Who Bears the Burden for Business Losses: To What Extent Are Liability Issues of Business Structures Taught in Australian Accounting Degrees?

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Running a business has its risks, especially as many fail in their early years of operation. The question as to which stakeholders associated with the business bear the loss is an important issue, which will largely depend on the business structure used. Accountants play a central role in the choice of business structure with their clients, with research demonstrating that liability issues are a central consideration. The Australian undergraduate accounting curriculum is heavily focused on sole proprietors, partnerships and companies, with scant coverage of trusts despite them being a popular business structure in Australia. This article goes back to first principles and examines whether there is justification for the differential coverage in the accounting curriculum on the liability issues concerning the various business structures. It will be argued that the liability issues with respect to trusts are just as important as that for the other popular business structure used to reduce liability exposure, being the company.

I. Introduction

In this article, it is argued that in Australia trusts are nearly as popular as companies as a business structure and that the law surrounding trusts are just, if not more, complicated as company law. If this is the case, this brings into question whether there is sufficient coverage of the liability issues concerning trusts in the Australian accounting curriculum given the historic focus on companies.

Accountants are seen as a trusted professional adviser and can be considered the most important adviser in the set-up phase of a business structure.[1] An integral part of being a "professional" is the educational requirements.[2] Indeed, professionals are seen as having specialised knowledge, training, qualifications and intellectual skills required for the work they will encounter.[3] These education requirements can canvass both technical knowledge and generic skills. Technical knowledge represents knowledge about a particular discipline area, whereas generic skills are not discipline specific and can be applied to a variety of contexts, including higher education and the workplace.[4] As part of this, there is increased awareness that Australian universities need to produce employable "work-ready"

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[1] P Davidsson, P Steffens and S Gordon, "Comprehensive Australian Study of Entrepreneurial Emergence (CAUSEE): Design, Data Collection and Descriptive Results" in K Hindle and K Klyver (eds), *Handbook of Research on New Venture Creation* (Edward Elgar, Cheltenham, 2011) 24.

[2] N W Hamilton, "Assessing Professionalism: Measuring Progress in the Formation of an Ethical Professional Identify" (2008) 5 *University of St Thomas Law Journal* 8.

[3] R Beck, P Beares and S Siegel, *Consumer Lending* (American Bankers Association, Washington, DC, 4th ed, 2001); C Howden and A D Pressey, "Customer Value Creation in Professional Service Relationships: The Case of Credence Goods" (2008) 28 *The Service Industries Journal* 789.

[4] N Bennett, E Dunne and C Carré, *Skills Development in Higher Education and Employment* (SRHE & Open University Press, Buckingham, 2000).

graduates to survive in a rapidly changing work environment.[5] To ascertain what this means in terms of generic and technical skills, it is essential to consider the employment context that graduates will find themselves in.[6]

There have been concerns raised about Australian accounting graduates in terms of their skills and knowledge. Much of this concern focuses on accounting graduates' generic skills and the expectation gap between them and employers.[7] However, there have been some research concerns about the technical knowledge being taught to Australian accounting graduates. In particular, the research project funded by the Australian Learning and Teaching Council "Accounting for the Future: More than Numbers" noted there were frequent comments by employers about the need for ongoing training for accounting graduates in terms of superannuation, tax and trusts and companies.[8] Given the growing utilisation of self-managed superannuation funds (SMSFs), a curriculum audit raised concerns about the adequacy of the Australian accounting undergraduate coverage of them.[9] Also, concerns have been raised as to whether Australian undergraduate accounting curriculum adequately prepares graduates in terms of the business structures they are likely encounter in practice, especially trusts.[10] Issues have also been raised about the overall legal literacy that accountants require as professional business advisers, even though they will not be drafting legal documents.[11] Cartan and Vilkinas have proposed a framework of how legal literacy could be formulated for business students in terms of the transactions and events that are likely to involve legal issues.[12]

In terms of business law content, the two main accounting professional bodies in Australia only require graduates to complete the following business law courses in their undergraduate degrees: Commercial Law, Corporation Laws and Taxation Law.[13] It is likely this accreditation requirement influences the structure and content of accounting degrees, as a survey of 231 Australian academics indicated that this is the major driver in designing program requirements.[14]

In the United States, there have been concerns about the legal education training of accountants, with increased legal business education said to be needed due to the critical role that law plays in society, especially with business structures and the ethical implications that this can entail.[15] Also, questions have been raised as to whether the American curriculum has stayed up-to-date and is representative of

[5] R Leong and M Kavanagh, "A Work-integrated Learning (WIL) Framework to Develop Graduate Skills and Attributes in an Australian University's Accounting Program" (2013) 14 *Asia-Pacific Journal of Cooperative Education* 1; M Low et al, "Accounting Employers' Expectations – The Ideal Accounting Graduates" (2016) 10 *e-Journal of Business Education & Scholarship of Teaching* 36.

[6] B Bui and B Porter, "The Expectation-performance Gap in Accounting Education: An Exploratory Study" (2010) 19 *Accounting Education: An International Journal* 23.

[7] M Kavanagh and L Drennan, "What Skills and Attributes Does an Accounting Graduate Need? Evidence from Student Perceptions and Employer Expectations" (2008) 48 *Accounting and Finance* 279; B Jackling and P De Lange, "Do Accounting Graduates' Skills Meet the Expectations of Employers? A Matter of Convergence or Divergence" (2009) 18 *Accounting Education* 369.

[8] P Hancock et al, *Accounting for the Future: More than Numbers* (Final Report, Australian Learning and Teaching Council, Canberra, 2009) Vol 1, 54, 58.

[9] B Freudenberg and D Boccabella, "Can Stakeholders Be Satisfied with Accountants' Education to Act as Advisors to Self-managed Superannuation Funds" (2016) 2 *Financial Planning Research Journal* 36.

[10] B Freudenberg and D Boccabella, "Changing Use of Business Structures: Have University Business Law Teachers Failed to Reflect This in Their Teaching?" (2014) 9 *Journal of the Australasian Tax Teachers Association* 180.

[11] B Freudenberg, "Beyond Lawyers: Legal Literacy for the Future" (Law Research Seminar, Graduate School of Business and Law, RMIT University, Melbourne, 26 May 2016).

[12] G Cartan and T Vilkinas, "Legal Literacy for Managers: The Role of the Educator" (1990) 24 *The Law Teacher* 246.

[13] CPA Australia and CA ANZ, *Professional Accreditation Guidelines Australia and New Zealand* (CPA Australia and CA ANZ, Australia, 2012) 12–13. Note that the Institute of Chartered Accountants of Australia requires the three courses listed to be undertaken, but CPA Australia allows the Taxation Law course to be undertaken in a candidate's professional examination process.

[14] K Watty, "Quality in Accounting Education: What Say the Academics?" (2005) 13 *Quality Assurance in Education* 120, 123.

[15] S Gunz and J McCutcheon, "The AICPA in Crisis and How It Impacts the Business Law Dispute" (2002) 20 *Journal of Legal Studies Education* 203.

the growing popularity of alternative business structures, compared to the traditional ones of companies and partnerships.[16]

Further study by accounting graduates with the two major professional bodies is also unlikely to further their legal knowledge, especially of business structures. Pursuant to the CPA Program, there are four compulsory subjects, two electives and a practical component. The compulsory subjects are ethics and governance, financial reporting, strategic management accounting, and global strategy and leadership. Also, the two courses "advanced taxation" and "advanced audit and assurance" are compulsory if not completed at the undergraduate level. Otherwise the electives include financial risk management and contemporary business issues. The CA ANZ Program is similar and has five courses: audit and assurance, financial accounting and reporting, management accounting and applied finance, taxation and a capstone course.

This article goes back to first principles and examines whether there is justification for the differential coverage in the accounting (business law) curriculum on the liability issues concerning the various business structures that are popularly used being companies and discretionary trusts. Given the popularity of trusts in the Australian commercial context vis-a-vis the other heavily used business structures, the article will argue that the liability issues with respect to trusts are just as important as that for those other structures.

The structure of this article is as follows. First, in Pt II, there will be a discussion about the different business structures utilised in Australia, which will highlight the popularity of both discretionary trusts and companies. Evidence will be provided about how accountants play an important role in this choice of business structure and how asset protection and liability issues can dominate their considerations. In Pt III, there is a discussion about the liability issues that can arise when the business structures of a sole proprietor, partnership, trust or company are utilised. It will be argued that the liability issues with respect to discretionary trusts involve greater uncertainty of outcome compared to that for companies, with the position of sole traders and partnerships also provided as a contrast. Then real-world examples will be canvassed where advisers appear to have largely failed to comprehend the nature of a trust (Pt IV). This will be followed in Pt V by empirical evidence about the likely topic coverage of the law relating to companies and discretionary trusts in the Australian accounting undergraduate curriculum. The article concludes that the current situation of scant coverage of trusts (including the liability issues) in accountants' undergraduate business law curriculum is a major concern that needs to be seriously reappraised.

II. Role of Accountants for Choice of Business Structure

In Australia, there is an array of business structures available to be utilised. The choice of business structure can be a fundamental decision as it influences such things as the management structure, ability for the raising of equity, the tax consequences for profits and losses and liability exposure and asset protection. Indeed, the introduction of the modern company over 100 years ago has been celebrated as a critical contribution to modern economic development, due in part to the ability to raise equity from diverse sources while providing some liability protection.[17]

When considering income tax return data, of the 2,999,190 taxpayers in 2012 who indicated that they were conducting a business, 36% were sole proprietors, 27% companies, 25% trusts and 12% partnerships (Table 1). In terms of trusts, approximately 78% of them are a type of discretionary trust.[18] Consequently, it can be appreciated that when a formal business structure is being used, the dominant structures are that of the company and the discretionary trust. Part of this popularity may be attributed to the liability and asset protection that these structures can provide investors. D'Angelo attributes part

[16] H Friedman, "The Silent LLC Revolution — The Social Cost of Academic Neglect" (2004) 38 *Creighton Law Review* 35.

[17] J Farrar, *Contemporary Issues in Company Law* (CCH, New Zealand, 1987).

[18] Freudenberg and Boccabella, n 10, 190, per Australian Taxation Office, *Taxation Statistics 2012* (Australian Taxation Office, Canberra, 2014).

of the popularity of trusts to the uncertainty surrounding the law applying to them and how this can frustrate creditors' rights and thereby inadvertently improve liability protection for investors.[19] This asset protection can be useful for beneficiaries in situations of divorce and bankruptcy.[20] In comparison, it has been argued that the lack of liability protection with general partnerships is part of the reason for their steady decline in use both in Australia and in overseas.[21]

Also, there have been assertions that popularity of trusts is based on aggressive tax planning opportunities and/or the ability to frustrate creditors.[22] These tax reasons include the following: trusts allow for the flow-through of tax concessions (compared with corporations); access to discounted capital gains and the non-CGT status of an interest of a mere object (beneficiary) in a discretionary trust.[23] A study by Freudenberg found that Australian advisers ranked discretionary trusts as the business structure that gave the greatest tax benefits/savings.[24] These tax savings were perceived by advisers as outweighing any potential increased compliance cost imposed by the trust compared to other business structures.[25] This is consistent with Scholes and Wolfson's theory, the choice of business structure involves a trade-off between tax costs and non-tax (transaction) costs,[26] and the business structure will be chosen that results in the best trade-off.

TABLE 1. AUS: Lodgement of Tax Returns – Business

Entity	2009–2010	2010–2011	2011–2012
Individual (sole proprietor)	1,044,386	1,057,392	1,067,700
Company	779,250	788,985	817,855
Partnership	382,400	370,000	359,905
Trust	702,080	729,620	753,730
Total (exc super)	2,908,116	2,945,997	2,999,190
Self-managed super fund	373,195	391,165	424,360
APRA and other funds	4,500	4,100	3,695

Note: Limited partnerships are not recorded separately and are included in the company figure. In 2010, there were 386 limited partnerships with taxable income greater than $0: Table 3.[10,26,27]

Source: Australian Taxation Office, *Taxation Statistics 2012* (Australian Taxation Office, Canberra, 2014), Table 1.

[19] N D'Angelo, "The Trust: Evolution from Guardian to Risk-taker, and How a Lagging Insolvency Law Framework Has Left Financiers and Other Stakeholders in Peril" (2009) 20 JBFLP 279.

[20] R Vann, "Taxation of Small Business" (Working Paper Series, University of Sydney, Law School, 2012).

[21] R W Hillman, "Limited Liability and Externalization of Risk: A Comment on the Death of Partnership" (1992) 70 *Washington University Law Quarterly* 477.

[22] Vann, n 20.

[23] Vann, n 20.

[24] B Freudenberg, "Tax on My Mind: Advisors' Recommendations for Choice of Business Form" (2013) 42 ATRev 33, 48.

[25] Freudenberg, n 24, 48.

[26] M S Scholes and M A Wolfson, *Taxes and Business Strategy: A Planning Approach* (Prentice-Hall Inc, Upper Saddle River, New Jersey, 1992).

[27] According to statistics for Australian Business Numbers, there are currently 2684 limited partnerships registered with an Australian business number. See <www.abr.business.gov.au/StatisticalSearchResult.aspx> 27 July 2012. Note that the formation, operation, etc of limited partnerships is governed by State and Territory law. The statistics available as to the number of limited partnerships in each jurisdiction are as follows: Queensland: 276 (unincorporated) and 10 (incorporated); New South Wales: 844 (unincorporated) and 119 (incorporated); Tasmania: 123; Australian Capital Territory: 1; Northern Territory: Zero; other States: Western Australia, South Australia and Victoria do not have a central register of limited partnerships. Limited partnerships can be registered with a number of bodies, which keep different databases. Additionally, partnerships may be registered with more than one body. As such, it is not possible to obtain figures for these three States.

In terms of size, 99.6% of sole proprietors have less than $2 million in turnover (Table 2). Excluding those taxpayers who have "nil business income" and superannuation funds, of the businesses with less than $10 million income (categorised by the Australian Taxation Office as "small"), 45% are sole proprietors, 29% companies, 12% partnerships and 13% trusts. Additionally, another 261 000 trusts are used for passive investments purposes (such as holding rental properties – which is technically not business purposes). However, the greatest majority of trusts (91%) are used for micro businesses with annual turnovers less than $2 million. For taxpayers with business income greater than $10 million, the corporation is the most popular (74%), followed by trusts (19%), partnerships (5%) and sole proprietors (2%). This re-enforces the dominance of both companies and trusts, especially for larger operations.

TABLE 2. AUS: Lodgement of Tax Returns – Size

Entity Size	Individuals	Companies	Super Funds	Partnerships	Trusts	Total
Loss (<$0)	1,400	1,790	35	275	735	4,235
Nil (ie not in business)	11,668,330	110,405	59,290	69,170	436,105	12,343,300
Micro (>$0 but <$2 million)	1,062,640	635,150	368,410	281,690	290,480	2,638,375
Small (>$2 million but <$10 million)	3,285	53,805	120	7,615	22,070	86,900
Medium (>$10 million but <$100 million)	360	14,535	100	1,050	4,150	20,200
Large (>$100 million but <$250 million)	10	1,185	40	65	150	1,450
Very large (>$250 million)	0	1,010	60	40	35	1,150
Total	12,736,030	817,885	428,055	359,905	753,730	15,095,605

Note: With the figures above, it needs to be highlighted that, for companies, the numbers are inflated, as a number of business forms are deemed for tax purposes to be companies (eg limited partnerships and certain public unit trusts).

Source: Australian Taxation Office, *Taxation Statistics 2012* (Australian Taxation Office, Canberra, 2014), Table 2.

Given the numerous consequences of the choice of business structure, it is understandable that professional advisers are consulted in this process.[28] Research from the United Kingdom demonstrates that in terms of setting up business structures, accountants are likely to play a dominant role, compared to other professional advisers such as lawyers.[29] For example, Hicks et al found that 70% of companies were set up by accountants, whereas only 12% were set up by solicitors.[30] This is supported in part from evidence in Australia that demonstrates that accountants are the most important consultant for

[28] However, it should be noted that for small business operations, evidence from the United Kingdom suggests that formal advice is not sought in approximately two thirds of cases: A Hicks, R Drury and J Smallcombe, "Alternative Company Structures for the Small Business" (ACCA Research Report No 42, Certified Accountants Educational Trust, London, 1995).

[29] Hicks, Drury and Smallcombe, n 28.

[30] Hicks, Drury and Smallcombe, n 28, 16. For a greater discussion about these studies, see Freudenberg, n 24.

entrepreneurs in the start-up phase.[31] This is despite the fact that advice in terms of which business structure should be used could be considered legal advice and outside the scope of what accountants are permitted to charge for. It has been argued that accountants can play a key role in the formation, operation and dissolution of a business.[32] This active role of accountants has raised concerns about the role of accountants in dealing with legal and governance documents. For example, in terms of trusts, Hor has highlighted that accountants may not have "the expertise or experience to properly understand the trust deeds that they are reviewing".[33] Hor notes that the involvement by accountants in amending a trust deed itself for a client may constitute the provision of "legal advice, which it is illegal for an unqualified person to provide for a fee".[34] While it is agreed that accountants should not be giving legal advice, they still need a certain level of legal literacy to identify potential legal issues and know when and how to consult the experts in legal matters to pursue their clients' legal rights and obligations.[35] Such an increase in accountants' legal literacy appears to be supported by the educational requirements of the Tax Practitioners Board, which require tax agents have greater legal education, especially in relation to business structures, than is currently provided in many Australian accounting degrees.[36]

Consequently, it would appear that reflecting upon accountants' role and their education with respect to business structures is important.

Australian research demonstrates for professional advisers when advising on business structures an important consideration is around liability, with such notions of asset protection, risk and limited liability dominating their advice. A survey of Australian professional advisers, who were predominately accountants (85%), found that the most important issue when advising on a business structure was "asset protection" (average ranking of 8.26 on a 10-point scale).[37] Asset protection was seen to be more important than "tax benefits/savings", which was ranked second (average ranking of 6.84 on a 10-point scale).[38] Also ranking in the top five issues were the notion of "level of risk" (5.96), "limited liability" (5.95) and "business expansion" (5.98). Indeed, it was argued that the notion of asset protection may be more important than limited liability itself, as due to legislative and common law duties, the notion of liability exposure is complex, and at the end of the day, protection of valuable assets is important.[39] Research from the United Kingdom supports that liability protection can be the most important characteristic when choosing a business structure, especially a company.[40] Consequently, it is important to reflect upon the liability issues that arise with respect to the different business structures available in Australia.

III. Liability Issues with Business Structures

The "choice of operating entity" question (or asset holding vehicle question) is one of the most important to face a person (and their advisers) contemplating the pursuit of a business or the purchase of investment assets. Many considerations are involved including the features and attributes of each entity type and the desires and goals of the relevant person and their family.

[31] Davidsson, Steffens and Gordon, n 1, 24.

[32] Freudenberg and Boccabella, n 10, 192–196.

[33] B Hor, "Reviewing Family Trust Deeds — It's Not Just About Tax!" (2012) *Taxation in Australia* 90, 90.

[34] Hor, n 33, 91.

[35] Freudenberg, n 11.

[36] For the educational requirements of Tax Agents, see <http://www.tpb.gov.au/> and Freudenberg and Boccabella, n 10.

[37] Freudenberg, n 24, 47.

[38] Freudenberg, n 24, 47.

[39] Freudenberg, n 24, 47.

[40] Hicks, Drury and Smallcombe, n 28, 17; J Freedman and M Godwin, "Incorporating the Micro Business: Perceptions and Misperceptions" in A Hughes and D Storey (eds), *Finance and the Small Firm* (Routledge, London, 1994) 111.

One of the central considerations though, if not the key consideration, is limiting liability to third parties (external parties). In particular, business operators are keen to "outsource" the risk associated with the failure or lack of success of their enterprise, so that the risk is borne by creditors and others that deal with the "operating entity", rather than the business operators and/or their family. Suppliers or other creditors of the enterprise do not want that risk or at least seek to minimise it or be able to make an informed decision to take it on.

The aim of this section is to provide an outline of the liability rules that apply in regard to each of the four main types of "entities" used in Australia to carry on business.[41] The coverage is sufficiently detailed to allow the reader to obtain an appreciation of the fundamental rules[42] for each entity so that a comparison can be made across entities as to where the economic burden (and therefore the risk) of debts and liabilities incurred will fall (eg equity investors, creditors).[43] Importantly, this section is also designed to allow the reader to appreciate the degree of uncertainty surrounding the fundamental rules, and from there, uncertainty of outcome, for each entity.

This section also contributes in helping the reader, in particular, business law academics at Australian universities, to consider the appropriate curriculum coverage in relevant business associations law courses. However, the precise coverage of which liability issues is beyond the scope of this article and can be addressed in future research.

Some constraints in coverage are worth noting. First, business or asset holding structures often involve much more than just one operating entity, usually with the aim of buttressing or maximising the limitation of liability aims of those behind the relevant business. These entity and asset holding structures can take many shapes. To attempt to deal with all or even some of the combinations would expand the article to an intolerable extent. Accordingly, this article will focus on the liability issues as they relate to an operating entity.

Second, coverage of the rules is limited to a noninsolvency or nonbankruptcy situation. Even though the outcome may not change markedly, entry by the "operating entity" into insolvency or bankruptcy raises an extra range of issues.[44] To deal with these here would also extend the article to an intolerable extent with only marginal benefit. Third, the division of property issues that arise on relationship breakdown will not be examined in this article.[45] Fourth, the focus is on debts and liabilities arising under contract, rather than liabilities for torts and wrongs.

Sole Proprietors

The sole proprietorship situation is where a natural person carries on an enterprise.[46] That is, the natural person is both the legal and beneficial owner of the assets and the business, and therefore contracts and

[41] They are the i) sole proprietor, ii) partnership, ii) trust and iv) company. Of course, some of these are not entities in the sense of having a separate legal existence independent of their [equity] owners.

[42] When it comes to rules concerning where liability for an entity's debts should fall, there are numerous exceptions and qualifications to the general or fundamental rule(s). For example, the exceptions to, or departures from, the separate legal entity rule for companies are effectively exceptions to the fundamental liability rule, see R P Austin and I M Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law* (LexisNexis Butterworths, 16th ed, 2015) [4.245]–[4.250] for a brief summary of the main exceptions. As far as possible, this article will be restricted to the fundamental rules for each entity; to deal with even a small number of exceptions would significantly extend the article for marginal benefit vis-à-vis the purpose of the article.

[43] The focus is on unsecured creditors and not secured creditors. Secured creditors, eg providers of loan capital will usually have security over assets and/or personal guarantees from associates of the borrower to secure repayment of debt.

[44] This would include such things as i) whether certain rights form part of the divisible property pool of the insolvent debtor and ii) reconciling the claims of multiple creditors under the respective regimes.

[45] While ascertaining the divisible property pool on relationship breakdown and orders for division of property under the *Family Law Act 1975* (Cth) can be seen as an aspect of "asset protection" for the relevant parties, that process does not generally interfere with outside creditors' rights.

[46] Commentators do not usually talk in terms of a company operating a business as a sole proprietor of that business. There may be a better descriptor than the term "sole" to indicate a natural person sole proprietor.

dealings with other parties, is entered into with the natural person.[47] The enterprise or activity is not a legal person, and hence, the "activity" has no separate legal existence independent of the legal owner and operator.

There is no specific legal regime dealing with the debts and liabilities of a sole proprietor. However, the legal position is clear from the general law. Subject to negotiated or implied contractual limitations with creditors, the sole proprietor is liable to an unlimited extent for the debts and liabilities arising from the activity. The liabilities are personal to the sole proprietor. This means that creditors can call on payment even if the sole proprietor has to draw on resources and assets that are not employed in the business that gave rise to the debt or liability.

Unless express clarification has been sought, those trading with the sole proprietor (eg suppliers) will not necessarily know they are trading with a sole proprietor in their beneficial capacity. While suppliers may be aware that they are not trading with a company (either beneficially or as trustee of a trust),[48] they may not necessarily know when the "sole proprietor" is a [natural person] trustee of a trust.[49] Finally, a sole proprietor is required to register its business name on the Business Names Register if he or she carries on business under a name other than their name.[50]

Assets Held in a Separate Name

It is worth noting briefly[51] that when an asset is legally owned by a person, or is "in someone's name", it does not necessarily mean the person is the beneficial owner of the asset or part of it under the general law.[52] Put another way, when an asset is not legally owned by a person (not in person's name), it does not necessarily mean that the person does not have beneficial ownership of the asset or part of it. The key aim of putting assets into someone else's name is to keep another [associated] person "asset-less" so that creditor claims against the latter person are ineffective.

Two areas of law (resulting trust and presumption of advancement), somewhat interrelated, are briefly canvassed. First, a resulting trust may arise in favour of a person (A) who has purchased property (with their own funds), but has directed the seller (B) to transfer the property into the name of a third person (C). In the absence of a contrary intention, equity will assume that C holds the property on trust (resulting trust) for the benefit of A. If a resulting trust arises, A will be the beneficial owner of the property and therefore A will not be asset-less. A resulting trust will also arise where two parties contribute to the purchase of property, but the property is only put into the name of one of them. A resulting trust will arise so that the property will be held on trust for the contributors of the purchase cost in proportion to their contribution to the purchase cost.

The assumption of a resulting trust can be rebutted (negatived) where there is evidence that a resulting trust was not intended and/or that the parties did intend that beneficial interests in the property were not to be held in proportion to contributions. In a sense, the assumption of resulting trust is displaced if the contributor intended to make a gift to the other person.

Second, under the presumption of advancement, equity will assume or presume that a person intended to make a gift of property to another. It can arise on purchase of property from funds from one

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[47] Where legal and beneficial ownership of an asset or "business" is not divided, it is appropriate to talk in terms of ownership per se, or legal ownership per se.

[48] It seems strange to talk in terms of a company having a beneficial capacity when the company is an artificial legal person or "mere piece of paper" or a mere vehicle for natural person shareholders to pursue economic gains. Yet, that is the legal position: *Macaura v Northern Assurance Company Ltd* [1925] AC 619, 626; *Ord Forrest Pty Ltd v Federal Commissioner of Taxation* (1973) 130 CLR 124; 74 ATC 4034, 4041.

[49] There may be an incentive for the natural person to reveal their trustee capacity if they can secure from creditors a contractual limitation of liability to trust assets; see later discussion under "Trustee Primarily Liable for Debts and Liabilities of the Trust".

[50] *Business Names Registration Act 2011* (Cth) s 18.

[51] The issues canvassed here are not just relevant to the sole proprietor situation. They are relevant whenever there is a need to determine the extent of a person's assets or net assets.

[52] P Agardy, *Risky Business: What Happens to Personal Assets When Business Fails?* (The Federation Press, 2012) 3.

person, unequal contributions to the purchase cost of property and direct transfers of already owned property. The presumption only arises in the case of two relationships: i) transfers, etc from husband to wife and ii) transfers, etc from parent (mother or father) to child (adult children included).

Like the assumption of a resulting trust, the presumption of advancement can be rebutted (negatived) by evidence of a contrary intention. Effectively, a successful rebuttal involves the conclusion that a resulting trust arises, so that the beneficial interest(s) in the relevant property is held in proportion to amounts contributed. Or, in the case of a direct property transfer, the beneficial interest stays with the transferor.

Partnership

The rules surrounding partnerships involve a combination of State and Territory (State) legislation, common law and the rules of equity.[53] A partnership exists when two or more persons carry on business in common with a view to making a profit. It being contractual in nature, the intention (often expressed in a written agreement) and/or conduct of the parties largely governs the question of the existence of a partnership and the rights and obligations as between partners.

A partnership is better described as a relationship rather than an entity. The partnership does not obtain a legal personality (legal persona) or existence, separate from the people comprising it (partners). This is the case even though the partnership is a vehicle for the pursuit of economic gain for the partners. This is also the case even though i) the commercial world often views the partnership as an entity (eg use of the term "firm"), ii) there are court rules that allow those suing partners to bring an action in the name of the firm (partnership)[54] and iii) the tax law gives semientity status to the partnership.[55]

The partnership's existence only continues for as long as the same people are associated in pursuing the business. There is no doubt that a husband and wife (or two people living together on a genuine domestic basis) can be in partnership.

Finally, there is no requirement that a partnership register with a regulatory agency that "it" is operating a business. Those trading with the partnership (eg suppliers) will not necessarily know they are trading with a partnership, and if so, the number of partners.[56] However, if the partnership is trading under a business name other than the names of its partners, there is a requirement to register the partnership's business name on the Business Names Register.[57]

Liability Rules

In terms of liability, the starting point is s 9(1) of the *Partnership Act 1892* (NSW) which states that, "[E]very partner in a firm is liable jointly with the other partners for all debts and obligations of the firm incurred while the partner is a partner."[58]

A few observations can be made. First, the liable parties are the partners; the existence of a partnership does not preclude the partners from being liable for the debts and liabilities of the partnership. Second,

[53] Every State and Territory (States) in Australia has partnership legislation. The relevant legislation is Queensland (*Partnership Act 1891* (Qld)); New South Wales (*Partnership Act 1892* (NSW)); Australian Capital Territory (*Partnership Act 1963* (ACT)); South Australia (*Partnership Act 1891* (SA)); Northern Territory (*Partnership Act 1997* (NT)); Tasmania (*Partnership Act 1891* (Tas)); Victoria (*Partnership Act 1958* (Vic)); and Western Australia (*Partnership Act 1895* (WA)). The *Partnership Acts* in Australia are largely a codification of, or restatement of, the common law rules and the rules of equity.

[54] See, eg *Supreme Court (General Civil Procedure) Rules 2005* (Vic) reg 17.01(1) and *Uniform Civil Procedure Rules 1999* (Qld) r 83.

[55] Various definitions deeming a partnership to be a taxpayer for calculation purposes in *Income Tax Assessment Act 1936* (Cth) s 90 and *Income Tax Assessment Act 1997* (Cth) s 900-100(1)(d).

[56] Partners may have an incentive to reveal that they are contracting as a partner to help guarantee joint liability for debts; this is discussed later in the article.

[57] *Business Names Registration Act 2001* (Cth) s 18.

[58] The position is the same in other States' *Partnership Acts*.

partners are liable to an unlimited extent for the debts and liabilities arising from the partnership's business. There is no limitation in the *Partnership Acts*. The liabilities are personal to each partner. This means that creditors can call on payment even if the partner has to draw on resources and assets that are not employed in the partnership's business from which the debt or liability arose.

Third, the liability is "joint", and not "joint and several". Prior to the introduction of procedural rules of State Supreme Courts allowing for a partnership to be sued in its own name (or sue in its own name), there were procedural pitfalls for those taking legal action against partners in a partnership. Briefly, partners who are [purportedly] jointly liable for a debt could insist that all partners are sued together. If the creditor only sues (joins) some of the partners and those partners consent to this, the creditor cannot subsequently proceed in a separate action against the partners who were not sued.[59]

In every State, aside from New South Wales, there are procedural rules that allow a partnership to be sued in its own name, or to sue in its own name.[60] This overcomes the problem of identifying and suing all the partners, and the pitfalls of failing to identify all the partners (see above). If a creditor chooses to sue "the partnership" pursuant to the State procedural rules, the creditor is deemed to have sued all the partners, thereby overcoming the pitfalls stated above.

Exceptions to Unlimited Joint Liability

Every State *Partnership Act 1892* contains a statutory agency rule, which reflects the common law rule.[61] The New South Wales rule reads:

> Every partner in a partnership … is an agent of the firm and of the other partners for the purpose of the business of the partnership; and the acts of every partner who does any act for carrying on in the usual way business of the kind carried on by the firm of which the partner is a member, binds the firm and the other partners, unless the partner so acting has in fact no authority to act for the firm in the particular matter, and the person with whom the partner is dealing either knows that the partner has no authority, or does not know or believe the partner to be a partner.[62]

In broad terms, there are two limbs here[63]: actual authority and ostensible (apparent) authority. Satisfaction of either limb establishes joint liability of partners, vis-a-vis the third party (creditor).[64] This is in spite of the fact that an innocent partner(s) may have an action for compensation against a wrongdoing partner that bound the firm contrary to an express limitation (ie absence of actual authority but ostensible authority existed).

Put the other way, there will be three circumstances where a partner(s) will not be liable jointly for contracts entered into by their "wrongdoing" partner. In these circumstances, the wrongdoing partner is solely liable on the contract. The circumstances are as follows: i) the contracting partner has no authority to transact and the third party (creditor) knew this, ii) the contracting partner has no authority to transact and the third party does not know the partner is a partner and iii) the contracting partner has no authority to transact and the third party does not believe the partner to be a partner.

Trust

The rules governing trusts and those dealing with them involve a combination of the trust's governing document (ie trust deed), the rules of equity and State trust or trustee legislation.[65] Given the central

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[59] *Kendall v Hamilton* [1879] 4 App Cas 504, 515–516.

[60] For example, see *Supreme Court (General Civil Procedure) Rules 2005* (Vic) reg 17.01(1) and *Uniform Civil Procedure Rules 1999* (Qld) r 83.

[61] *Construction Engineering (Aust) Pty Ltd v Hexyl Pty Ltd* (1985) 155 CLR 541; [1985] HCA 13, [11]–[12].

[62] *Partnership Act 1892* (NSW) s 5(1).

[63] *Construction Engineering (Aust) Pty Ltd v Hexyl Pty Ltd* (1985) 155 CLR 541; [1985] HCA 13, [11].

[64] For a discussion of each element of the two limbs, see S Graw, *An Outline of the Law of Partnership* (Lawbook Co, Sydney, 4th ed, 2011) 77–100 and K L Fletcher, *The Law of Partnership in Australia* (Thomson Lawbook Co, Sydney, 9th ed, 2007) 159–172.

[65] The relevant legislation in New South Wales is the *Trustee Act 1925* (NSW).

place of creditor rights in this article, the contract between the trustee and the creditor may also be important.

There are essentially four elements to a trust: trust property, trustee, beneficiaries and obligation on the trustee to deal with the trust property for the benefit of beneficiaries. The absence of one element will usually result in there being no trust.[66] The trust "entity" is not a uniform entity. They can vary considerably. For example, express trusts can be fixed trusts, where beneficiary entitlements are set out in the trust deed, or discretionary trusts, where beneficiary entitlements will largely depend on the favourable exercise of the trustee's discretion.[67]

In a similar way to the partnership "entity", a trust is better described as a relationship. The trust as such does not obtain or have a legal personality (legal persona) or existence. This is the case even though the trust is a vehicle for the pursuit of economic gain for the beneficiaries. This is also the case even though i) the commercial world often views the trust as an entity and ii) the tax law and other law gives semientity status to the trust.[68]

The rule against perpetuities that applies in most Australian States and to most trusts effectively means that a trust must come to an end at some time (ie trust does not have perpetual life).

Finally, subject to the qualification below, there is no requirement that a natural person trustee register with a regulatory agency that it is operating a business. A corporate trustee, as a result of incorporation (through registration) under the *Corporations Act 2001* (Cth), is necessarily registered with the Australian Securities and Investments Commission. Aside from asking for clarification, those trading with a trust (eg suppliers) will not necessarily know they are trading with a trust. If the trustee(s), both natural person and a corporate trustee, is trading under a name other than the name(s) of the trustee, there is a requirement to register the trustee's business name on the Business Names Register.[69]

What follows is a systematic, step-by-step approach that reflects the legal rules that may be relevant to an entity "dealing with" the trust in regard to a particular debt or liability. Unfortunately, the law is a little unclear in some areas. Accordingly, the main aim is to raise awareness of the "rules", and the considerations that are relevant, rather than offering a high critique of the rules.

Trustee Primarily Liable for Debts and Liabilities of the Trust

Subject to the comments below, when the trustee incurs debts and liabilities, the trustee is acting as a principal. In the first instance, this means the trustee has unlimited liability for debts and liabilities incurred by him/her/it in the course of carrying on the trusts. Put another way, the trustee's debts are its debts, and not those of anybody else.[70] This is in spite of the fact that the trustee is acting for the benefit of the beneficiaries, and not for himself/herself/itself. Again in the first instance, the trustee's personal assets (or nontrust assets) can be required to meet the debts that arose from the trust.

It is a combination of factors that leads to this result. The common law does not recognise a trust at all; it is the rules of equity that recognise a trust. But under the rules of equity, the trust is not an entity having a separate legal personality (not a person). Instead, it is an "arrangement" or "relationship". All this means is that the law of contract, itself a common law creation, applies to the contracting

[66] The absence of a trustee at a particular time, eg due to death, will not destroy a trust as a replacement trustee can be appointed. It is also worth mentioning that in order for an express trust to be validly constituted, the three certainties must be present (ie certainty of intent to create a trust, certainty of trust property and certainty of beneficiaries).

[67] This article is restricted to express trusts (trusts established under a trust deed with some care and planning) because implied trusts and resulting trusts would not be "used" to pursue economic gains on a sustained basis.

[68] The income tax law refers to a trust as an entity: *Income Tax Assessment Act 1997* (Cth) s 960-100(1)(f).

[69] *Business Names Registration Act 2001* (Cth) s 18.

[70] *Vacuum Oil Company Pty Ltd v Wiltshire* (1945) 72 CLR 319; [1945] HCA 37, [5] (Latham CJ), [23] (Dixon J); *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360; [1979] HCA 61, [13].

party, namely, the trustee. The common law does not generally recognise the representative capacity (as distinguished from personal capacity) in which a person (here, trustee) is acting.[71]

Trustee as Agent for Beneficiaries

Ordinarily, a trustee will not be an agent for beneficiaries.[72] However, if the trustee is acting as an agent for a beneficiary/beneficiaries, the trustee cannot be liable for the debts incurred; the beneficiary, as principal, is liable under [normal] agency law. In some cases, this could be a desirable outcome for a creditor.

The test seems to be that the trustee must be subject to the control of (or have the right to be controlled by) beneficiaries, along similar lines to the control that exists in a clear-cut principal–agent relationship. This is a factual question. Clauses in the trust deed that give beneficiaries power to direct the trustee could be an indicator of this control, as would the conduct of the trustee and beneficiaries.

In closely held trusts where one person has various capacities, one must be careful to identify the capacity in which he or she is exercising control "over the trustee".

In the end, it is submitted that the degree of control of the trustee by beneficiaries would have to be quite significant before a finding of agency is made.

Settlor Liability

A settlor or creator is a party to the creation of an express trust; the person who has agreed to act as trustee of the trust is the other.[73] The settlor (sometimes called the contributor) is the person who contributes the initial sum or property to the trust in order for it to get started.[74] Often, a so-called nominal settlor who contributes $10 will be used to create the trust (eg employee in advising accountant's office).

The generally accepted position is that even though the settlor has requested the trustee to assume the office of trustee wherefrom debts and liabilities will be incurred, the settlor is not obliged to indemnify the trustee for its trust debts and liabilities. There appear to be two recognised exceptions (ie settlor indemnifies trustee and trustee is agent for settlor), but they will rarely be made out.

Limitation of Liability through Contract

A trustee can negotiate with each creditor contractually to limit the creditor's rights to payment to the assets of the trust fund.[75] While there may be very few creditors willing to do this, if done, it would be legally effective. The creditor would then bear the risk of debts and losses rising to a level above the trust fund net assets.

Personal Liability "As Trustee"

While this area of the law is a little unclear, the situation seems to be that by simply writing on a contract, a purchase order, letterhead, etc that the person is "contracting as trustee" or in "the capacity as trustee of the XXX family trust" will not be enough for the trustee to remove their [normal] personal liability.[76]

The situation might be different if there is other evidence to support the conclusion that the creditors and trustee have excluded liability by implication (eg in the past, the creditor has acted on that basis).

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[71] However the rules of equity and/or State and Territory trust or trustee legislation and/or the trust deed are likely to overcome the harshness of this outcome (ie trustee often has a right of indemnity in regard to trust debts).

[72] *Scott v Davis* [2000] HCA 52, [228] (Gummow J).

[73] Of course, there must be beneficiaries in order to satisfy one of the three certainties for the existence of a trust (ie certainty of beneficiary).

[74] This also helps satisfy one of the three certainties for the existence of trust (ie certainty as to trust property).

[75] *McLean v Burns Philp Trustee Co Pty Ltd* (1985) 2 NSWLR 623, 640.

[76] *Re Anderson; Ex parte Alexander* (1927) 27 SR (NSW) 296, 300; *Helvetic Investments Corporation Pty Ltd v Knight* (1984) 9 ACLR 773; *General Credits Ltd v Tawilla Pty Ltd* [1984] 1 Qd R 388, 389.

Trustee's Right of Indemnity against Trust Fund

To help overcome the harshness (unfairness) of the unlimited liability rule that applies to debts incurred by a trustee, the trustee is likely to have a right of indemnity out of the trust fund (trust property).[77] If this right of indemnity is available, the trustee does not have to meet expenses out of their own pocket first and then obtain reimbursement. Instead, trustees can simply meet trust expenses directly out of trust property.[78]

This right of indemnity may come from one or more sources: i) the rules of equity,[79] ii) the relevant trust/trustee legislation[80] and/or iii) the trust deed. In a particular case, it could be important to know which is under discussion (see below). The broad idea though is that as soon as the trustee incurs a trust expense[81] (or pays a trust expense),[82] this right in the trustee arises.

The legal nature of the trustee's right of indemnity against trust assets has been variously described. The most accurate description is that the trustee has a beneficial interest in the trust assets, and that this beneficial interest it to take priority over the beneficial interests held by beneficiaries, to the extent of the value of the indemnity (debt incurred or amount to be reimbursed).[83] Accordingly, beneficiaries cannot demand possession of trust assets while the trustee has an unsatisfied right of indemnity.

Condition(s) to Establish the Indemnity

The key requirement is that the expense must have been incurred in the course of carrying out the trust; it must have been properly incurred or not improperly incurred.[84] A failure to disclose to the counterparty (creditor) that he or she or it was acting in the capacity of trustee does not mean the expense was improperly incurred.[85] Also, a "mere slip" or "error of judgment" will not mean the expense was improperly incurred.[86]

Can This Right of Indemnity Be Ousted or Excluded?

Given the importance of this right of indemnity to trustees, and arguably, the institution of the trust,[87] it is hard to see how anything short of an express statement in the trust deed would be sufficient to exclude

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[77] The right of indemnity has or can have two elements. They are i) the right of exoneration (where the trustee has incurred a liability but has not yet discharged or paid it) and ii) the right of reimbursement (where the trustee has discharged or paid a trust liability with his or her own funds). This article will only refer to these two sub-elements where necessary.

[78] The right of exoneration arises when the liability is incurred. When the liability is discharged (or paid) from the trustee's own funds, the right of exoneration is extinguished and is replaced by the right to reimbursement. Where the trustee discharges the liability from trust assets, the trustee has no further rights.

[79] *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360, 367.

[80] Queensland (*Trusts Act 1973* (Qld) s 72); New South Wales (*Trustee Act 1925* (NSW) s 59(4)); Australian Capital Territory (*Trustee Act 1925* (ACT) s 59(4)); South Australia (*Trustee Act 1936* (SA) s 35(2)); Northern Territory (*Trustee Act 1893* (NT)); Tasmania (*Trustee Act 1898* (Tas) s 27(2)); Victoria (*Trustee Act 1958* (Vic) s 36(2)); and Western Australia (*Trustees Act 1962* (WA) s 5).

[81] Strictly, right of exoneration arises.

[82] Strictly, the right of exoneration is extinguished and the right to reimbursement arises.

[83] *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360; [1979] HCA 61, [13]–[14]; *Chief Commissioner of Stamp Duties (NSW) v Buckle* (1998) 192 CLR 226; 98 ATC 4097, 4105; *CPT Custodian Pty Ltd v Commissioner of State Revenue* (Vic) (2005) 224 CLR 98; 2005 ATC 4925, 4935.

[84] *Re Beddoe; Downes v Cottam* [1893] 1 Ch 547, 558; *JA Pty Ltd v Jonco Holdings Pty Ltd* (2000) 33 ACSR 691; [2000] NSWSC 147, [50].

[85] *JA Pty Ltd v Jonco Holdings Pty Ltd* (2000) 33 ACSR 691; [2000] NSWSC 147, [50].

[86] *Nolan v Collie* [2003] VR 287, [44]–[50]. The decision to instigate legal actions and defend legal actions is one area that raises difficulties in regard to the properly incurred expense question: see D S K Ong, *Ong on Subrogation* (The Federation Press, 2014) 26–26 for a discussion of the cases.

[87] *Worrall v Harford* (1802) 32 ER 250, 252 (trustee's indemnity is an incident of the office and is inseparable from it) and *Chief Commissioner of Stamp Duties (NSW) v Buckle* (1998) 192 CLR 226; 98 ATC 4097, 4106 (right of indemnity conferred on the trustee is a necessary incident of the office of trustee).

the indemnity. It seems odd to ask this question: Why would a trustee give up their right of indemnity against the trust fund and thereby be exposed in an unlimited way to debts incurred as trustee? This will be addressed below when discussing trust creditor rights.

Rules of Equity

The trustee's right of indemnity is well established under the general law (rules of equity);[88] the failure to confer this right on the trustee in the relevant trust deed does not disentitle the trustee.

The debate is whether the general law right can be ousted by the trust deed. It is fair to say there is no clear answer.[89] There are statements pointing both ways.[90] Part of the problem is that some of the cases appear to be cases on the trustee's legislative right to indemnity against trust assets conferred by State and Territory (States) trust legislation (see below). Another complicating factor is that in some States, the relevant trust legislation provides for the [statutory] right of indemnity to be excluded by the trust instrument, and in some States, it cannot be excluded.[91]

Trust Legislation

In short, every State provides a statutory rule conferring on trustees a right to be indemnified out of trust assets for expenses reasonably incurred in or about the execution of the trusts or powers.[92] However, in some States, the legislation appears to contemplate that the right can be ousted or curtailed.[93] Some of the [interrelated] issues raised by the State trust legislation are: i) Does the State trust legislation override the general law right of indemnity against trust assets so that the trust law becomes an exclusive code in regard to the conferral of this right? It is submitted the answer is "no". ii) On the assumption that the general law right of indemnity subsists alongside the statutory right conferred, does the legislation in the four "ouster States" also contemplate the ousting of the general law right, or, just the statutory right?

Trustee's Right of Indemnity against Beneficiaries

This is a separate right to the right against trust assets. It is a rule of equity, and it is not provided for in State trust legislation,[94] nor is it likely to be provided for in the trust deed.

In certain circumstances, the trustee's right of indemnity extends to beneficiaries of the trust. That is, if trust property is not enough to reimburse the trustee (or to meet the trustee's undischarged

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[88] *Vacuum Oil Co Pty Ltd v Wiltshire* (1945) 72 CLR 319, 324 (Latham CJ), 335 (Dixon J); *Octavo Investments Pty Ltd v Knight* (1979) 144 CLR 360, 367.

[89] *Moyes v J & L Developments Pty Ltd (No 2)* [2007] SASC 261, [38].

[90] In favour of the position that ousting should not be permitted are: *Worrall v Harford* (1802) 32 ER 250, 252 (trustee's indemnity is an incident of the office and is inseparable from it); *Kemtron Industries Pty Ltd v Commissioner of Stamp Duties (Qld)* [1984] 1 Qd R 576, 4386; *Chief Commissioner of Stamp Duties (NSW) v Buckle* (1998) 192 CLR 226, 246–247 (rights conferred upon the trustee as a necessary incident of the office of trustee); *JA Pty Ltd v Jonco Holdings Pty Ltd* (2000) 33 ACSR 691; [2000] NSWSC 147, [50]; and *Moyes v J & L Developments Pty Ltd (No 2)* [2007] SASC 261, [40] (right of indemnity is of benefit not only to trustees but also to creditors. A trustee ought not be allowed to waive a right enjoyed by creditors). In favour of ousting being permitted is *RWG Management Ltd v Commissioner for Corporate Affairs* [1985] VR 385, 395 (the trustee is free to waive its right of indemnity against beneficiaries, and therefore it is hard to see why the trustee should not be free to waive its right of indemnity against trust assets) and the cases cited therein. Note below that *Corporations Act 2001* (Cth) s 197(1) appears to be drafted on the basis that the general law right of indemnity can be ousted by the trust instrument.

[91] *Trusts Act 1973* (Qld) s 65.

[92] Queensland (*Trusts Act 1973* (Qld) s 72); New South Wales (*Trustee Act 1925* (NSW) s 59(4)); Australian Capital Territory (*Trustee Act 1925* (ACT) s 59(4)); South Australia (*Trustee Act 1936* (SA) s 35(2)); Northern Territory (*Trustee Act 1893* (NT) s 26); Tasmania (*Trustee Act 1898* (Tas) s 27(2)); Victoria (*Trustee Act 1958* (Vic) s 36(2)); and Western Australia (*Trustees Act 1962* (WA) s 71).

[93] Northern Territory (*Trustee Act 1893* (NT) s 26); Tasmania (*Trustee Act 1898* (Tas) s 27(1)); Victoria (*Trustee Act 1958* (Vic) ss 2(3) and 36(2)).

[94] In light of the discussion below concerning creditors of the "trust", it is unlikely that the trust deed will confer this right of indemnity.

liabilities), beneficiaries can be required to contribute to the trustee's costs. The scope of this right of indemnity is not clear, but some principles can be stated.

Where there is a single beneficiary who is the absolutely entitled owner (ie fixed trust) of trust property and who is of full legal capacity (eg over age of majority), the trustee has a right of indemnity as against the beneficiary. The right does not exist or arise where the beneficiary is underage. There is some debate about the situation where there are multiple absolutely entitled beneficiaries of full legal capacity. The court will be guided by the presence or absence of facts that make it just or unjust for the trustee to be reimbursed.[95] This right of indemnity does not apply to mere objects (potential beneficiaries) of a discretionary trust.

However, it is clear that the trust deed can exclude this right of indemnity.[96]

Creditors Rights

Given that in closely held trusts, the trustee (natural person or corporate) and beneficiaries will often be associates and/or members of one family, their interests will often be aligned, Thus, those associated with a closely held trust collectively may not be too concerned with ensuring creditors obtain payment for their debts. What they are interested in achieving is limitation of liability against "outside creditors" should the trust enterprise fail.

If the natural person trustee has assets well below the debt owed to the creditor, the creditor is not going to get his or her debt paid by that person. If there is a $2 corporate trustee, then the creditors are also not going to get their money from the company (aside from $2 of share capital). While the corporate trustee's liability to the creditor is theoretically unlimited, the company will have insufficient funds to meet the debt, and the shareholders cannot be required to subscribe more funds to the company (that would help the company meet its debt to the creditor).

The reason for this apparent unfair outcome is that, in the first instance, creditors only have a personal action against the trustee for debts. They have no rights against trust assets or beneficiaries.

Right of Subrogation to Trustee's Right of Indemnity

To overcome this potential harshness or unfairness to creditors, creditors may have access to the equitable remedy of subrogation. Subrogation involves placing one party (A) in the position of another (B) with respect to rights against third parties, so that A may enforce B's rights against the third party for A's own benefit.[97] In the current context, creditors would be placed in the position of the trustee, so that the creditor can exercise the trustee's right of indemnity against trust assets (ie obtain payment of debt).

There is some debate as to whether the right of subrogation extends to the trustee's right of indemnity against beneficiaries. The better view is that it is available in these circumstances.[98]

Limits to the Right of Subrogation

There are a number of concerns for creditors in regard to the right of subrogation. Given that it is an equitable doctrine or remedy, and not a cause of action, it is subject to the usual judicial discretion that accompanies equitable remedies and the usual equitable defences (eg delay, unclean hands).[99]

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[95] *Countryside (No 3) Pty Ltd v Best* [2001] NSWSC 1152, [31]–[39].

[96] *Kemtron Industries Pty Ltd v Commissioner of Stamp Duties (Qld)* [1984] 1 Qd R 576, 581, 584; *Ron Kingham Real Estate Pty Ltd v Edgar* [1999] 2 Qd R 439, 442.

[97] *Highland v Exception Holdings Pty Ltd (in liq)* (2006) 60 ACSR 223; [2006] NSWCA 318, [90] (Santow J).

[98] *Marginson v Ian Potter & Co* (1976) 136 CLR 161, 175–176; *Ron Kingham Real Estate Pty Ltd v Edgar* [1999] 2 Qd R 439. It is worth noting, as Denis Ong points out that the right of indemnity against beneficiaries can only apply to the right of exoneration element (and not the reimbursement element) of the right of indemnity because in regard to discharged liabilities there cannot be trust creditors (and hence no subrogation to the right of reimbursement): D Ong, *Trusts Law in Australia* (Federation Press, 4th ed, 2012) 336–337.

[99] G E Dal Pont and D R C Chalmers, *Equity and Trusts in Australia* (Lawbook Co, 3rd ed, 2004) 429–430.

The bigger concern for creditors is that the right of subrogation is derivative in nature. This means that the creditor can only obtain what the trustee could have obtained under the trustee's right of indemnity. If either of the trustee's indemnities is not available to the trustee, the creditor has nothing to be subrogated to.

For example, if the trustee's right of indemnity against beneficiaries has been excluded by the trust deed, this avenue of recourse will not be available to the creditor. Further, if the trustee's right of indemnity against trust assets has been impaired or is not available (eg breach of trust, expense improperly incurred), this avenue of recourse will also not be available to creditors.

In addition, one can readily appreciate the potential importance to creditors of the debate as to whether the general law right of indemnity can be excluded by the trust deed, and the interaction of the statutory indemnity concerning trust assets and the general law indemnity.

Section 197 of the Corporations Act 2001 (Cth)

Another provision that potential influences the liability protection properties of a trust is s 197(1) of the *Corporations Act 2001* (Cth), which reads:

> 197 Directors liable for debts and other obligations incurred by corporation as trustee
>
> (1) A person who is a director of a corporation when it incurs a liability while acting, or purporting to act, as trustee, is liable to discharge the whole or a part of the liability if the corporation:
>
> (a) has not discharged, and cannot discharge, the liability or that part of it; and
>
> (b) is not entitled to be fully indemnified against the liability out of trust assets solely because of one or more of the following:
>
> (i) a breach of trust by the corporation;
>
> (ii) the corporation's acting outside the scope of its powers as trustee;
>
> (iii) a term of the trust denying, or limiting, the corporation's right to be indemnified against the liability.
>
> The person is liable both individually and jointly with the corporation and anyone else who is liable under this subsection.

The note under s 197(1) reads: "The person will not be liable under this subsection merely because there are insufficient trust assets out of which the corporation can be indemnified."

The clear focus of s 197(1) is directors of corporate trustees, and the section can be described as remedial in nature as in the absence of s 197(1), directors would not be liable for debts of the company. The section does not apply to a company acting beneficially (ie nontrustee company). The section can be seen as "lifting of the corporate veil".[100] Three (or four) observations can be made about s 197(1) being activated.

First, the definition of "director" in s 9 of the *Corporations Act 2001* (Cth) is relevant to s 197(1). This not only includes persons validly appointed as directors but also includes "de facto directors"[101] and "shadow directors". Second, the company must not be able to meet, and does not meet, the liability. This is very likely to be the case where the trustee is a $2 corporate trustee, and the trust enterprise has failed. Third, the impaired indemnity that is the subject of s 197(1) is the company's right of indemnity against trust assets; the right of indemnity against beneficiaries is not the subject of s 197(1). The consequence is that the s 197(1) remedy is not available where the right of indemnity against beneficiaries is impaired or removed.

[100] It might be better described as lifting the "trust veil".

[101] Paragraph (b) of the definition of "director" in *Corporations Act 2001* (Cth) s 9. A de facto director is a person, while not validly appointed a director, occupies and is discharging the functions attached to the office of director. Therefore, having a nominal director(s) who has no assets, with a "non-director" who has assets and is the real "power behind the throne", will not be an effective strategy of escaping the reach of *Corporations Act 2001* (Cth) s 197(1). See J Gooley et al, *Corporations and Associations Law: Principles and Issues* (LexisNexis Butterworths, 5th ed, 2011), [21.15]–[21.31] for a good summary of this area.

Fourth, the s 197(1) remedy is only available where the indemnity is impaired solely by one or more of the listed circumstances. One of those is where the trust deed has excluded the trustee's right of indemnity against trust assets. Therefore, if the general law indemnity can be excluded by the trust deed, s 197(1) can be triggered. The limitation as to how impairment of the indemnity arose to the three listed circumstances means that a situation falling outside those three items cannot trigger s 197(1). The note to s 197(1), which deals with "mere insufficient trust assets", confirms this.

Company

General Position

The focus here is on companies (associations) incorporated under the *Corporations Act 2001* (Cth).[102] In addition, the focus here is on companies limited by shares,[103] and not on other types of companies. Companies limited by shares must have the word "Limited" (or Ltd) as part of its name.[104] Also, the focus is on proprietary companies as this would be the relevant company classification for operators of small- to medium-sized businesses. It should also be noted here that we are dealing with a company in its beneficial capacity, and not in a capacity as trustee of a trust.[105]

Company Itself

On registration,[106] a company obtains a legal personality (legal persona) or existence; it becomes a legal person, albeit an artificial person. This artificial legal person has an existence that is independent of shareholders[107] in the company, even though the company is a vehicle for the pursuit of economic gain for the company's [ultimate] natural person shareholders. The company's existence continues until it is deregistered.[108]

All the powers and capacities that a natural person has are conferred on the company.[109] This includes owning assets, entering into contracts, operating a business and incurring debts and liabilities. Importantly, a company can also commit compensable wrongs, even though this can only occur through its human agents.

The key point here is that in legal terms, the company is liable to an unlimited extent to meet its debts and liabilities. It is true that in practical terms, this statement needs qualification by the shareholder limited liability rule (see below). But, the statement stands as a correct account of the legal position. Creditors can sue the company for its debts and liabilities.

There is no legal obligation in the *Corporations Act 2001* (Cth) on a company to disclose on its letterheads, invoices, etc that it is acting in its capacity as trustee of a trust. Further, there is no such obligation under State trust legislation. Finally, a company is required to register its business name on the Business Names Register if it carries on business under a name other than its name.[110]

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[102] An association of persons can incorporate understate associations incorporation legislation (eg *Associations Incorporation Act 2009* (NSW)), but this is only available in regard to non-profit and non-commercial activities. Also, given a single member company can now exist under the *Corporations Act 2001* (Cth) s 114, the description of a company as an association of persons is no longer completely accurate.

[103] Definition of "company limited by shares" in *Corporations Act 2001* (Cth) ss 9 and 112(1).

[104] *Corporations Act 2001* (Cth) s 148(2).

[105] As noted in an earlier footnote, it seems strange to talk in terms of a company having a beneficial capacity when the company is an artificial legal person or "mere piece of paper" or a mere vehicle for natural person shareholders to pursue economic gains. Yet, that is the legal position.

[106] *Corporations Act 2001* (Cth) s 119.

[107] The *Corporations Act 2001* (Cth) uses the terms "shareholders" and "members" interchangeably.

[108] *Corporations Act 2001* (Cth) s 601AD(1).

[109] *Corporations Act 2001* (Cth) s 124(1).

[110] *Business Names Registration Act 2001* (Cth) s 18.

Shareholders in Company

Shareholders in a company have an existence that is independent from the company. This is also the position where there is a single shareholder company.[111] Putting aside dividend distributions, profits and gains made by the company do not belong to the shareholders. Nor does the shareholder have any interest in the company's assets.[112] Debts and liabilities incurred by the company are not debts and liabilities of shareholders.

Shareholders in a company limited by shares enjoy limited liability. Their liability to contribute to the company (and therefore the enterprise carried on "through" the company) is limited to the unpaid amount on his or her shares.[113] So, eg if shares were issued to a shareholder for consideration of $1, and the shareholder makes full payment, the shareholder cannot be required to make any further contributions to the company even if the company cannot meet all of its liabilities. This is the practical manifestation of "limited liability"; shareholders' assets cannot be accessed to satisfy a debt owed to the creditor by the company. This effectively means that creditors,[114] to some extent, bear the risk of a company's operations not succeeding.

Piercing the Corporate Veil

There is a range of legal doctrines, some statutory and some common law based, where the law does attribute actions of the company, and ensuing liability, to the company's shareholders and/or directors. It is fair to say that attribution only occurs in unusual or extreme circumstances. Accordingly, we will not set them all out here. One though is worth briefly setting out as it is more likely to occur, namely, insolvent trading.

Section 588G of the *Corporations Act 2001* (Cth) contains the company insolvent trading rule that applies to directors of companies; the rule does not apply to shareholders per se.[115] Insolvent trading occurs when a company incurs a debt at a time that it is insolvent or becomes insolvent by incurring the debt, and there are reasonable grounds for suspecting the company is insolvent or will become insolvent. If a person(s) is a director of the company when the company incurs the offending debt, and none of the defences are made out by the director(s),[116] a number of "penalties" may be visited on the director(s).

However, the key thing is that the court can order directors to pay compensation to the company.[117] The legislation contemplates the aggrieved creditor taking action directly against the director(s); however, there are some barriers to this occurring (eg liquidator's consent, leave of court to proceed).[118]

Internal Company Irregularities ("Indoor Management Rule")

Subsection 128(1) of the *Corporations Act 2001* (Cth) states that persons who have dealings with a company are entitled to make the assumptions listed in s 129, and that the company cannot assert that the assumptions are incorrect.[119] The assumptions may be made even if an officer or agent of the

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[111] *Corporations Act 2001* (Cth) s 114.

[112] *Macaura v Northern Assurance Company Ltd* [1925] AC 619, 626; *Ord Forrest Pty Ltd v Federal Commissioner of Taxation* (Cth) (1973) 130 CLR 124, 148.

[113] Definition of "contributory" in *Corporations Act 2001* (Cth) ss 9, 117(2)(k) and 516.

[114] Unsecured creditors carry most risk because a secured creditor will have access to a particular asset to satisfy the debt owed to them.

[115] In closely held companies though, some or all of the directors are likely to also be shareholders. In the end, if a person is held liable for an amount, he or she will not care much about the capacity in which he or she came to be liable.

[116] *Corporations Act 2001* (Cth) s 588H.

[117] *Corporations Act 2001* (Cth) ss 588J, 588K and 588M(2).

[118] *Corporations Act 2001* (Cth) ss 588R and 588S (liquidator consent) and s 588T (leave of court).

[119] A person (A) who has dealings with a person (B) who acquired property from a company can also make the s 129 assumptions. This means that B and the company cannot assert that the s 129 assumptions are incorrect: *Corporations Act 2001* (Cth) s 128(2).

company acts fraudulently or forges a document in connection with dealings.[120] On the other hand, s 128(4) states that a person cannot make the assumptions in s 129 if at the time of the dealing, the person knew or suspected that the assumption was incorrect.[121]

Some of the more important assumptions in s 129 are as follows: i) company's constitution has been complied with,[122] ii) directors and company secretary have been properly appointed and they have the authority to exercise powers usually exercised by such persons,[123] iii) anyone who is held out by the company to be an officer or agent of the company has been properly appointed and they have the authority to exercise powers usually exercised by such persons[124] and iv) officers and agents of the company properly perform their duties to the company.[125]

The practical effect of ss 128 and 129 is that a company cannot refuse to meet a liability to an "outside creditor" on the basis that an "internal breach" of duties or procedures occurred. For example, where an officer or agent of the company has had their authority to incur debts curtailed and he or she proceeds in any event to contract with a creditor in breach of the limitation, the company will still be liable on the contract to the creditor. Certainly, the company will have an action for breach of contract against the officer, but the liability to the creditor will stand.[126]

Complexity of Liability Rules Re Each Entity

From the above, it is submitted that the liability rules concerning trusts are far more complex than those concerning sole proprietors and partnerships. It is also submitted that the rules are just as complex as those relating to companies.

IV. Evidence of Adviser Misunderstanding of Trust Liability Rules

This part canvasses two categories of "adviser misunderstandings", and/or judicial commentary on misunderstandings that have come to light before Australian courts. These two categories were chosen as such misunderstandings may impact liability issues where a trust is involved. Thus, there is no attempt to deal with the other areas of trusts where there have clearly been adviser misunderstandings,[127] or careless or negligent adviser conduct.[128]

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[120] *Corporations Act 2001* (Cth) s 128(3).

[121] It may be worth noting that s 130 of the *Corporations Act 2001* (Cth) overrides the common law constructive notice rule. That is, persons dealing with a company are not taken to have information about a company merely because the information is on the ASIC public register.

[122] *Corporations Act 2001* (Cth) s 129(1).

[123] *Corporations Act 2001* (Cth) s 129(2).

[124] *Corporations Act 2001* (Cth) s 129(3).

[125] *Corporations Act 2001* (Cth) s 129(4). Broadly stated, ss 128 and 129 restate the common law: P Lipton, A Herzberg and M Welsh, *Understanding Company Law* (Lawbook Co, 17th ed, 2014) 149.

[126] See Lipton, Herzberg and Welsh, n 125, 149–163, for a full discussion of the application and scope of the s 129 assumptions, and the exception in s 128(4).

[127] For example, the accountant of longstanding, in *Canehire Pty Ltd v Themis Holdings Pty Ltd* (2014) 12 ASTLR 437; [2014] QCA 296, appears to have had no appreciation that a trustee cannot put their own interests ahead of the duties they owe to beneficiaries. In *Lambert v Federal Commissioner of Taxation* (2013) 94 ATR 903, numerous misunderstandings concerning the rules that applied to a discretionary trust were made (eg failure to comply with a trust deed notification requirement, attempt to allocate income for a lengthy period when trust deed required periodical exercises of the discretion). It is fairly clear that the advising accountant was heavily involved in these decisions. The accountant (son) in *Thomas v Arthur Hughes Pty Ltd* (2015) 107 ACSR 443; [2015] NSWSC 1027 was willing to "gamble" that standard discretionary trusts could equally achieve the fixed allocations of assets that the father desired to achieve through the mechanism of a life estate (wife) followed by fixed remainder interests (for children) on expiry of the life estate.

[128] For example i) the accountant who did not check that the trust deeds specifically drafted to give effect to a family arrangement restricted the beneficiaries so as to qualify for the inter-family transfer stamp duty exemption (*Re Keadly Pty Ltd* [2015] SASC 124), ii) either because of poor client instructions or poor drafting, a person (wife) was included as a beneficiary of a family

This part does not assert a causal connection between the limited coverage of the law of trusts in commerce degrees and the adviser misunderstandings or errors identified. There are too many other intervening factors at play to allow for such a conclusion. However, as a matter of logic, the limited coverage of the law of trusts in accounting degrees must be a contributor to the lack of education of advisers re the law of trusts. At its lowest, it is a missed opportunity.

The two categories chosen for discussion are trust is an entity and failure to clarify the capacity in which a party is transacting.

Trust is an Entity

In the New South Wales Court of Appeal decision in *Kelly v Mina*,[129] Leeming JA said:

> [I]t may be readily inferred that neither party had a correct understanding of the legal nature of a trust, despite their academic and professional qualifications, and despite the fact that the accountancy practice was conducted by the trustee of a unit trust. A trust is not a legal person; … The incorrect but prevalent notion that a trust is a legal person was reflected throughout the trial. It was seen not merely in the "Structure" contained in the parties' "Partnership Agreement". It was also seen in the appellant's principal affidavit she [Kelly] had sworn that "the Mina Family Trust [sic] and Eastern Suburbs Accounting entered into an agreement to form an entity partnership [sic] called the Kelly and Mina Unit Trust"). Indeed, the proposed pleading the subject of the amendment application alleged a partnership between "Eastern Suburbs Accounting Services Pty Ltd and the Mina Family Trust".[130]

These highly critical comments in terms of the lack of appreciation of the legal structures and entities adopted were mainly directed at the two central parties involved in the litigation (Kelly and Mina), both accountants.[131]

The facts in *Kelly v Mina* involved the merging of two unrelated accounting practices, and the ultimate buyout (exit) of one of the parties from the combined practice after four years. Karen Kelly was the 100% owner of shares in Eastern Suburbs Accounting Services Pty Ltd, a company that owned and operated the Churton Kelly accounting practice. Akis Mina controlled the Mina Family Trust, a "trust" that owned and operated the Ezy Accounting practice. The trustee of the Mina Family Trust was Mina Enterprises Pty Ltd.

In short, the parties interposed a unit trust (called the Kelly and Mina Unit Trust) between their respective practice "entities" and their previous practices (now combined). The Kelly and Mina Unit Trust issued units to the former owners (company for Kelly, and trust for Mina) of the separate practices.

It needs to be pointed out that legal advisers involved with the parties and their dispute also allowed the inaccurate description of the parties and legal structure(s) to subsist for considerable time. Indeed Kelly claimed that the reason she changed her solicitor was due to the solicitor's failure to pick up the point that she was being sued personally when she was not the correct party.[132]

It may be possible to explain the repeated misdescriptions of relevant parties in the various documents in *Kelly v Mina* as the use of "loose language". However, the extracted comment of Leeming JA goes further than this, and Leeming JA also suggests that there is a prevalent notion that a trust is regarded as a legal entity. There are other cases that provide some support for Leeming JA's assertion of a wider prevalence of the incorrect view that a trust is a legal entity. In both *HP Mercantile Pty Ltd*

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trust when the clear intent was to exclude her. Both the drafting solicitor and the solicitor who subsequently represented the husband were under the wrong impression (*Galvan v Galvan* [2015] FamCA 1092) and iii) a solicitor who was the settlor of a trust appointed himself trustee of a trust when he in fact was excluded by reason of his being the settlor (*Londy v Van Nieuwburg* [2014] QSC 290).

[129] *Kelly v Mina* [2014] NSWCA 9.

[130] *Kelly v Mina* [2014] NSWCA 9, [103].

[131] However, the legal advisers to the parties involved also failed to pick up the mis-descriptions of relevant parties. Indeed, they seem to have created the mis-descriptions.

[132] *Kelly v Mina* [2014] NSWCA 9, [40].

v Federal Commissioner of Taxation[133] and *P & M Quality Smallgoods Pty Ltd v Leap Seng*,[134] the incorrect view appears to stem from, or is embodied in, documents created by lawyers in pursuit and defence of litigation.

In many cases, no harm will arise from an adviser labouring under the incorrect impression that a trust is a legal entity. For example, the attempt by Kelly to take advantage of the parties' misdescriptions of the entities involved in *Kelly v Mina* was rejected both at first instance and in the Court of Appeal.[135] On the other hand, the incorrect impression of a trust as a legal entity may raise the following [overlapping] inquiries and/or result in the following [overlapping] conclusions.

If the trust is an entity, the next [perhaps logical] inquiry may focus on the character of this entity. It is possible that one may reason that its character is taken from the character of the trustee, either a natural person or a company.[136] From there, one may readily conclude that the liability rules relevant to the two respective legal entities apply. In short, this would be incorrect. In the case of a natural person, this could give the impression that he or she has unlimited liability for debts and liabilities incurred, without any potential recourse to the trust fund and/or beneficiaries. Similarly, in the case of a company, it could give the incorrect impression that, in effect, liability for debts is limited to the company's resources and that no recourse is available to the assets of those "behind the company."[137]

Viewed from the perspective of the creditors, the entity view of a trust may invite the incorrect impression that creditors can only look to the entity for satisfying amounts owed to them. After all, this is the general position with the other indisputable legal entity, the company. But this is not necessarily the case as in some trusts; creditors may have a right of subrogation to the trustee's right of indemnity against beneficiaries, assuming this right of indemnity has not been ousted.

Capacity in Which Entity Owns Property, Entered into Contracts

The issue as to whether an entity is contracting in their personal capacity (beneficially) or as trustee (representative capacity and not beneficially) is important, and it arises not infrequently.[138] In regard to the purchase and holding of property, resolution of the capacity question determines who the beneficial [economic] owner of the property is. Where the entity is contracting personally, the property belongs to him, her or it beneficially. This is the case whether a natural person or company is contracting.[139] Where the entity is contracting as trustee, the property does not belong to the trustee beneficially, but rather to beneficiaries.[140]

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[133] *HP Mercantile Pty Ltd v Federal Commissioner of Taxation* (2005) 143 FCR 553, 555.

[134] *P & M Quality Smallgoods Pty Ltd v Leap Seng* [2013] NSWCA 167, [6]. Barrett JA said: "Naming of 'Homebush Unit Trust' or 'Trustees of the Homebush Unit Trust' as a party was irregular - and the allegation in the statement of claim that 'Homebush Unit Trust' was 'a corporation and/or business name … liable to sue and/or be sued in and by its name and style' was a nonsense. However, since no issue is taken about this and the other parties are presumably aware of the person or persons concerned (who appeared below and on appeal), no more need be said about the matter."

[135] Kelly argued that the buyout document could not possibly be binding because it imposed obligations on the wrong entities, ie on Kelly and Mr Mina personally, whereas none of the liabilities and assets held within the entities were held by them personally: *Kelly v Mina* [2014] NSWCA 9, [36]. This was rejected: *Kelly v Mina* [2014] NSWCA 9, [72]–[82].

[136] Let us ignore the multiple natural person trustee situation for present purposes.

[137] While not directly on point, the authors regularly hear the comment from both tax students and tax practitioners that a corporate trustee should be used to limit liability. While further inquiry may be necessary from the makers of such statements, it is arguable that the entity view of a trust underlies some of these comments.

[138] See, eg *Valeress Pty Ltd v Valenest Pty Ltd (in liq)* [2011] NSWSC 465; *Bechara v Sotrip Pty Ltd (in liq)* [2013] QSC 100; *Canehire Pty Ltd v Themis Holdings Pty Ltd* (2014) 12 ASTLR 437; [2014] QCA 296; *Lambert v Federal Commissioner of Taxation* (2013) 94 ATR 903.

[139] It seems strange to describe a company, as opposed to the company's natural person shareholders, as beneficially owning property. But that is the accepted legal position.

[140] Where the person is acting in his or her capacity as trustee of a discretionary trust, beneficial ownership of trust property is unlikely to be known yet as property of a discretionary trust is in "suspended ownership", until an appointment of capital is made by the trustee, or the vesting date of the trust has arrived.

Where a company is the legal owner of property, and its natural person shareholders differ from beneficiaries of the trust, the question of capacity may be very important to the two potential categories of claimants (ie shareholders through increased value of their shares and beneficiaries). The question may also be important to creditors because, in one case, a debtor may have property of value (eg shareholder in company that beneficially owns property), and yet in the other case, the same debtor may not have property of value (eg object of discretionary trust).

Similarly, in regard to the incurring of debts and liabilities, resolution of the capacity question is also important. Where the entity is contracting personally, the liabilities are its own. Where the entity is contracting as trustee, the liabilities "are its own", but the trustee may effectively have rights to shift the liability to others (ie beneficiaries). Again, the question may also be important to creditors, as in the latter case, creditors may effectively be able to claim against others (ie beneficiaries).

In *Valeress Pty Ltd v Valenest Pty Ltd (in liq)*, Valenest Pty Ltd (Valenest) owned and developed properties beneficially. On advice from the company's accountant (Mura), a trust was created and Valenest became trustee so that future property purchases would be made by the "trust". Valenest purchased a property (Wetherill Park) and entered into various transactions concerning that property after purchase (eg borrowing, providing the property as security for a loan). The purchase contract did not state that Valenest purchased the Wetherill Park property as trustee. Other transactions entered into by Valenest and related companies made no mention that Valenest is a trustee.

Both accountants for the company – one from 1999 to 2004 (Mr Mura) and the other post-2004 (Seymour) – prepared Valenest's financial accounts on the basis that it did not hold any properties on trust, and there was no mention anywhere that Valenest was a trustee. The key issue was whether Wetherill Park was purchased as trust property. Even though there were factors pointing both ways, Sackar J held that the Wetherill Park property was purchased in Valenest's capacity as trustee.[141]

Sackar J was critical of the accountant's, Mura's, failure to prepare separate accounts for the trust, especially in light of the fact Mura set up the trust and he knew of the purchase of Wetherill Park.[142] Seymour is not the subject of criticism from Sackar J, perhaps due to the limited scope of his retainer.

Briefly, in *Bechara v Sotrip Pty Ltd (in liq)*,[143] the issue was also whether a company (Sotrip Pty Ltd (Sotrip)) purchased a property beneficially or in the capacity of trustee. Sotrip was controlled by an accountant, Sam Cassaniti. The purchase contract did not state Sotrip was purchasing as trustee. The registered transfer did not state Sotrip was a trustee. The loan contract that funded the purchase did not state Sotrip was borrowing as trustee. There was also a failure, even though there is no obligation, to register the interest in the land at the land titles office as one held by Sotrip as trustee.

In spite of the above failures, Philip McMurdo J held that Sotrip did purchase the property as trustee.[144]

While reference to a small number of cases is not a basis for generalising, there is enough evidence to raise a suspicion that some accountants may not fully appreciate the distinction between when an entity is acting beneficially, as opposed to when they are acting in a representative capacity (as trustee).

Consequently, there is some evidence as to the possible misunderstanding of accountants in terms of the legal rules surrounding trusts.

V. Coverage of Liability Issues

Given the popularity of using companies and discretionary trusts for business operations, to what extent are accounting undergraduates taught about them, and in particular the liability issues surrounding them? In a curriculum audit of Australian accounting degrees in terms of business structures, a

[141] *Valeress Pty Ltd v Valenest Pty Ltd (in liq)* [2011] NSWSC 465, [70]–[75].

[142] *Valeress Pty Ltd v Valenest Pty Ltd (in liq)* [2011] NSWSC 465, [74].

[143] *Bechara v Sotrip Pty Ltd (in liq)* [2013] QSC 100.

[144] *Bechara v Sotrip Pty Ltd (in liq)* [2013] QSC 100, [10].

survey was conducted of 138 business law and accounting academics from 36 Australian universities who taught into undergraduate accounting degrees.[145] The findings suggest that the five common mandatory business law courses would be where undergraduate accounting students have the greatest exposure to the law surrounding business structures.[146] Overall, the results illustrate that the business structure that has the greatest emphasis consistently throughout lectures, tutorials and assessment was the company.[147] This was then followed by general partnerships and sole traders.[148] Despite trusts, including discretionary trusts, being a popular business structure in Australia, exceeding partnerships, there was low coverage of discretionary trusts and little of unit trusts in the accounting (business law) curriculum.[149] There was also low coverage of limited partnerships, and very little of SMSFs. The authors argued that this raised concerns about the level of knowledge that accounting graduates would have in terms of business structures, especially trusts and SMSFs.[150] The results in relation to the mandatory business law courses lecture time in respect of companies and discretionary trusts are detailed in Table 3. This table demonstrates that on average over 70% of the mandatory business law courses spent greater than 30 minutes, with 34% spending greater than five hours discussing companies. In contrast, only approximately 2% of mandatory business law courses on average spent greater than five hours discussing discretionary trusts. There was likely to be greater coverage of discretionary trusts within the tax course, with on average 52% of them spending greater than 30 minutes but less than five hours.

TABLE 3. Lecture Coverage of Companies and Discretionary Trusts

	"Corporations/Companies" in the Lectures				**"Discretionary Trusts" in the Lectures**			
Mandatory Business Law Courses	**Not Covered or <5 minutes**	**<30 minutes >5 minutes**	**>30 minutes but <5 hours**	**> 5 hours**	**Not Covered or <5 minutes**	**<30 minutes >5 minutes**	**>30 minutes but <5 hours**	**> 5 hours**
Introduction to Law/ Foundations of Law	35%	9%	43%	13%	59%	23%	18%	0%
Introduction to Business Law	32%	24%	38%	6%	78%	19%	3%	0%
Law of Business Associations/ Law of Commercial Associations	5%	5%	15%	75%	45%	40%	10%	5%
Company/Corporations Law – Introduction	0%	0%	24%	76%	76%	19%	0%	5%
Taxation Law – Introduction	21%	14%	65%	0%	24%	24%	52%	0%
Average for mandatory courses	19%	10%	37%	34%	56%	25%	17%	2.0%

[145] Freudenberg and Boccabella, n 10.

[146] The five common business law courses were Introduction to Law/Foundations of Law ("Intro to Law"); Introduction to Business Law ("Intro to Business Law"); Law of Business Associations/Law of Commercial Associations ("Law of Associations"); Company/Corporations Law – Introduction ("Company"); and Taxation Law – Introduction ("Tax"). Note it is likely that within each accounting degree, there is only three or four mandatory business law courses, but there can be different names used to describe the course.

[147] Freudenberg and Boccabella, n 10, 200.

[148] Freudenberg and Boccabella, n 10, 200.

[149] Freudenberg and Boccabella, n 10, 200.

[150] Freudenberg and Boccabella, n 9.

While not previously reported, the survey also asked what topics were covered in the lectures of these courses in relation to the business structures. The average data in respect of the five mandatory business law courses as it pertains to companies and discretionary trusts are detailed in Table 4. When considering the lecture coverage for companies, it appears that there is largely equal distribution of time spent on topics, with an average of around 45% of courses spending between 30 minutes and less than five hours on such topics as nature of and governing law; formalities; liability issues (members/controllers); asset protection; admission of new (equity) members and ability to sell (equity) membership interests; profit distribution and cessation of business. The lowest coverage in this time band was taxation of business profits/losses and tax implications on sale of business.

TABLE 4. Lecture Topic Coverage in Mandatory Business Law Courses (Average)

Please Indicate the Extent to Which the Following Topics Are Covered in the Lecture for Your Mandatory Business Law Course in Relation to	"Corporations/Companies" in the LECTURES				"Discretionary Trusts" in the LECTURES			
	Not Covered or <5 minutes	**<30 minutes > 5 minutes**	**>30 minutes but <5 hours**	**> 5 hours**	**Not Covered or <5 minutes**	**<30 mins > 5 mins**	**>30 mins but <5 hours**	**>5 hours**
Nature of and governing law	17%	32%	45%	6%	47%	45%	8%	0%
Formalities	23%	29%	45%	3%	55%	37%	8%	0%
Liability issues (members/controllers)	26%	23%	46%	5%	53%	35%	11%	0%
Asset protection	31%	23%	45%	1%	55%	39%	6%	0%
Admission of new (equity) members and ability to sell (equity) membership interests	33%	23%	45%	1%	63%	31%	6%	0%
Profit distribution	29%	22%	47%	2%	47%	39%	15%	0%
Cessation of business	34%	18%	45%	3%	68%	23%	10%	0%
Taxation of business profits/losses	48%	26%	26%	0%	47%	37%	16%	0%
Tax implications on sale of business	64%	17%	19%	0%	61%	29%	10%	0%

In comparison, when considering the lecture topics for discretionary trusts, there is a greater emphasis on attributes that are relevant to tax. For example, when considering the timeframe of between 30 minutes and less than five hours, the emphasis is on such topics as taxation of business profits/losses (16%); profit distribution (15%); and tax implications on sale of business (10%). This emphasis would be in part due to the fact that the mandatory business law courses most likely to discuss discretionary trusts with accounting students were the taxation courses. However, it should be noted that there are some courses devoting substantial time in this time band to the topics of liability issues (members/controllers) (11%) and cessation of business (10%).

This data overall suggest that Australian accounting undergraduate students have little exposure to the law relating to discretionary trusts, with there being greater emphasis on sole proprietors, companies and general partnerships. This is despite the popularity of discretionary trusts as a business structure in Australia. Even when students are exposed to trusts, there is greater emphasis on the law relating to their (and their members) taxation treatment, with reduced coverage on liability and asset protection. Overall, this means that accounting graduates are likely to have reduced understanding about the governing law, liability implications and asset protection of using a discretionary trust for a business structure. This brings into question whether accounting graduates are being taught adequate technical knowledge as part of their undergraduate accounting degrees in terms of business structures, especially discretionary trusts.

VI. Recommendations and Future Research

With the findings of this research, a number of recommendations are proposed, as well as areas for future research.

The authors hope that this article will stimulate business law academics in Australia to consider whether the coverage of business structures in their business law courses is appropriate. Given the use of trusts in Australia and the role that accountants play as a trusted adviser, serious consideration must be given to accountants' legal literacy in terms of asset protection and liability issues about trusts. As to whether this occurs at the undergraduate or postgraduate level, a sound cost–benefit analysis should be undertaken as to whether the increased teaching of the law of trusts should be done in the university program, or in subsequent professional courses of accountants. Overall, it is argued that there needs to be curriculum review and renewal of accounting. In particular, the accounting professional bodies should critically consider their accreditation requirements for Australian undergraduate university degrees, as well as their own programs, and the continued professional development requirements of their members. Otherwise the accountants of the future (and today) risk not having the basic legal literacy demanded for their profession.

Also, consideration should be had to providers of business structures and measures that could be implemented to ensure that people nominating a business structure do have some understanding of the legal nature of the structure chosen. Unfortunately, once a business structure has been chosen, it can be difficult (and costly) to alter although some reduction in tax costs may be available through recently legislated tax rollover rules that are available to small businesses that are changing their business structure.

Further research could consider how best professional advisers, such as accountants, should be taught about business structures. This could consider what aspects are needed for professional practice, as well as what context is required to be able to learn key attributes. A fine balance needs to be struck here, given that accountants are not legal advisers themselves, but nevertheless they need a degree of legal literacy in this area, even if it is only to communicate to the client specialist advice obtained from a lawyer specialising in business structures. In terms of this, the framework of contextualising legal issues for business students developed by Cartan and Vilkinas could be beneficial.[151]

Future research also could involve surveying accountants as to their legal literacy in terms of business structures and attempting to ascertain if there are areas requiring more education and professional development.

VII. Conclusion

Accountants are seen as a trusted professional adviser and can be considered the most important adviser in the set-up phase of a business structure.[152] An integral part of being a "professional" is educational requirements.[153] This article has sought to bring evidence about the important role that accountants play in the recommendation of different business structures to their clients. It has highlighted the growing use of discretionary trusts and companies in Australia, as well as evidence to suggest that asset protection and liability issues are large motivators behind accountants' advice, with tax benefits being secondary.

[151] Cartan and Vilkinas, n 12.

[152] Davidsson, Steffens and Gordon, n 1, 24.

[153] Hamilton, n 2.

However, through a curriculum audit of Australian accounting degrees concerns were raised about the extent that accounting students are taught about trusts, as well as the interrelated issue of the how this structure affects asset protection and liability. This was then followed by a discussion about the liability issues that can arise with the major business structures, including trusts and companies, which sought to demonstrate the increased complexity that a trust structure can entail. Evidence was then presented about where advisers appear to have at times failed to comprehend the nature of a trust.

It is argued that through this discussion that the current scant coverage of discretionary trusts in the Australian accounting curriculum is of great concern, as accountants as professional advisers need this core technical knowledge. This technical knowledge needs to extend beyond just the tax treatment of discretionary trusts, but also how this structure affects asset protection and liability issues. While accountants are not lawyers, given their intimate and ongoing relationship with clients using business structures, it is important that they have a solid foundational technical knowledge about this important business structure in Australia. Given the influence of the professional bodies in driving the Australian curriculum, it is incumbent on them to seriously reconsider their accreditation requirements and/or their own study programs. Without a solid foundation knowledge about discretionary trusts, the trusted accountant as a professional adviser may struggle to fully appreciate the liability issues surrounding their business structure advice.