants as trustees sold the house back to Reynolds at the same price Reynolds bought it for.
  - Reynold later signs a contract on behalf of the trust to buy the Queenstown property with another mortgage. Trustees decide for the benefit of beneficiaries to sell the Invercargill property and purchased the Queenstown property. Seemed sensible as trust only had 5000 and could purchase another property which can appreciate in value for the benefit of the beneficiaries. Trustees not acting as if Reynolds made all the decision.

- However, the mortgage for the Queenstown property was borrowed with 150,000 more than the purchase price where trustees paid of Reynold's personal debts on BNZ mortgage and for mortgage over Invercargill property to be discharged.
  - Not the wisest move for the trustees as amount owing under second mortgage guaranteed against Invercargill property as well. Reynolds still personally liable for mortgage debt over trust property.
  - Trustees associated themselves with an undischarged bankrupt. OA: not to the benefit of the beneficiaries and seemed to be for the personal benefit of Reynolds to pay off his debts. Cynical view trustees purchased property, took mortgage and restructured mortgages for Reynold's financial benefit.
  - Reynolds not the legal owner of the property – OA: trust is a sham for nominated beneficiaries and the real situation is that Reynolds is the effective beneficial owner of a bare trust where he is entitled to call for the property and has a fixed interest in the property. There was also poor administration as no resolutions or minutes etc kept and intermingling of financial situation between trustees and Reynolds where trust records sent to Reynolds and trustees may not pay attention
  - CA: rejects sham trust claim as Reynolds despite some dodgy aspects of trust claim as Reynolds getting the trust to be embroiled in complex financing of the house, getting involved with an undischarged bankrupt. Evidence not interpreted as meaning at all points people involved did not intend to give effect to the trust. Poor administration of trust not enough by itself to establish a sham. Likewise, evidence of breach of trust does not show that at all points of time the parties did not intend to give effect to the trust.
  - Reynolds subjectively wished to establish a trust. Documentation was consistent with that intention and trustees had same intention to give effect to the trust declared on documents
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- Sham intention to not give to effect to the trust but a different situation
  - Palmer: only need intention on the part of the settlor, easier to show Reynolds had the intention that it was a trust for himself rather than his children. This is because the basic rule establishing a trust requires looking at the intention of the settlor.
  - CA agrees with Conalgen incoherent to only look at the settlor's interest. Need to consider both settlor and trustees' intention to give effect to an unannounced arrangement before can establish a sham intention. This is because settlors may have a secret intention undisclosed to the trustee, while the trustee acts for the benefit of the beneficiaries, hence the trust should not seem to be a sham.
  - CA: rejects Palmer on policy as sham arguments are an extreme claim as only considering the settlor's intention would make it easier to provide the claim, thus depriving the beneficiaries of their rights under the trust deed.
  - Rule: both settlor and trustees have to be found from the start to have intended a different transaction where one is claiming that the court should give effect to and the property in equity really belongs to the settlor.

### Indicators of sham intention in trusts context

- [110] “contemporary evidence of the actions (and words) of the relevant parties showing that the trust was not intended to be genuine”
- Actions of trustees that show disregard for their trust obligations and the beneficiaries’ interests – breaches of trust eg. taking directions from 3<sup>rd</sup> party
- Use of trust property for another’s benefit
- Settlor control (‘alter ego’ arguments)
- Poor administration: absence of meetings / resolutions / annual accounts; intermingling of financial arrangements or trust property with other property  
Eg *Rosebud v Bublitz* [2014] NZHC 2018
- Could justify a shared financial borrowing arrangement with Reynolds as he was personally guaranteeing loan to the trust to purchase the Queenstown property and Invercargill property was mortgaged as security for that purchase which achieved a better rate for the trust. House was purchased in the name of the trustees and Reynolds still received a benefit from the house by living in it but structured financial arrangement where it was good for the beneficiary of the trust.
- Does not seem like a case where a person deprives themselves of assets to prevent creditors claiming his property as Reynolds did not put much property into the trust
- CA: not enough to show the trustees not acted for the benefit of the beneficiaries.

### *Illusory trusts – Clayton v Clayton*

- What powers did Mr Clayton hold over the trust?
- What did that mean for the external P(R)A 1976 relationship property regime? Why?
- Was there a trust at all? What are the possible answers to this question?
- Limits on trusts when someone holds too much power over trust property that there is no longer a trust
- Settlers may want to retain control over trust and want to nullify sham doctrine where they compel trustees to do certain things with the property.
- Hence, they may formally give themselves control in the trust deed.
- In OA, Reynolds does not retain any control – when he tried to exercise defacto control there was an issue of a sham.
- Clayton settles property in discretionary trust worth 28 million. Mr Clayton was sole trustee. Beneficiaries were Mr and Mrs Clayton and children. No beneficiary guaranteed property and trustee decides who receives income. Final beneficiaries were children who would receive after final vesting day if no distributions made before.
- SC: Whether it is an illusory trust when settlor and trustee has the ability under the deed to give themselves all the trust property as a beneficiary of the trust.
- One position is that its not a trust despite the deed. A trust requires fiduciary relationship between trustees and beneficiary whereas there cannot be a fiduciary relationship if the trustees can take full benefit of the trust property and distribute it to themselves.
- Clayton was principal family member in the trust deed where they could appoint or remove beneficiaries under cl 7, and appoint or remove trustees under cl 17. Had full discretion to appoint property for the beneficiaries.

- Trustee's ability to not only use property for their exclusive benefit by distributing the property for themselves as a beneficiary, also have the ability to add or remove any beneficiary and trustee. Issue of whether it is no longer trust due to trustee's powers.
- Mr Clayton's powers:
  - He could bring vesting day forward & final distribution
  - He could resettle property on a different trust for beneficiaries rather than appoint property to a discretionary beneficiary.
- Another option is that there is no trust relationship once trustee gives himself all the property, as there was a trust with a fiduciary relationship where the trustee has to consider making distributions to other beneficiaries.
- May not be a trust as trustee does not need to hold the property for the benefit of others and can use it for their own benefit. Trust deed stating the trustee does not need to consider beneficiary interests. Trust deed also says trustees can act in a conflict of interest when distributing property under cl 11 but also implicit as discretionary trust. Another provision allowing trustee to do whatever they want with the trust property before the distribution.
- If trust about separating out ownership and control of property and giving to beneficiaries, if retain use of property, have you disposed of property, given that trusts are about the disposition of property to others through equity
- Trustee is classic status based fiduciaries and if trust deed says you can benefit yourself, is it really a trust.
- Were fiduciary duties remaining enough to say there's a trust? Whether trustee retained all the powers of control and ownership that they would have been the absolute owner.
- Illusory trust: suggesting the legal owner was also the real, absolute owner rather than holding the property on trust.
- HC: no trust, property formed part of relationship property pool. Mr Clayton was beneficial owner and the trust was illusory as he retained too much control and power. Limit on how much power trustees can have while holding property. Trust no longer had the consequences of a discretionary trust. Cannot go further as absolute owner than what Mr Clayton had.
- Bennett: Form over substance if court recognised a trust where trustee held so much power
- CA: Enough fiduciary obligations on the trustees for there to be a trust, such as holding property for the beneficiaries, and the beneficiaries can enforce the basic obligation. There is still a trust if irrevocable core obligation still exist despite trustee benefiting.
- Although there was a trust, perspective from property relationship regime means the property held formed a part of the relationship property pool. Same result as HC but different method.
- Appeal: whether illusory trust claim possible as settlors often retain control over the trust as trustee and beneficiary.
- SC: Clayton holds property as part of the property pool in PRA which can be shared equally between parties.
- No final decision on illusory trust
- Disagrees with HC which said there was an illusory trust.

- Disagrees with CA that there is no illusory trust doctrine and that there was simply a trust. Disagrees with CA where there can only be either a valid trust or a sham. No argument that a settlor/trustees hold too much power hence there was no trust.
- SC: A failed sham argument does not preclude a finding that an attempt to create a trust had failed eg. because parties retained too much power. May not be a sham but thing created is not a trust either. Does not like illusory trust label.
- Illusory trust – useful label – where thought created a trust and wrote out a trust deed and intended to give effect to the trust deed but the trust was only an illusion. Better than true nature of the deed claim.
- Clayton’s powers can be interpreted as:
  - Not a valid trust as he has not disposed of property in favour of another
  - He’s been given so many powers that one may question whether the irreducible core of trustee obligations apply to him. i.e. exclude certain obligations of a trustee in a trust deed to beneficiaries so that it is no longer a trust.
  - Liabilities excluded: Clayton did not have to consider beneficiary interests before making a decision and Clayton could take full benefit of the property
  - However CA: despite Mr Clayton’s power to bring the trust to an end by removing all the beneficiaries or give himself all the property, it is still a trust until that point of time
- SC: complicated matter, disagreement as court does not have unanimous opinion, so do not need to decide it. Also, unusual trust deed and issue is unlikely to arise in future cases
- However, creditors may make a claim, whether this is a valid trust may come up
- Rickett: sham and illusory trust doctrine is part of the shambolic nature of trusts in NZ, strange beasts. Should not be able to create new doctrines in trust law just because want certain people to have property.
- However, sham is an orthodox doctrine in trust and within the common law. Not shambolic reasoning, Wilson cited English cases. Recognised to exist in Commonwealth as created a document and never intended to give effect to it, hence court will not give effect to the legal relationship in the document but the actual intended transaction.
- Illusory trusts – instrumentalism theme and NZ courts finding contrary ways to orthodox trust law to get a result. Giving property to a person who should be able to make a claim.
- Eg. Mrs Clayton, property belonged to Mr Clayton due to illusory trust doctrine as legal title holder. Seems like achieving relationship property division but detrimental to principles of trust law.
- HC seemed to be using non-existent doctrine to place property for Mrs Clayton. Seems instrumentalist. No cases stand as binding precedent for illusory trust doctrine, hence CA’s reluctance to recognise its existence.
- SC: unsure if there was a trust where one person is the settlor, only trustee and one of the discretionary beneficiaries.
- Pugachev (English HC) upheld SC in Clayton where can read trust deed and find there was no trust. Person was a principal family member but not a trustee where they could control what the trustees were doing & add/remove trustees. The trust deed allowed Pugachev to retain beneficial ownership, despite looking like a discretionary trust for Pugachev’s family, therefore not a trust

- Court can say if trustees/settlor retains so much power over trust deed that they become either the absolute beneficial owner or as beneficiary under a bare trust
- Webb v Webb Cooks Island CA: husband holds property and retained powers under the trust deed. 2 trust deeds failed to effectively alienate settlor's beneficial interest, therefore invalid.
- Both apply SC in Clayton as if the court said the illusory doctrine exists
- Sham trust, there is no trust – pretence of a trust deed, not valid and not something court will give effect to. Court give effect to actual transaction
- Illusory trust, trust deed looks like a trust but when interpret the rights retained as a settlor or trustee in the trust deed, the fact you have those rights means it is not valid as a trust for discretionary beneficiaries. May still be a trust eg. Pugachev where trust held by trustees for their benefit or Webb where settlor was effectively an owner.
- Reason SC did not go into illusory trust reasoning: obiter, like in Wilson
- Official Assignee: OA cannot say the trust is a sham –
- Joliff: there was a settled trust and one of the trustees giving effect to the trust but then claimed they did not subjectively intend to give effect to the trust. Glazebrook J: not a good rule as people can objectively present that they have created a trust but then state they had the subjective intention to never hold property for the benefit of the beneficiaries. Shammer benefiting from the fact they carried out a sham.
- CA: cannot be the rule, so OA steps into the shoes of the bankrupt, they cannot objectively set up a trust but then subjectively not intend for there to be a trust Treated OA and settlor as the same, but may want to treat them differently as OA wants to return property back to creditors whereas settlors want to keep property for themselves [19] – [23]