

# Charitable mistrust

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A new High Court case provides useful guidance to practitioners on the responsibilities of trustees of a charitable trust.

The High Court has provided practitioners and trustees with a helpful guide about the responsibilities of trustees of charitable trusts to exercise their powers for a charitable purpose in the decision of the High Court in *Commissioner of Taxation v Bargwanna* [2012] HCA 11 (*Bargwanna*).

In *Bargwanna*, the trustees of a charitable trust applied trust funds settled on a charitable trust by a wealthy businessman to, among other things, offset the interest payments on the trustees' personal home loan. The High Court found that the actions of the trustees in this regard were not charitable at all, and delivered a helpful analysis of the duties and obligations of trustees of a charitable trust.

In addition to being excellent authority for the proposition that a trustee of a charitable trust is best advised not to use the trust funds to get ahead on their mortgage payments, the High Court's reasoning is an important aide-memoire to solicitors on both sides of the giving – those who advise benevolent clients eager to give back to the community, and those who advise trustees whose job it is to administer that legacy and allocate it to the needy. It is a reminder that care should be taken in the course of drafting trust documentation to ensure that both the purposes of the trust and the duties of the trustees are explicit. And it confirms that trustees should be advised that their powers in administering a charitable trust are far from unfettered – despite what the trust deed might say.

In *Bargwanna*, the trust deed had been drafted to provide that every discretion and power conferred on the trustees was "an absolute and uncontrolled discretion or power".<sup>1</sup> The High Court expressed concern about the use of clauses attempting to confer such wide powers and said that they should always be read in the light of authorities "which treat such apparently unfettered discretions and powers as not extend-

ing to the alteration of the substratum of this trust for charitable purposes".<sup>2</sup>

The lesson in this for practitioners drafting trust deeds is that they should take care to ensure they are not intentionally or unintentionally providing trustees with a power which is potentially unlawful and could defeat the purpose of the trust if exercised.

## High Court case

Unfortunately for the average legal practice, and the advancement of society generally, very few solicitors have clients who require assistance to bequeath part or all of their personal wealth to charity. This is not to suggest the general public is miserly in nature, quite the opposite – Philanthropy

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Australia has reported that over 4.6 million Australian taxpayers made a tax-deductible donation in the 2008/2009 tax year.<sup>3</sup>

However, in light of recent case law regarding the misuse of charitable donations, many clients could be forgiven for being somewhat reluctant to make more grand philanthropic gestures. This is particularly so in the context of the establishment of charitable trusts. Sadly, some generous benefactors have seen money they have settled on charitable trusts used, not for their preferred charitable purposes, but in a somewhat more curious manner, as was the case in *Bargwanna*.

The case concerned a charitable trust called the Kalos Metron Charitable Trust (the trust), which was settled in 2002. The trustees were Mrs Bargwanna and her husband (the trustees). Mrs Bargwanna's father, Mr Craik, was the principal ben-

efactor of the trust fund.

The specified purpose of the trust was relatively vague in nature and appeared to give the trustees a wide discretion as to how they applied the trust funds: the trust deed stated that the trustees' duty was to hold the trust funds "in trust for such public charitable purposes as they shall from time to time determine".

Mr Craik, in a very generous fashion, had settled various amounts totalling over \$1 million on the trust to be applied for these charitable purposes. By all accounts, the trustees did make some distributions to various public charities. However, it later became apparent that the manner in which the trustees were administering the trust was a little off-kilter. In particular, the trustees had failed to establish a separate account for the money which was settled on the trust, and in breach of trust, had mingled the trust funds with other funds and earnings arising from Mr Craik's business accounts. Worse, the trustees had transferred a sum representing almost half the assets of the trust into a non-interest bearing account as partial consideration for a housing loan in their favour.<sup>4</sup> Despite it containing trust property, that account was used by the trustees in order to reduce the interest on their personal loan.

The sums withdrawn from the trust account and used by the trustees in their personal capacity equalled almost half the net assets of the trust. Mr Craik had subsequently credited to the trust ledger approximately \$40,000 to address the resulting shortfall in the assets, and he later made a further payment into trust of just over \$6,000 as compensation (for exactly what, it is unclear).

This was all well and good until the trustees sought an endorsement, in accordance with the *Income Tax Assessment Act 1997* (the Act), that the trust was "a fund established in Australia for public charitable purposes by ... instrument of trust" and thereby qualified as an entity exempt from income tax under the Act. The request for this endorsement was rejected by the Commissioner of Taxation (the Commissioner) on the basis that the purposes for which the trust monies were being applied were not actually charitable at all, potentially giving rise to a rather large tax bill for the trust.

The main issue for consideration in the litigation was the construction and operation of the Act as it applied to the income tax exemption claimed by the trustees. However, in analysing the issues, it was also necessary for the courts to consider matters of general law concerning the administration of charitable trusts.

## Charitable trusts

In very basic terms, a charitable trust is a form of legal vehicle which allows the transfer of gifts from an individual, family or corporation to a charity. It is created when an initial sum of money is settled on the trust, usually by a wealthy benefactor who, in doing so, relinquishes all rights to the funds. The settled funds, known as the corpus, are usually invested by the trustee and the income from this investment is then distributed to charitable organisations for the promotion or advancement of the particular "charitable purposes" specified in the trust instrument.

The "special purposes" of a charitable trust must, quite obviously, be charitable in nature and include public, as distinct from private, purposes. Defining what charitable means in this context has troubled courts and law makers for many years, but it is now generally accepted that charitable trusts fall into one of four categories: trusts for the relief of poverty, the advancement of religion or the advancement of education, and trusts for other purposes beneficial to the community not falling under any of the preceding heads. This last category might include, for example, trusts to help the elderly or sick (but not, as discussed below, to help those wanting a better interest rate on their home loan).

As it is concerned with special purposes, rather than named people, a charitable trust is not a trust for individual beneficiaries. So, while some individuals might benefit, either directly or indirectly, from a distribution of funds from a charitable trust, those individuals cannot challenge the trust or otherwise seek to enforce its terms. Almost all charitable trusts are intended to continue indefinitely and, while these consequences would be fatal to a private trust, the law encourages gifts to charities, and the rule against perpetuities has no application to charitable trusts.

While it is not the only vehicle by which



a generous benefactor might seek to facilitate the distribution of their wealth for philanthropic purposes, a charitable trust is one of the most commonly used structures in Australia to do so. Charitable trusts are particularly popular because of the tax benefits they attract, including the income tax exemption sought in the *Bargwanna* case.<sup>7</sup>

#### Trustee's duties and powers

A charitable trust is administered by the trustee, not the settlor of the funds, and the trustee wields great control over the business of the trust and the money settled on it.

Trustees have many powers which are conferred upon them by the trust instrument, by statute and by the court. These powers can include powers to sell trust property, and to carry on business on behalf of the trust.

Trustees have certain rights, including a right to an indemnity out of the trust assets for liabilities incurred in the authorised conduct of the trust and a right to approach the court if the trustee is in doubt as to the rights or interest of any person as against the trust. The powers are varied, but not unfettered: the trustee's position is ultimately fiduciary in nature, and the trustee must have regard to the duties, powers and discretions provided for both in the trust instrument and in the relevant legislation.<sup>8</sup>

Trustees also have basic duties, which have been discussed and developed through a long line of case law. The most important of these duties are as follows: to become acquainted with the terms of the trust, to control the trust property, to adhere to and carry out the terms of the trust, to properly invest the trust funds, to keep proper accounts, to exercise reasonable care in managing the business of the trust, and to not delegate duties or powers unless expressly authorised by the trust deed or statute.

#### Bargwanna: What went wrong

The main question to be resolved in *Bargwanna* was whether the trust was truly operating for a public charitable purpose. This question was initially answered by the Administrative Appeals Tribunal (AAT), which found that the combined activities of Mr Craik and the trustees, despite being somewhat irregular, included charitable actions and nonetheless manifested "the basic and dominant purpose" of the trust for the purposes of the Act. This meant that the trust would be exempt from income tax.

The Commissioner successfully appealed this decision to the Federal Court. The full court then allowed an appeal by the trustees and reversed the position, again rendering the trust exempt from income tax.

Not happy with this result, the Commissioner brought the matter before the High Court seeking to have the decision regarding the tax-exempt status of the trust overturned and succeeded.

#### Decision of the High Court

The High Court found that there had been a misapplication of the funds of the trust through the mixing with other non-trust funds in the trust account. It was held that the trustees had also failed in their duty to obtain interest on the trust money and wrongly used the interest offset account in order to reduce the interest payable on their personal home loan. The High Court found that these acts of maladministration could hardly be considered actions in the course of carrying out the public charitable purposes for which the trust had been settled.

In reaching this decision, the High Court concluded that the administration of a charitable trust does not differ from that of a private trust. Distilled from the judgment are the following helpful guidelines to which legal practitioners should have regard when advising trustees administering a charitable trust:

□ a trustee of a charitable trust should take care to ensure that they are furthering its charitable purposes at all times. Acknowledging the findings of the *Privy Council in Latimer v Commissioner of Inland Revenue* [2004] NZLR 157, the High Court confirmed that it is the essence of a charitable trust that it promotes or advances social purposes rather than being a trust for individual beneficiaries. It is not appropriate to have a declaration of charitable intent and not follow through with it;

□ the trustee of a charitable trust is obliged to strictly conform to and carry out the terms of the applicable trust deed. In doing so, a trustee is obliged to "act with the care that an ordinary prudent man of business would take".<sup>9</sup> For the avoidance of doubt, such an individual would not mix trust business with their personal banking;

□ a trustee of a charitable trust is under a

duty to keep the property comprising the trust fund distinct from their own property and from property which was held on other trusts. If trust funds are mingled with other property those funds become more difficult to trace and identify and are at risk of being lost. Care should also be taken by trustees to maintain accurate trust accounts;

□ in terms of investing the trust money, trustees should have regard to Part 2, Division 2 of the *Trustee Act 1925* (NSW) (the *Trustee Act*) regarding proper investment of trust funds. If they have any concerns about their proposed dealings with trust fund, it would be proper to have

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regard to s.63 of the *Trustee Act*. The section enables trustees to apply to the Supreme Court for an opinion, advice or direction on any question regarding the management or administration of the

trust property, or regarding the interpretation of the trust deed. Trustees unsure of whether the purpose for which they propose to use trust money is lawful would be best advised to consider making use of the section; and

□ a trustee's exposure to personal liability may be mitigated by the power conferred by s.85 of the *Trustee Act*. The section allows the Supreme Court wholly or partly to relieve trustees of personal liability for breach of trust where it appears to the court that the trustees have "acted honestly and reasonably" and that they "ought fairly to be excused".<sup>10</sup> However, this is not the preferred path for trustees as it is somewhat akin to the proverbial ambulance at the bottom of the cliff. A trustee in doubt about a course of action should seek judicial advice under s.63 rather than proceed and then seek relief under s.85.

By having close regard to the principles set out above, it may be possible to ensure that it is ultimately the pureness of the benefactor's intentions and the greatness of their cause which makes the news, rather than tales of good deeds gone bad. □

#### ENDNOTES

1. *Commissioner of Taxation v Bargwanna* [2012] HCA 11, at [13].

2. *Ibid.*, see [13], together with the cases listed at footnote 8 of the judgment.

3. As reported on the Philanthropy Australia website at [www.philanthropy.org.au/involved/charities.html](http://www.philanthropy.org.au/involved/charities.html).

4. In fairness to the trustees, it does not appear from the judgment that they were aware that their actions in this regard were inconsistent with their

duties as trustees, nor did they set out to deliberately deceive Mr Craik. The High Court noted in the judgment that "the misapplication of the Trust Fund was not deliberate in the sense that the trustees or Mr Craik were conscious that the intermingling was in breach of trust or that the interest offset account conferred a benefit on the trustees in breach of trust" (at [63]).

5. An analysis of the intricacies of these tax benefits is not within

the scope of this article.

6. In NSW, the relevant legislation is the *Trustee Act 1925* and the *Charitable Trusts Act 1993*.

7. This is a standard set out in *Yonyang Pty Ltd v Minter Ellison Morris Fletcher* [2003] HCA 15.

8. To this end, the court had regard to *Macedonian Orthodox Community Church of St Petka Inc v His Eminence Petar the Diocesan Bishop of The Macedonian Orthodox Diocese of Australia and New Zealand* (2008) 237 CLR 66. □