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Equity as an Alternative to Consent Property Alteration

1. Introduction

1.1 Most separated parties to a marriage reach agreement about the division of their property without recourse to a Court. Of those parties who do embark upon litigation, in excess of 80% of them resolve their property settlement matters before a Judge is called upon to do it for them. Once the parties to a marriage have reached agreement they can record it in a binding and enforceable manner in two ways, either by way of a Consent Order of the Court pursuant to the *Family Law Act* or a Financial Agreement. Parties to a qualifying domestic relationship in New South Wales have a similar choice, namely between a Consent Order pursuant to the *Property (Relationships) Act* or a Termination Agreement.

1.2 Creditors of a party to a marriage have interests that can sometimes be inconsistent with a property settlement that the parties have proposed or already entered into. The problem usually arises where assets that might otherwise be available to a creditor of one party to satisfy a debt are transferred to the debtor's spouse where the creditor cannot reach them. The law has developed mechanisms in relation to Consent Orders, Financial Agreements and Termination Agreements to protect the rights of third parties to ensure that this does not happen.

1.3 Parties to a continuing marriage have frequently called upon Equity to avoid a particular asset being lost to the enforcement of a creditor. The general principles of property law as modified by Equity have long recognised that legal title is not a definitive determination of ownership. In particular, that part of Equity to do with the law of trusts has always recognised that in

certain circumstances persons other than the legal owner of property may have rights akin to ownership that attach to that property. Real estate registered in the name of the debtor may in the right circumstances in fact be beneficially owned by the debtor's spouse and not be available to the creditor trying to enforce the payment of a debt.

1.4 There is nothing to prevent the same principles of Equity and trusts being applied in circumstances where parties are separated and attempting to resolve property settlement matters. The property to be transferred to a non-debtor spouse or partner may in fact already be beneficially owned by that spouse or partner. The asset may never have been available to the creditor in the first place. Equity is an alternative that separating parties with unsatisfied creditors should consider before embarking upon the traditional means of consent property settlement.

2. The protection of creditors in traditional means of achieving binding property settlement

2.1 An order for property settlement under the *Family Law Act* is made pursuant to Section 79 regardless of whether it is made by consent or on a defended basis[1]. The same applies in relation to Section 20 of the *Property (Relationships) Act*. Both sections operate in the same way although there are additional factors a Court considers in making an order under the *Family Law Act* that are not relevant to the *Property (Relationships) Act*[2]. To a point, in both cases the Court divides the parties' property between them based on their contributions to that property. The contributions that are considered are not only of a direct and financial nature but also indirect and non-financial including those that relate to homemaking and parenting tasks. Courts administering both Acts have found that where there are significant homemaking and parenting contributions of a party they are to be taken into account in a substantial way and are not necessarily to be regarded as inferior to financial contributions[3].

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[1] *ASIC v Rich* (2004) Fam LR 667 at 673.
[2] *Evans v Marmont* (1996-7) 21 Fam LR 760 at 763.
[3] *Evans v Marmont* (1996-7) 21 Fam LR 760 at 763.

2.2 Because of the broad nature of the contributions to be considered, usually Courts divide the parties' property on a 'global basis'. Instead of trying to measure each parties' contributions to each piece of property they measure the contribution to all of the parties' property. When considering contributions like parenting and homemaking that do not by their nature attach to any particular asset it can be difficult if not impossible to approach the measurement of contribution on an asset by asset approach. On a 'global basis' the court is measuring the parties' entitlement to their combined net property, their gross assets less their liabilities secured and unsecured[4]. Any order the Court will make will be an adjustment of a portion of the net property. Accordingly a Court will not ordinarily make an order for final property settlement that would leave one of the parties without any net property. That is, the Court would not usually make an order that would see a party receive less assets than liabilities. In this manner, provided that the Court knows about the creditor's claim, the creditor will not be prejudiced by the Court's property settlement order. The instances where the Court has made an order for property settlement in priority to the interest of a legitimate and certain[5] third party creditor are rare[6].

2.3 There are situations where the Court has made an order, unaware of the existence of a creditor, that prejudices a creditor's claim by removing from the debtor's control property that a creditor might otherwise been able to get to satisfy the debt owed. The law as it applies to the *Family Law Act* has recognised this possibility and responded in a two step manner[7]:

- Firstly, by requiring parties to notify persons or entities that might be affected by an order proposed to be made by the court; and

- Secondly, by finding that a failure by a party to notify persons or entities that might be affected by an order will constitute a miscarriage of justice for the purposes of

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[4] *Biltof and Biltof* (1995) FLC ¶92-614 at p, 82,116.
[5] For examples of where a liability might be uncertain and such should be treated see
[6] *Re Q (Damages for sexual assault)* (1995) FLC ¶92-565.
[7] *Official Trustee in Bankruptcy v Donovan* (1996) 20 Fam LR 802; (1996) FLC 92-703.

Section 79A which grants a Court the power to set aside an order for property settlement.

2.4 The power to set aside orders made pursuant to the *Property (Relationships) Act* is limited to applications brought by persons in respect of whom orders have been made[8]. Whereas under the *Family Law Act* it need only be a person affected, such as a creditor. On the other hand the State Courts are not restrained in their power to make orders about property in the way courts exercising federal jurisdiction are by the Federal Constitution. This inherent power over property gives the State Courts ample means to set aside an order that defeats a creditor's claim.

2.5 The alternative to consent under the *Family Law Act* is a Financial Agreement. It has some very distinct advantages to parties who have reached agreement about property alteration. It is prepared and executed without any oversight or approval from a Court. If properly done it acts to prohibit a Court from making any order under Section 79 altering property that is dealt with in the agreement. A Financial Agreement effectively ousts the power of the Court to make property settlement orders. However, like an order made under Section 79, a Court can set aside a Financial Agreement and in particular where[9]:

> *either party to the agreement entered into the agreement:*
>
> *(i) for the purpose, or for purposes that included the purpose, of defrauding or defeating a creditor or creditors of the party; or*
>
> *(ii) with reckless disregard of the interests of a creditor or creditors of the party;*

2.6 There is not a similar section in the *Property (Relationships) Act.* However, Section 37A(1) of the *Conveyancing Act 1919 (NSW)* provides:

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[8] Property (Relationships) Act 1984 (NSW) s 41.
[9] Family Law Act 1975 (Cth) s 90K(1)(aa).

Save as provided in this section, every alienation of property, made whether before or after the commencement of the Conveyancing (Amendment) Act 1930, with intent to defraud creditors, shall be voidable at the instance of any person thereby prejudiced.

2.7 It follows that there are significant means available to a creditor to set aside a property settlement that the creditor believes has permitted an asset to be removed from his reach. If the creditor's claim is to be successful he must prove that the asset was within his reach before the property settlement occurred. In the first instance he might simply allege that the asset was formerly registered in the name of the debtor. However, in some cases the non-debtor spouse who received legal title by way of property settlement may at all times have been the beneficial owner so far as equity is concerned.

3. The Law of Trusts and how it can determine beneficial ownership

3.1 Third party creditors do not only come knocking on the door when parties separate. In fact far more often a creditor is seeking to attack property of a debtor during the subsistence of that debtor's marriage or domestic relationship. A critical question in these claims is whether or not the property to be attacked by the creditor is in fact the property of the debtor. After the intermingling of finances, joint decision making and hurly burly of married life, which assets are the debtor's and which are the other spouse's? To the uninitiated, legal title might be regarded as a definitive answer. It rarely is in a marriage. Many spouses and domestic partners record legal title in a manner entirely inconsistent with the concept of true ownership at law. These principles have over time be adapted to consider true ownership of assets between spouses and domestic partners. Accordingly they have been used to remove from the reach of creditors assets that might at first glance have otherwise been available.

3.2 Every trust has four essential elements. There must be:

- A Trustee
- Trust Property

- A Beneficiary
- A personal obligation on the Trustee to deal with the Trust property for the benefit of the Beneficiary that is attached to the property.

The obligation on the Trustee is personal. A Beneficiary can compel the trustee to do certain things. It is a right *in personam*. But that right is also attached to property. It creates an "equitable interest" in favour of the beneficiary. It resembles a right *in rem*[10]. It attaches to the property and recognises that the real owner of property is the beneficiary. It recognises the beneficiary's beneficial ownership of the trust property.

3.3 The Express Trust

3.3.1 In an express trust the intention of the trustee to hold the property for the benefit of the beneficiary is 'expressed' at the time the trust is created. The intention can be evidenced in writing or orally but it must be expressed at the time of the creation of the trust. It cannot be inferred from subsequent written or oral expressions.

3.3.2 Section 23C(1) of the *Conveyancing Act* places a further restriction on express trusts. In most instances an express trust in relation to real property has to be in writing. The legislation's intention is to limit what might otherwise be a preponderance of fraudulent claims of beneficial ownership in real estate. There is an important exception to the requirement in Section 23 where the reliance on that legislation would itself perpetrate a fraud.

3.3.3 The most easily recognised form of express trust in modern use today is the Family Discretionary Trust. It is created by Deed. The Deed specifies whom the trustee will be, the subject matter of the trust, how that subject matter might be enlarged, whom the beneficiaries are or can be and the obligations on the trustee to deal with the trust property for the beneficiaries' benefit. A simpler form of express trust might relate to some shares that have been purchased in one person's name because of subscription

[10] Meagher and Gummow, *Jacob's Law of Trust in Australia, 6th Ed, Butterworths, Sydney, 1997*.

restrictions. If at the time that the shares where purchased the purchaser said to the beneficiary "These shares are yours. I will hold them in my name for you" an express trust exists.

3.3.4 In *Paul v Constance* [11] a Court found an express trust to exist in relation to a bank account that was in the husband's name and contained at his death £950 from a damages payout. There was evidence that the husband said to his de facto wife throughout their relationship words to the effect "The money is as much yours as mine." The Court found that language was sufficient to create an express trust in favour of the husband's de facto wife over one-half of the amount in the bank account.

3.4 The Resulting Trust

3.4.1 If a person purchases property in their name from funds wholly provided by another person, the law presumes that the person who provided the funds for the purchase is the beneficial owner of the property[12]. The person in whose name the property is acquired therefore holds that property on trust for the beneficiary. This a resulting trust. It arises from a presumed intention rather than an expressed intention. The requirement for writing in Section 23C of the *Conveyancing Act* is expressly excluded[13].

3.4.2 There is a difficulty in asserting the existence of a resulting trust from husband to wife and from parents to children. These are people who have an obligation at law to support the other. Where that relationship exists between the potential trustee and beneficiary the law assumes the property vested in the registered proprietor as a gift or advancement and so the fact that a related person paid the purchase price does not

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[11] 1977 (1) WLR 527.

[12] *Napier v Public Trustee (WA)* (1980) 32 ALR 153 at 158 and the discussion in Meagher and Gummow, *Jacobs' Law of Trust,* 6th ed,Butterworths, Sydney, 1997 at ¶1210.

[13] Conveyancing Act 1919 (NSW) s 23(C)(2).

matter[14]. This is referred to as the presumption of advancement. It does not apply however where a wife makes a purchase in name of her husband[15]. Neither does it apply at all regardless of who is the purchaser to parties to a de facto relationship[16].

3.4.3 It is important to carefully consider the facts surrounding a purchase to make sure there are no facts that might rebut the presumption. If there is any expressed intention that is inconsistent with what otherwise the law could presume, the trust will not exist. In *Muschinski v. Dodds*[17] the court upheld findings that the presumption of a resulting trust did not arise because the parties had expressed intentions about the ownership of the property at the time it was purchased that differed from the presumption upon which a resulting trust would arise.

3.5 The Constructive Trust

3.5.1 The circumstances that give rise to a constructive trust are varied. For the purposes of property alteration in domestic situations it is usually imposed to prevent an unconscionable assertion of a legal right in property.

3.5.2 In *Baumgartner v. Baumgartner*[18] the High Court of Australia considered a matter where the parties to a de facto relationship had pooled their earnings with a view to meeting all of their expenses and outgoings including living expenses and mortgage repayments on loans that were used to purchase two properties. One of the parties attempted to assert beneficial ownership of those two properties to the exclusion of the other party. Their Honours Mason CJ, Wilson and Dean JJ found that denying beneficial ownership to that other party who had made contributions to it and the joint endeavours of their relationship amounted to unconscionable conduct which attracts

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[14] *Martin v Martin* (1959) 110 CLR 297 and the discussion in Meagher and Gummow, *Jacobs' Law of Trust,* 6th ed, Butterworths, Sydney, 1997 at ¶1212.
[15] *Mercier v Mercier* [1903] 2 Ch 98.
[16] *Calverley v Green* (1985) 155 CLR 242.
[17] (1985) 160 CLR 583.
[18] (1987) 164 CLR 137.

the intervention of equity and the imposition of a constructive trust. The Court then proceeded to measure the parties "contributions" and imposed a trust over their property in accordance with that measurement.

3.5.3 Some of the members of the Court in *Muschinski v. Dodds* found that a Constructive trust existed. However when they came to make their orders they specifically said that the trust would arise from the date of their judgment and not earlier. The Court deliberately intended that the Constructive Trust did not come into being until the delivery of the reasons for judgment. This meant that a creditor with a claim that arose earlier in time might have priority. No such delay in the creation of the trust was discussed in *Baumgartner v. Baumgartner.* It remains an interesting issue and one that should be carefully considered as to the timing of the creation of a Constructive Trust. Some potential dates for the creation of a Constructive Trust are:

- the date of the purchase of the relevant real estate;
- the date of the last transaction or contribution that was made and is relevant to the Trust;
- the date that the assertion is made that amounts to unconscionable conduct; and
- the date of delivery of judgment.

4. Equity as an alternative to property alteration

4.1 Consider a hypothetical situation where a husband and a wife own as joint tenants a residence in which the wife lives with their children. The wife owns a car of minimal value. The parties have no other assets. The husband is engaged in property speculation and his latest project has failed, due he says in no small part to his recent separation from his wife. The investors in the husband's latest deal have brought proceedings against him for unjust enrichment and are seeking the payment from him of a monetary sum of $600,000. If those proceedings were successful there would be no assets from which to satisfy the judgment other than the husband's interest in the former matrimonial home. The home was acquired as to 5/6th from an

inheritance the wife received from her late father and as to 1/5th from the husband's savings. The husband and wife have agreed that the former matrimonial home should be transferred to the wife. The home is worth $1,500,000.

4.2 If the parties applied to a Court to have Consent Orders pursuant to Section 79 of the *Family Law Act* made in terms of their agreement and the husband disclosed to the Court his contingent debt of $600,000, the Court would probably refuse the application. If the parties made the same application but the husband did not disclose the contingent debt, and the investors' suit against him was successful, the investors would have a basis to set aside the consent orders. On the Court's re-exercise of discretion pursuant to Section 79A it is possible that the Court would regard the net assets of the parties available for adjustment as $900,000. If the wife received an alteration at the top end of the range of results of 80% in her favour she would get net worth of $720,000.

4.3 In Equity the circumstances of the purchase of this property and the money provided by the wife give rise to a Resulting Trust in favour of the wife in respect of 4/5th of the property. If instead of proceeding with their original agreement to ask a Court to make a property settlement order, the parties prepared an agreement that merely restated the circumstances giving rise to the resulting trust and transferred the property on those terms to the wife, with the wife paying proper consideration for the husband's remaining 1/5th share there would be no change in beneficial ownership that prejudices the investors. The wife will have retained the home at a cost of only $300,000, which if borrowed against the home leaves her with equity in the home of $1,200,000. This is a far better and more certain result than the $720,000 she might receive from a Court by way of property alteration if she used Section 79.

4.4 Even if equity is to be used to substantiate continuing beneficial ownership in an asset that is about to be transferred, it is prudent to make some documentary record prior to the transfer taking place. A common form of document to draw in these circumstances is a Deed of Acknowledgement of Trust. The document does not create a trust. It simply records the circumstances that gave rise to a trust that was created sometime in the past. It is

recommended that the Deed attach as annexures any documentary record at that time which supports the trust. A good example of a supporting document is a bank statement in the case of a resulting trust showing monies being withdrawn for the purpose of purchase to a property. Letters from a solicitor acting on a conveyance recording where funds to purchase a property came from would also be useful. The document is useful in two ways. Firstly, it can be submitted to an unsatisfied creditor making a complaint as a convenience summary of the circumstances giving rise to the continuing beneficial ownership. Secondly, it is the type of document that will assist any claim for exemption from stamp duty on the transfer of the trust assets from the legal owner to the beneficial owner.

4.5 What a deed of acknowledgement will not do, is achieve final property alteration in a binding way. For this to occur you still have to deal with existing statutory rights for alteration of property in a final way. With this in mind the Deed of Acknowledgement of Trust could be incorporated into a Financial Agreement or Termination Agreement. It is important to stress in any such Agreement that the transfer of the beneficial ownership in the trust asset is occurring as a consequence of the trust and not by way of final property alteration. Separate clauses or even a separate part to the Agreement can deal with the issue of final property alteration.

5. Summary

5.1 It should be apparent at this point that Equity can be used in the right circumstances to establish that assets being transferred from one spouse to another were never really owned by the former and were at all times beneficially owned by the latter. Once established, a creditor cannot establish any prejudice has befallen them by reason of the transfer. This accords with the rationale of the *Bankruptcy Act 1966 (Cth)* that exempts from the property that vests in the trustee those assets which the bankrupt owns on trust for another person or entity[19].

5.2 If there are issues about unsatisfied creditors lawyers should carefully determine what the existing beneficial ownership of assets is before embarking on property alteration. If the

[19] Bankruptcy Act (Cth) s 116(1).

beneficial ownership of assets accords closely with what was intended to be the position after property alteration, property alteration may not be required. Alternatively, it may be useful in a consent document to record the beneficial ownership of assets immediately prior to property alteration.

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