

9 December 2021

Manager, Market Conduct Division
The Treasury
Langdon Crescent
PARKES ACT 2600

By email: MCDinsolvency@treasury.gov.au

Dear Manager

Clarifying the treatment of trusts and insolvency law

Chartered Accountants Australia and New Zealand and CPA Australia represent more than 300,000 professional accountants in over 100 countries, supported by more than 19 offices globally. We make this joint submission to the *Clarifying the treatment of trusts under insolvency law* consultation on behalf of our members and in the broader public interest.

The use of trusts

In seeking feedback from our members, we understand that trusts are used primarily to protect assets for future generations of family members and distribute income from a business enterprise in a tax effective manner. Where it is decided to have a corporation as the trustee, commonly that corporation only acts in its capacity as trustee and does not act in its own right. Generally, the beneficiaries, the appointor and settlor of the trust and the directors of the corporation acting as trustee are the same, if not closely related individuals.

For trading trusts, from the business owners' perspective, there is no difference between the legal and beneficial owners of the affairs and property of the business. Establishing a trading trust is simply part of an effective framework to manage the assets and profits of the business. The following comments reflect changes that will benefit small business trading trusts and will not disadvantage larger corporations whose business may be to act as a corporate trustee for many trusts.

Key recommendations

Our comments acknowledge that, while a trust is categorised as an economic entity by the Deputy Commissioner of Taxation, it remains that a trust is not a legal entity. Accordingly, as the ownership of assets and the liabilities incurred by a corporate trustee rest with the corporation, we seek inclusion of the following in the *Corporations Act 2001* (the Act), to give similar effect of to that of the ipso facto clause:

- that on appointment of a registered liquidator to any, and all, external administration roles to a corporation that also acts in the capacity of a trustee, an eviction clause in the related trust deed or deeds that would automatically remove a corporate trustee is not enforceable.
- that on appointment of a registered liquidator to any, and all, external administration roles to a corporation that also acts in the capacity of a trustee, the right of an appointor to appoint a new trustee is not enforceable.

This will enforce the rights, duties and obligations of a registered liquidator appointed to a corporation to externally administer its business and affairs including the business and affairs, in its capacity as a trustee. This would also clarify that in an event of insolvency, the property and assets held on trust by a corporation will be dealt with by a registered liquidator in accordance with the Act including distributions pursuant to Section 556 unless a party to the corporation or trust obtains a court order to prevent such dealings.

Further, to enable any party to undertake due diligence on a corporation prior to entering an agreement with them, the Government registration record of that corporation should indicate if it also stands as a trustee. Ideally, a second tier of information should be available which lists the names of the trusts for which a corporation is trustee.

In appendix A, we provide detailed responses to the question raised in the consultation paper. Please do not hesitate to reach out to Karen McWilliams of CA ANZ on (612) 8078 5451 or at karen.mcwilliams@charteredaccountantsanz.com and Kristen Beadle of CPA Australia on 0413 883 581 or at Kristen.Beadle@cpaaustralia.com.au to discuss further.

Yours sincerely

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Appendix A

External administration of insolvent trusts

- Q1: 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?
- Q2: What benefits would a legislative framework deliver?
- Q3: Is there potential for detrimental or unforeseen impacts if the statutory regime is extended?

Q1: On the understanding that trusts are not a legal entity, it does not appear possible that they can be considered insolvent. Given all activities of a corporation are dealt with under the *Corporations Act 2001* (the Act), it appears unnecessary to legislate to specifically deal with trusts with a corporate trustee, particularly in light of the Government's deregulation agenda. Equally, when seeking clarification in the specific instance of insolvency, the various external administration processes are already dealt with under the Act.

We support amendments to the Act so that an event of insolvency is considered through a corporation's business and affairs undertaken in its capacity as a trustee. Accordingly, such changes will, and should, capture all forms of external administration.

Q2: Clarification in the current framework to enable assets of the trust to be recovered by way of the existing indemnity in an insolvent event should ultimately reduce both federal and state court capacities. It provides the external administrator clarity as to the treatment of trust assets without the need for judicial review. Our proposed changes, as noted in our covering letter, would also ensure creditors of a corporation acting as trustee are not unfairly treated.

Q3: While it may appear that such a change could be detrimental to the beneficiaries of a trust, ultimately, beneficiaries should only receive a distribution from the trust after all liabilities arising from the business and affairs undertaken on behalf of that trust have been satisfied.

In extending the regime for corporate trustees, consideration should be given to similar changes in relevant law for individuals acting as trustees. Any change should aim to simplify legislation and maintain consistency for assets held in trust irrespective if the trustee is a corporate body or an individual.

When is a trust insolvent?

- Q4: Should legislation expressly set out when a trust is deemed to be insolvent?
- Q5: What is the most appropriate way to prescribe when a trust is taken to be insolvent?

Q4: A trust is not responsible for liabilities incurred by its trustee acting under a trust deed nor can a trust own property or assets. We do not see the need for additional legislation to set out when a trust is deemed to be insolvent.

Q5: As provided in above responses, it is the Act, in particular Section 95A Solvency and insolvency, that should apply to determine the solvency of a corporation in its capacity as trustee.

Role of external administrator

- Q6: Should the power of an insolvency practitioner to administer the trust assets and liabilities be expressly provided for in legislation?
- Q7: 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?

Q6: Yes. Expressly outlining the power of a registered liquidator to a corporation should capture not only the business and affairs undertaken by that corporation but also the business or affairs undertaken by that corporation in its capacity as a trustee. This will remove significant costs and time from the external administration process.

Currently, registered liquidators must make an application to the courts to seek appointment of a receiver over assets held in trust by a corporation. Members indicate that these costs are high, circa \$7,000 - \$20,000 in legal fees alone. These costs, and the cost to administer the corporation pending such orders being made, which can take upwards of six months, are funds that may have been available for distribution to creditors and beneficiaries.

We appreciate court oversight may be considered necessary where the assets and liabilities of a trust are significant. We propose the inclusion in the Act to allow a registered liquidator to deal with assets held in trust without approval of the court where they are less than the prescribed amount (*Corporations Regulations 2001 5.4.02*, currently \$100,000), similar to Section 477(2A) of the Act. This will allow for a timely and cost-effective external administration process.

Q7: This proposition is in line with our recommendation and would remove the need to apply to the court separately to administer the assets and liabilities attributable to any trusts. Such an approach would remove the duplication of costs associated with having two external administrators appointed to effectively wind up the affairs of, in essence, the same entity given that the affairs of a trust and its corporate trustee are intertwined.

Distribution of assets

- Q8: Should the affairs of a trustee company and each trust it administers be resolved separately in external administration?
- Q9: Should there be a statutory order of priority in the winding up of a trust?
- Q10: 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?

Q8: In principle we support that the affairs of a corporation acting under a trust deed should be resolved with the assets held in the associated trust in the event of external administration.

Q9: In line with our previous responses that call for the business and affairs of a corporation to include those when acting as a trustee to be captured in the *Corporations Act 2001*, the existing statutory order of priority for winding up would apply.

Q10: The drafting of such legislation should be cognisant that, in small business trading trusts, the corporate trustee may record loans between its various trusts. Accordingly, consideration should be given as to how to recognise relationships between the affairs of multiple trusts and when the assets of related trusts can be made available to satisfy the liabilities of the corporate trustee.

Ejection and indemnity clauses

Q11: 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?

Q12: What would be the impacts of any such limits?

Q11: Yes. An insolvency event should not trigger an ejection clause or allow an appointor to exercise their right to replace the trustee.

Q12: Therefore, on appointment, the registered liquidator will have a "right of indemnity" and an associated lien over the assets held in trust by the corporation to recoup the liabilities and pay the debts the trustee incurred whilst lawfully acting on behalf of the trust.

Other issues

Q13: Are there any other issues that need to be considered in light of the questions above?

Q14: What is the most appropriate model by which a statutory regime could be expressed in the legislation?

Transparency

- The Government register of a corporation's name, its ACN and ABN, should be returned in results of a simple search if the corporation acts as a trustee and provides the names of the trusts for which they act.
- Not only would such transparency aid external administration, as a simple search would reveal all business and affairs for which a corporation is responsible, it would also aid due diligence undertaken by any party seeking to interact with a corporation.
- It is of particular importance to a potential creditor to know all parties with an interest in assets of a business which would include beneficiaries of a trust. Equally, where the ABN provided is for a trust, creditors would be aware that further due diligence is required to seek out the body legally liable for debts incurred in the name of the trust.
- This transparency could be achieved as part of the current program of modernising of business registers.
- Potentially outside this consultation, we raise the need for a consistent approach across Federal, State and Territory arrangements, of disclosing a trustee relationship. For example, on the collection of the ASIC levy from corporations acting as a trustee for a self-managed super fund through to legal documents such as a land title. We propose that such documents should indicate the legal entity responsible and where that obligation exists, such as when acting as a trustee.

Voidable transactions

- Expand the creditor-defeating disposition in the *Corporations Act 2001* to explicitly include property and assets held by a corporation as trustee.
- Make it a strict liability offence for directors of a corporation to take any steps to dispose of property or assets held in its capacity as trustee if such actions are creditor defeating.
- Make a strict liability offence for appointors of a trust to change a trustee if its purpose is a creditor defeating disposition.