

When not to trust

Beware of alter egos, warns Maria Kazmierow

Trusts planned to protect property have flourished in recent years. Some 250,000 – 300,000 family trusts are thought to operate in New Zealand. Unsurprisingly, lawyers' attacks on those trusts have sharpened where the couples separating do not have equal rights to the trust property.

One commentator estimated that 22 per cent of problem trusts reviewed by his company were at serious risk of being challenged on the grounds that the assets have been treated as if they were not owned by a trust (Integrity Trust Chief Executive Mark Maxwell, quoted by Helen Twose in "Family trusts at risk of being challenged – expert", *The New Zealand Herald*, 9 January 2007).

Lawyers' attacks on problem trusts and their assets are many and varied. They include use of the *Property (Relationship) Act 1976* (the PRA) (ie determining whether the trusts' assets were dispositions to a trust in terms of section 44 or 44C of the PRA, whether there were contributions to separate property, and whether any increase or gains resulted from the contributions, or whether there is an interest in the trust "property" under the PRA), and equity (ie is the trust the alter ego of the partner or a sham?).

Trusts as 'alter ego'

The "trust as an alter ego" avenue has had success in a developing line of New Zealand cases; in *Prime v Hardie* [2002] 22 FRNZ 553 (HC), *Glass v Hughey & Others* (2003) 23 FRNZ 674 (HC), and *Begum v Ali* (10 December 2004, Family Court, Auckland FAM 2001-004-866, Judge O'Donovan), the Courts found trusts to be the alter ego of husbands or partners.

Most recently, the Dunedin Family Court decision of Judge O'Dwyer in *Olliver v Sparkes* (12 December 2006, Family Court, Dunedin FAM 2004-002-80) shows the Court treating trusts as the alter ego of a spouse or partner, permitting claims against "trust" assets.

Olliver is notable as it establishes the doctrine is alive and well in the family arena (contrary to the view of Justice Chisholm in the High Court decision of *The Official Assignee v Wilson & Clyma* [2006] 2 NZLR 841. It observes the doctrine's distinctiveness from sham trust doctrine. Its reasoning and findings send a warning shot across the bows for both counsel who advise on trusts and their clients.

Olliver v Sparkes

Ms Olliver and Mr Sparkes had a 10-year de facto relationship. Both had children from previous relationships. Eighteen months into the relationship, the couple established and lived in a family home until separating in January 2004.

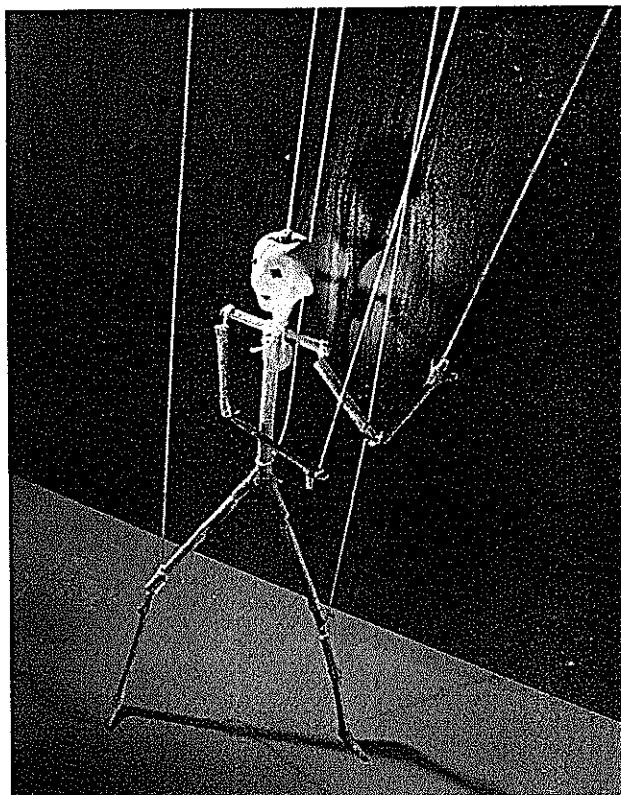
The property was registered in the name of a trust as Sparkes "had received legal advice to the effect that if he had assets owned by the trust he would be protected against any relationship property claim". The trust had a solicitor as settlor, three trustees – Sparkes, an accountant, and a solicitor, and Sparkes was appointor. Until separation, the primary beneficiaries were Sparkes and Olliver.

After separation, the trust served a Trespass Notice on Olliver and executed a deed excluding her as a beneficiary under the trust. She was left with nothing.

Alter ego explored

Judge O'Dwyer accepted an alter ego doctrine existed in New Zealand, relying on both New Zealand and Australian family law cases. The Judge observed this was not universally accepted. His Honour referred to the High Court decision of Justice Chisholm in *Wilson & Clyma*, where Justice Chisholm held that the alter ego doctrine existed only as a means of helping to prove the existence of a sham trust (at [57] – [59]), in contrast to other family law High Court cases.

Judge O'Dwyer distinguished this decision. He relied on Justice Chisholm not explicitly distinguishing the family alter ego cases *Prime v Hardie* and *Glass v Hughey*, allowing a distinctly family law doctrine to be pursued. He states that Justice Chisholm "noted that there was an emerging line of authorities ... where the Courts have been prepared to treat a trust as the alter ego of the person in control of trust property, particularly where



there is a relationship property claim."

Factually, his Honour found that the trust was Sparkes' "puppet", stating "this trust in reality was treated as if it was under Mr Sparkes' sole control". These factors were:

- **Trust Intention:** To remove his property from relationship property claims whilst retaining full benefit and control;
- **Operational deficiency:** No records, evidence of meetings, or minute books;
- **Financial Merging:** No acknowledgements of debt or advances, mortgage repayments met through parties' joint account. Trust tax returns did not show mortgage liability or any rentals received to offset that liability, and renovations to the family home not paid for by the trust;
- Mr Sparkes' decisions dominated – not the trustees:
 - Solicitor's letter in support of trespass order: "Mr Sparkes tells us that she (Ms Olliver) is in the process of being removed as a beneficiary in any event, as he is entitled to do";
 - Failure of trustees to approach Olliver as an equal primary beneficiary prior to deed of exclusion being executed;
- Affidavit evidence from Sparkes that he was in control of the Trust: "I had always made it clear to her that I had to retain control..."

Alter ego v sham

Sham and alter ego doctrines were distinct concepts. The trust being a "puppet" of the settlor does not make the trust a sham. A sham "can either exist from the outset or develop over time if the parties develop an intention to mislead. The intention to mislead must be shared by all the trustees and parties" (at [66]). It was found that no shared intention to mislead existed in this case. Here, one trustee had control and the others acquiesced. This had important consequences in terms of remedies.

Consequences of alter ego

Where a trust is a sham, the trust is void. This allows the court to treat the assets as if they were relationship property and divide the assets accordingly. If this trust had been a sham, it is likely Olliver would have a 50 per cent share of the proceeds of sale of the family home.

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This is not so in alter ego situations. Judge O'Dwyer stated he "doubt(s) ... the Court [can] simply disregard the terms of the trust and treat the assets as Mr Sparkes' property" (at [67]). Trustees of alter ego trusts may engage in genuine transactions in good faith, even though carried out by the direction of one party. They may have no shared intention to mislead as to the legal rights and obligations of the trust.

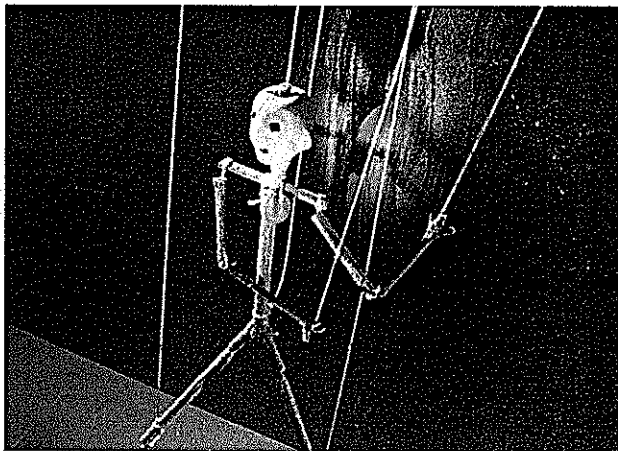
In these circumstances, His Honour believed the Court could "impose a constructive trust over the express trust to recognise and compensate the applicant for her contribution to the trust property. However, that remedy should only be considered if the applicant has no remedies under the PRA. This flows from [section] 4 of the PRA. The Act is a code... If satisfactory remedies are not available under the Act, the Court can impose a constructive trust because of contributions to trust property."

The Court found that under the constructive trust umbrella, Olliver had a reasonable expectation of an interest in the home. That was quantified at 33 per cent – the extent of contributions made over the relationship.

His Honour found that an order should be made under the PRA as a priority if one was available. He found that section 44C of the PRA was available to Olliver, as relationship property had been disposed of to the trust with the effect of defeating her claims under the PRA. She was entitled to 33 per cent of the proceeds of sale – not 50 per cent. This is because relationship property was disposed of to the trust for over nine years. The trust gave some consideration for the dispositions as Olliver had the benefit of living in the home. Also, Sparkes had made considerably higher contributions to the property. The decision also took into account Olliver's removal as a beneficiary.

Views of senior counsel

Barrister Mark Vickerman is of the view that the case highlights "the emerging doctrine of alter ego and the remedy of the constructive trust. It harks back to the pre-PRA law for de facto relationships.



Lawyers' attacks on problem trusts and their assets are many and varied

"Property obviously controlled by one partner will create an assumption of ownership and expectation that contributions to the relationship will produce an interest in that property. But so far the remedy appears to be stuck in pre-PRA notions of unequal sharing according to elusive contributions rather than presumptions of equality.

"Given the limitations of section 44C, the development of the doctrine is nevertheless to be welcomed."

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