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Electronic transmission: MCDInsolvency@Treasury.gov.au.

Mr Matthew Bowd
Manager
Market Conduct Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Matthew,

Clarifying the treatment of trusts under insolvency law

As part of The Treasury's overall reforms concerning insolvency, one area for improvement that has been identified is the treatment of Trusts under corporate insolvency.

In the Consultation Paper published by The Treasury and dated 15 October 2021 a description of a corporate trust was provided citing that there were approximately 313,000 'Trading Trusts' of varying sizes in operation in 2018.

The Consultation Paper further recounts the statutory regime established by the Corporations Act 2001 (*Cwlth*) that applies a regulatory framework to companies that are insolvent and placed under external administration.

Broadly, the Consultation Paper describes the application of the legislative framework that applies when a company is confronted with insolvency; this includes the following:

- Defining when a company is insolvent;
- The consequences of insolvency;
- Who conducts any external administration and controls the distressed company;
- The rights, duties and obligations of affected parties;
- How the future of the distressed company is to be decided; and
- The order in which debts are to be repaid in a liquidation.

The Consultation Paper states that no such regime exists for the insolvent Corporate Trusts and that where a Corporate Trust becomes insolvent that the External Administrator appointed over the company is required to apply to the Court for directions on how to administer the assets and liabilities subject to the trust.

The Consultation Paper sets out a series of questions on the above and seeks submissions from stakeholders. See **Appendix A** for the list of questions as put. The following is my submission.

1. My background and experience

I am a Fellow of the Institute of Chartered Accountants Australia and New Zealand (CA) and founder of the firm CJG Advisory a boutique practice specialising as insolvency practitioners and forensic accountants. I am a member of Australian Restructuring Insolvency & Turnaround Association (ARITA).

Until 2020 I retained a licence to act as a Registered Company Liquidator. I am a Registered Trustee in Bankruptcy.

I have been in practice for in excess of 40 years and during that time have had extensive experience in business consulting and appointments in both corporate and personal insolvency administrations. I have been involved in many complex administrations at the request of major banks, financiers, legal firms, creditors and other stakeholders.

I am the author of the technical commentary and explanation on Divisions of the Goods and Services Act that impact on corporate and personal insolvency administrations.

I have also published a number of articles on this topic in the Australian Insolvency Journal (ARITA) and the Australian GST Journal (Thompson Reuters).

In the course of conduct of my practice I have been appointed as liquidator of many Corporate Trustees and been required to administer many insolvent Trading Trusts.

2. Types of trusts

The Consultation Paper refers to 'Corporate Trusts' and/or 'Trading Trusts'; these are not the only the form of trusts that exist where a company has been appointed as the Corporate Trustee. Trusts may also have individuals who are appointed as Trustees.

See the attached **Appendix B** with other forms of Trusts and a brief description as to the nature and structure of that trust.

3. Governing legislation for trusts

Each State and Territory of Australia has their own legislation which provides for the basic powers and responsibilities of Trustees.

See the attached **Appendix C** for particulars of the legislation that applies in each State or Territory.

The State based legislation does not apply to complying superannuation funds (since the Federal Legislation overrides State Legislation in that area), nor will it apply to

any other trust to the extent the trust deed is intended to exclude the operation of that legislation.

The State or Territory based legislation will usually apply to forms of trusts where there is no trust deed or where a trust deed is silent on specific matters.

The State or Territory based legislation also applies where the Trust is based on a Trust Deed.

Such Trust Deeds are subject to stamp duty applied in the state where the Trust has been established. Stamping is required if a Trust Deed is to be admitted as evidence.

4. Key aspects of a trust

The trust fund

In principle, the trust fund can include all forms of assets and be any size – the assets may range from cash to a huge factory, from shares to one contract, from operating a business to a single debt.

Trust Deeds usually have wide powers of investment however, some deeds may prohibit certain forms of investment.

The critical point is that whatever the nature of the underlying assets, the Trustee must deal with the assets having regard to the best interests of the beneficiaries.

Failure to act in the best interests of the beneficiaries would result in a breach of trust which can give rise to an award of damages against the Trustee.

A Trustee must keep trust assets separate from the Trustee's own assets.

The trustee's liabilities

A Trustee is personally liable for the debts of the Trust as the Trust assets and liabilities are legally those of the Trustee. For this reason, if there are significant liabilities that could arise, a limited liability company is often used as Trustee – the **Corporate Trustee**.

The Trustee is entitled to use the trust assets to satisfy those liabilities as the Trustee has a **right of indemnity** and a **lien** over them for this purpose.

This explains why the balance sheet of a Corporate Trustee will show its only asset as being the right of indemnity but list all liabilities.

In the case of a discretionary trust, it is usual that the trust liabilities cannot generally be pursued against the beneficiaries' personal assets, but this may not be the case with a fixed or unit trust.

Powers and duties of a trustee

A Trustee must act in the best interests of beneficiaries and must avoid conflicts of interest. The Trust Deed will set out in detail what the Trustee can invest in and the businesses the Trustee can carry on.

The Trustee must exercise powers in accordance with the deed and this is why deeds tend to be lengthy and complex so that the Trustee has maximum flexibility.

Any legally competent person, including a company, can act as a Trustee. Two or more entities can be Trustees of the same Trust and a Trustee may be appointed to act over more than one Trust.

Broad Framework for Creditor's Claims, Corporate Trustees and Corporate Trusts

See the attached **Appendix D** for a schematic description of creditors' claims against Corporate Trustees and Corporate Trusts.

Winding up

The Trust Deed typically deals with the vesting (or winding up) of the Trust and the methodology for distribution of trust assets.

This applies in circumstances where the Trust is solvent; as the Consultation Paper suggest Trust Deeds are silent on the aspect of insolvency and in the period I have been in practice I have not observed any Trust Deeds incorporating such provisions and hence the need for Orders by a Court.

Replacement trustees

A Trust Deed permits the replacement of a Trustee and may in some instances set out circumstances in which a Trustee is automatically removed; this may include the appointment of an External Administrator of a Corporate Trustee.

In the above circumstance this brings into question the ability of the Trustee to make claim under the lien given that an 'Alternate Trustee' has been appointed and further there may be additional competing claims in respect of the lien to that Alternate Trustee.

5. The corporate trust becomes insolvent

The Consultation Paper poses various questions concerning a trust being insolvent or becoming insolvent.

The State or Territory based legislation does not incorporate sections that address the core issues concerning insolvency nor the appointment of an External Administrator.

The rights, in respect of trust property afforded to Trustees, do not migrate to the External Administrator when an appointment is made to a Corporate Trustee and hence the current requirement for Orders of the Court.

6. Response to consultation questions

Question 1: *Should the corporate insolvency framework be amended so that it expressly provides for the external administration of insolvent trusts with a corporate trustee? If so, what external administration processes should the amendments apply to?*

Question 2: *What benefits would a legislative framework deliver*

My submission is that amending the framework would ensure consistency in the priority of creditors for companies and Corporate Trusts which of itself is the expectation of creditors. An External Administrator's appointment is pursuant to the Corporations Act 2001 and without legislative amendment to the state based legislation changes to the Corporations Act will be constitutionally flawed.

The above may be achieved by each State and Territory adopting Chapter 5 of the Corporations Act 2001 as a 'Uniform Code of Insolvency Law'.

This approach in effect adopts the Corporations Act's procedure and practice as it applies to all forms of External Administration and the rights of creditors.

In respect of forms, I make particular reference to the Summary of Affairs (Form 509) and Report on Company Activities and Property (Form 507). In the compilation of these forms, the assets of the Trust and liabilities of the Corporate Trustee may be incorporated in the one document together with a suitable note that the Trustee was acting in that capacity and that the liabilities are subject to a Right of Indemnity.

Ideally the format of Form 507 would be amended to be consistent with Form 509.

The adoption of the above also would incorporate the Insolvency Practice Schedule (Corporations), Insolvency Practice Regulations (Corporations) and Company Regulations Chapter 5.

Lodgement of the requisite forms would be with the ASIC and this would be consistent with that for companies as required by the Corporations Act 2001 and its rules.

The above would also be consistent where External Administrators are appointed to Cooperatives or Incorporated Associations (State based legislation).

Question 3: *Is there potential for detrimental or unforeseen impacts if the statutory regime is extended?*

On the basis that Chapter 5 of the Corporations Act 2001 is adopted uniformly by the State as the relevant legislation for dealing with insolvent corporate trusts (and corporate trustees) I do not believe there to be any detrimental or unforeseen impact.

Certainly, the beneficiaries' position would be secondary to creditors' interests but this is no different than the circumstance of the Corporate Trustee and solvent trust where the Trustee realises assets pursuant to his lien.

Whether the above should apply in the circumstance where the Trustee of the Trust is an individual is less clear because of the potential application of the Bankruptcy Act 1966.

It would be my view that the Bankruptcy Act should not apply as this Federal Legislation is intended to apply to the divisible assets of individuals; trust assets are not divisible.

The question then is how is the External Administrator appointed given that the Corporations Act refers to directors and shareholders.

The above may be overcome by the inclusion of simple provisions in the State or Territory based legislation for the appointment of an External Administrator by an individual. This may be similar to a Debtor's Petition as is executed in Bankruptcy or the execution of a Deed similar to that at the commencement of a Voluntary Administration.

Question 4: *Should legislation expressly set out when a trust is deemed to be insolvent?*

Question 5: *What is the most appropriate way to prescribe when a trust is taken to be insolvent?*

The Corporations Act 2001 provides a definition of "Insolvent" in its dictionary of terms – Section 9. Further amplification of this is in Section 95A where the Act specifies when a person is solvent.

The importance of the objective statement as to solvency enables triggering of various points in Chapter 5 of the Act such as Section 588G – where the director has a duty to prevent insolvent trading.

The Bankruptcy Act 1966 adopts a similar position to the Corporations Act in its interpretation at Section 5(2) and (3).

In this submission I adopt the position that Chapter 5 of the Corporations Act 2001 shall apply and this, in turn, relies on the definitions ascribed in the Chapter 1. The inclusion of an objective definition is required for Chapter 5 to be effective.

This submission adopts the position that the most appropriate way to prescribe when a trust is taken to be insolvent is to refer to Section 95A of the Corporations Act 2001.

Question 6: *Should the power of an insolvency practitioner to administer the trust assets and liabilities be expressly provided for in legislation?*

In this submission I adopt the provisions as specified in Chapter 5 of the Corporations Act 2001.

The Chapter provides powers to the External Administrator so as to enable the performance of prescribed duties and responsibilities.

The Chapter also applies checks and balances on the actions of the External Administrators so as to ensure a standard of conduct.

The inclusion of express powers is essential.

Question 7: *The seventh question posed is should the law provide that, subject to a contrary order by a court, the same insolvency practitioner may administer both the company, and the assets and liabilities attributable to any trusts for which the company is trustee?*

Question 8: *And in the eight question should the affairs of a trustee company and each trust it administers be resolved separately in external administration?*

In this submission the same External Administrator would administer the affairs of the Corporate Trustee and the Trust in the one administration. The reason for this is the promotion of efficiency, however to the extent that a breach of trust has occurred the External Administrator should consider obtaining Orders by a Court and possibly the appointment of a Special Purpose External Administrator to deliberate on the specific aspect in question.

Where the Trustee acts for more than one Trust and each of the Trusts are insolvent the same External Administrator may act subject to any conflicts of interest. Each trust would be required to be separately identified by the External Administrator by the respective ABN.

To the extent there has been a mixing of trust assets Orders by a Court would be appropriate – viz the financial collapse of Estate Mortgages which comprised 6 separate trusts.

Question 9: *Should there be a statutory order of priority in the winding up of a trust?*

Question 10: *Should a statutory order of priority replicate the regime for companies? Do additional factors need to be considered where a corporate trust structure is involved?*

In this submission the adoption of Chapter 5 imposes an order of priority and this same order of priority should apply to Trusts. The reason for this is that it is consistent with that as applied to insolvent companies and adopts the same reasoning for such priorities as applied by our social and economic norms.

The Corporate Trust operates in the same commercial environment as companies, accordingly I see no reason to adopt a different order.

The position of unit holders in a Unit Trust would be the same as shareholders in a company. The External Administrator would consider the terms of the Trust Deed with the winding up of the Unit Trust.

The position of beneficiaries of a discretionary trust would also be the similar to that of shareholders in company however the terms of the Trust Deed would dictate the distributions made to beneficiaries on vesting

Question 11: *Should there be additional limits on the enforceability of ejection clauses and/or clauses that seek to limit a trustee's right to indemnity, in situations involving insolvency or external administration?*

Question 12: *what would be the impacts of any such limits?*

Question 13: *Are there any other issues that need to be considered in light of the questions above?*

In this submission I propose that the Trustee's Right of Indemnity be unchanged in situations involving insolvency or External Administration.

To place a limit on the right fails to consider the circumstances or events leading to insolvency. Creditors contracted with the Trustee assuming no limit or impediment and for this to be imposed as a consequence of insolvency would be discriminatory.

Where a Trust Deed incorporates a clause for the ejection of the Trustee upon the insolvency of the Trustee I refer to Sections 301 through 302B of the Bankruptcy Act 1966 where the provisions in a Trust Deed or other contract that refer to a debtor becoming a bankrupt or commits an Act of Bankruptcy are declared void.

In my submission an equivalent section in the Uniform Code as proposed would provide certainty.

Question 14: *What is the most appropriate model by which a statutory regime could be expressed in the legislation?*

In this submission I propose the appropriate model to be that each State and Territory put up an amendment to the respective Trustee legislation that adopts Chapter 5 of the Corporations Act 2001 as a "Uniform Code".

The Uniform Code necessarily would incorporate a dictionary of terms and reference to the following specific Sections in Chapter 1

- Chapter 1, Part 1.2
 - In particular
 - Division 5A
 - Division 6
 - Division 6A
 - Division 7
 - In particular
 - Section 90
 - Section 91 and
 - Section 95A

The Uniform Code also would necessarily adopt the rules and regulation that apply to Chapter 5 as specified in the following:

- Insolvency Practice Schedule (Corporations) 2016

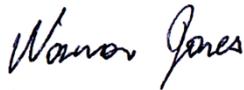
- Corporations Regulations 2001
- Insolvency Practice Rules (Corporations) 2016

General

This submission sets out my personal views and opinions and does not necessarily represent that of my firm.

Should you require further information concerning the above please do not hesitate to contact me.

Yours faithfully,



Norman K. Jones

Consultant

Trusts - Submission - Clarifying treatment of trusts under insolvency law (NKJ) 12021

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Appendix A

Consultation questions

Question 1: Should the corporate insolvency framework be amended so that it expressly provides for the external administration of insolvent trusts with a corporate trustee? If so, what external administration processes should the amendments apply to?

Question 2: What benefits would a legislative framework deliver?

Question 3: Is there potential for detrimental or unforeseen impacts if the statutory regime is extended?

Question 4: Should legislation expressly set out when a trust is deemed to be insolvent?

Question 5: What is the most appropriate way to prescribe when a trust is taken to be insolvent?

Question 6: Should the power of an insolvency practitioner to administer the trust assets and liabilities be expressly provided for in legislation?

Question 7: Should the law provide that, subject to a contrary order by a court, the same insolvency practitioner may administer both the company, and the assets and liabilities attributable to any trusts for which the company is trustee?

Question 8: Should the affairs of a trustee company and each trust it administers be resolved separately in external administration?

Question 9: Should there be a statutory order of priority in the winding up of a trust?

Question 10: Should a statutory order of priority replicate the regime for companies? Do additional factors need to be considered where a corporate trust structure is involved?

Question 11: Should there be additional limits on the enforceability of ejection clauses and/or clauses that seek to limit a trustee's right to indemnity, in situations involving insolvency or external administration?

Question 12: What would be the impacts of any such limits?

Question 13: Are there any other issues that need to be considered in light of the questions above?

Question 14: What is the most appropriate model by which a statutory regime could be expressed in the legislation?

Appendix B

Types of Trusts

Fixed trusts

In essence these are trusts where the trustee holds the trust assets for the benefit of specific beneficiaries in certain fixed proportions. In such a case the trustee does not have to exercise a discretion since each beneficiary is automatically entitled to his or her fixed share of the capital and income of the trust.

Unit trusts

These are generally fixed trusts where the beneficiaries and their respective interests are identified by their holding “units” much in the same way as shares are issued to shareholders of a company. The beneficiaries are usually called unitholders. It is common for property, investment trusts (e.g. managed funds) and joint ventures to be structured as unit trusts. Beneficiaries can transfer their interests in the trust by transferring their units to a buyer. There are no limits in terms of trust law on the number of units/unitholders, however, for tax purposes the tax treatment can vary depending on the size and activities of the trust.

Discretionary trusts

These are often called “family trusts” because they are usually associated with tax planning and asset protection of family members. In a discretionary trust the beneficiaries (who are sometimes referred to as “objects”) do not have any fixed interests in the trust income or its property but the trustee has a discretion to decide whether any of them is to be entitled to income or capital and, if so, to how much.

For the purposes of trust law, a trustee of a discretionary trust could theoretically decide not to distribute any income or capital to a beneficiary, however, there are tax reasons why this course of action is usually not taken. The attraction of a discretionary trust is that the trustee has greater control and flexibility over the disposition of assets and income since the nature of a beneficiary’s interest is that they only have a right to be considered by the trustee in the exercise of his or her discretion.

Bare trusts

Where there is only one trustee, one legally competent beneficiary and no specified obligations, the beneficiary has complete control of the trustee (or “nominee”) and this is known as a bare trust. A common example of a bare trust is a nominee shareholding – where the shareowner holds shares on behalf of someone else who does not want to be identified.

Hybrid trusts

These are trusts which have both discretionary and fixed characteristics. The fixed entitlements to capital or income are dealt with via “special units” which the trustee has power to issue.

Testamentary trusts

As the name implies, these are trusts which only take effect upon the death of the testator. Normally, the terms of the trust are set out in the testator’s will and are often established where the testator wishes to provide for their children who have yet to reach their adulthood or who have a disability.

Charitable trusts

These Trusts provide a vehicle for the establishment of philanthropic Trusts that are allowed concessional taxation treatment and deductions to taxpayers for gifts to such Trusts.

Superannuation trusts

All superannuation funds in Australia operate as trusts. The deed (or in some cases, specific acts of Parliament) establishes the basis of calculating each member’s entitlement, and sometimes the contributions that have to be made for a member, while the trustee will usually retain discretion concerning such matters as the fund’s investments and the selection of a death benefit beneficiary. The Federal Government has legislated to establish certain standards that all funds (for which tax concessions are sought,) must comply (and which are called “complying funds”). For instance, the “preservation” conditions, under which a member’s benefit cannot be paid until a certain qualification has been reached (such as reaching age 65), are a notable example.

Other Trust Forms

- Quistclose trust
- Constructive trust
- Blind trust
- Secret trust
- Shares are frequently held in trust by “nominees”
- Cash management trusts and property trusts are used by many people for investment purposes
- Joint ventures are frequently conducted via unit trusts
- Money held in accounts for children will generally involve trusts
- Executors of deceased estates act as trustees
- Solicitors, real estate agents and accountants operate trust accounts
- There are trustees in bankruptcy and trustees for debenture holders
- There are some large companies established by statute which carry on business as trustee companies

Appendix C

State and Territory based legislation

State/Territory	Legislation	
ACT	Trustee Act 1925	Trustee Amendment Act 1999
New South Wales	Trustee Act 1925	Trustee Amendment Act 1997
Northern Territory	Trustee Act	Trustee Amendment Act 1995
Queensland	Trusts Act 1973	
South Australia	Trustee Act 1936	
Tasmania	Trustee Act 1898	Trustee Amendment Act 1997
Victoria	Trustee Act 1958	Trustee Amendment Act 1995
Western Australia	Trustees Act 1962	Trustee Amendment Act 1997

Appendix D

Broad Framework for Creditors' Claims, Corporate Trustees and Corporate Trusts

