Navigating the Middle Market

Season 2, Episode 1 — Lachlan Wraith

Time	Transcript
00:01	**Anna Hacker** This is season two of Navigating the Middle Market, a podcast by Pitcher Partners. Every business leader reaches a moment where the decisions get harder and the path forward isn't as clear. Each episode, we sit down with experts to shine a light on the challenges, the turning points, and the strategies that separate businesses that grow from those that don't. I'm your host, Anna Hacker. Let's jump in. Today we're chatting with Lachlan Wraith. Lachlan is a barrister here in Melbourne who focuses on the wills and estates and family law space. He's worked extensively with families, business owners, and high net worth individuals to resolve disputes and manage a distribution of assets, drawing on both his legal expertise and his experience within the trustee company industry. In this episode, you'll hear Lachlan share practical insights on how families can safeguard their businesses and wealth from succession planning and governance to managing the risks that come up when personal relationships and business interests overlap. Let's jump in. Hi Lachlan, welcome to the show. I think that what our listeners would love to understand is what happens if they have just grown their business, they're in that growth phase or maybe they've just finished it, and then there's a relationship breakdown of one of the key parties.
01:17	**Lachlan Wraith** Well, so there's quite a bit to that question. It depends on who the relationship is between that's broken down. Is it a relationship between the founder of the business? So let's call them mum and dad who started the business. If their relationship breaks down, is it a relationship that is broken down between one of their children and a spouse in circumstances where the child and perhaps the spouse have been working in the business? Is it relationship between one generation and the next where the mum and dad have been running the business, the kids have been working in it, and then there's a falling out between the kids and mum and dad? So the relationship that we're dealing with is significant, as is the structure in which the business or through which the business is operated. Is it a trust, is it a discretionary trust, a unit trust, a number of trusts, is it just through a corporate entity, who are the shareholders? Who's the appointor of any trust, who control the corporate trustees, what do the trust deeds say, what do any relevant corporate constitutions say? So, you know, there's a thousand different permutations and combinations, but if there's a significant amount of money involved, then people typically will find things to argue about and to disagree about, and then that's where the court comes

	in.
02:37	**Anna Hacker** And so it sounds like there's not a one size fits all approach to any of this area.
02:41	**Lachlan Wraith** No, it's absolutely bespoke in every instance, depending upon on the particular situation that's being confronted. So the areas that I deal with mostly are situations where these sorts of issues find their way into something that's before the family court and disputes in the Supreme Court, often dealing with deceased estates, but also disputes between siblings. Typically and the control of entities which were established by their parents in circumstances where their parents have now passed away. So there's various jurisdictions in which these issues can be fought through as well as various ways or issues over which they can be fought.
03:22	**Anna Hacker** And probably a lot of our listeners are thinking, Okay, I'm about to have to go to court. The court will look at this in the same way in my family law matter as it will if it was a deceased estate. Is that actually the case?
03:33	**Lachlan Wraith** No. So deceased estates are dealt with through state courts, principally the Supreme Court, but the county court also has jurisdiction to deal with certain estates disputes called testator's family maintenance disputes, essentially where someone contends that the deceased person had an obligation to provide for them but failed to do so. There's particular provisions in the Administration and Probate Act that enable certain classes of people to To make a claim against an estate in those circumstances, and the county court has jurisdiction to deal with with those matters. And also you see these issues sometimes being fought out in VCAT in circumstances where a party has lost capacity, say due to dementia, in circumstances where they may have been the controller of significant wealth, and then the next generation are vying for control through them. So there's a number of different places it can play out, but significantly between the state courts. And calling VCAT a court for that purpose, even though it's technically not, it's a tribunal. But the state courts and the family court, which is a commonwealth court, is that they adopt quite different definitions of property. So under the Family Law Act, the court adopts a very expansive definition of property which takes it well beyond what the common law or equitable principles, certainly accounting principles, would normally consider to be property, and in particular the family court has the power and as a matter of practice often does, look through trust structures and treats the assets of a trust or

	the trust itself as if it were property of a party in circumstances where the state court simply wouldn't do that. So that is a significant difference in the protection that trusts can provide in a family court context.
05:14	**Anna Hacker** And so then let's say we have a family business, it is growing, it's expanding, and there's children that are potentially about to join. Are there things that the family as a whole should consider as those children are joining the business?
05:29	**Lachlan Wraith** well, yes, many of which are probably outside my field of expertise, but if what is contemplated as there being employees, consideration needs to be given to the terms of their employment obviously, and the rights and entitlements that they're getting. But also consideration needs to be given to any representations that are being made to the children about future benefits that they will receive in exchange for working in the business because there's an area of law called equity which enables the court to effectively declare that legal interests exist by virtue of, for example, representations that are made. If you come and work for the business one day it'll all be yours, sort of claim, can in certain circumstances give rise to person to whom that representation is made actually getting a legal interest by virtue of them having acted in reliance upon that representation. And that's something which is acknowledged in state courts as well as in family courts. But what you sometimes see in the Family court context is that the husband wife will have been working in a business owned by one of their parents for many years and the relationship breaks down and the party whose parents own the business says, Well, it's not mine. I've got no property in it, it might be worth fifty million dollars, but it's all mum and dad's. And the other party says, Well, hold on, you know, we worked for less than market wages. We devoted huge hours outside normal working hours to this, all on the basis that we were being told that one day it'd all be ours. And where those sorts of claims are being made, then the court has to determine whether there are recognizable legal rights that the spouse or the child have in the assets that are prima facie under the control of the parents. So Look, it's difficult to say what to consider because, you know, every business will be different and the structure it's set up through will differ. But that is one area that's gives rise to a significant amount of litigation is the claim that representations were made that if you work in the business you will receive a future benefit. So where children are coming into a business, it's very important to be there for there to be clarity. If it is the intention that they're working in the business on the basis that one day it will all be theirs. Then fine, make it clear. But if they are just getting a job in the business, then make sure they're being paid appropriately, so that it cannot be said that that they're acquiring any equitable interest by

	virtue of their participation.
08:00	**Anna Hacker** And so would imagine that one of the things that is often brought up at that point when a child might be joining the business or or potentially taking on a bigger role is is there a need to have a binding financial agreement with their partner or potentially future partners if there's not one already on the in the picture? Have you seen that as being something that then comes up later that there was a requirement to have that binding financial agreement? And potentially for our listeners who might not know this terminology, can you maybe briefly explain what a binding financial agreement is?
08:29	**Lachlan Wraith** Okay, so many people might know it as a prenup or something of that description. It's an agreement which is recognized under the provisions of the Family Law Act, which if executed in accordance with the terms of the Act, is effective in ousting the jurisdiction of the family court to make orders dealing with the property the division of the property of the parties. So and it's it doesn't have to be entered into prior to a marriage, it can be entered into at any time either prior to, during or after the breakdown of a marriage. And when I say marriage, de facto relationship is interchangeable with marriage in this context. Not all contexts. In the Supreme Court estate area there are significant differences between the rights and entitlements of de facto partners and married couples. So a binding financial agreement can be used to prevent the spouse of a child from making any claim with respect to the business of the spouse child's parents, or indeed making any claim against the assets of the child themselves, so long as the agreement's enforceable, which means that the formal requirements of the Act need to be complied with, which include each party getting independent legal advice and getting a certificate from the lawyer that such advice has been provided, but also that the agreement is valid having regard to the general principles that are applied to contracts. Including significantly concepts like duress or undue influence, which can vitiate a contract. So if someone is effectively forced to sign a contract to the extent that their free will is effectively overborne, then the court will not hold them to be bound by that contract. And that applies to binding financial agreements as well. So if the circumstances are such that the spouse of the child can convince the court that they were effectively coerced into signing the agreement, then there's a possibility that the agreement might be set aside. But failing that the agreement will be effective and it will stop the spouse from having any access to the family's wealth.
10:27	**Anna Hacker** And so all of the succession planning and the tools that I'm hearing about is about planning. It's about getting things in

	place earlier rather than later to try and be as clear as possible around what happens in the future, setting things up now for something that might happen in the future.
10:44	**Lachlan Wraith** Yes, that's true, but I'd caution against trying to deal exclusively with a particular set of circumstances. For example, the breakdown of this particular child's marriage, without regard to the other circumstances that might impact the arrangements that are being put in place. If you focus on on one particular problem, you can come up with an estate plan that might deal pretty effectively with that, but give rise to others. And I'm what I've got in mind in particular is that in the family court, as I said, it has an expansive concept of property, which includes potentially property in trusts that are controlled by a party to a relationship and from which they're entitled to benefit. And the only way that you can really guarantee or have a very high probability that the family court won't have regard to trust assets is by ensuring that the child doesn't have control of those assets. So they're not a sole appointor, they're not the sole shareholder of the corporate trustee and so on. And you can put arrangements in place which are highly likely to prevent the court from finding that the trust assets are the assets of that child. But unfortunately, that also gives rise to another range of potential problems because if it's not the child who's in control of the trust, it's somebody else. And there's a real risk that that somebody else might have a different view about their responsibilities with regard to the trust and deal with the assets of the trust in a way that isn't what the parents might have intended when the thing was being set up. So look, you know, I if your only objective is to protect assets from matrimonial property division, there are certainly things that can be done, but they can be things that come with pretty significant consequences in other areas.
12:17	**Anna Hacker** And presumably, again, it's not one size fits all. You need to look at the circumstances of each case and every circumstance then changes the approach. It's definitely not a vanilla approach.
12:29	**Lachlan Wraith** It's not vanilla and the law changes. It's not just the family situation that changes. But the law's evolving in this area. There are a number of cases that are going through the family court system at the moment, which one, for example, a case of Woodcock is a case that in which it's accepted that the husband doesn't have control in the relevant sense of a series of trusts, but he's a beneficiary and he is very involved in the control of the trust, but he doesn't have unilateral control. And in that case, the courts determined that his right to be considered for discretionary distributions is of itself property which is capable of being valued. And that case is actually

	starting today, the day that we're recording the trial of the question of exactly how a value is to be attributed to that right to be considered for discretionary distributions and with the objective of fixing a value on it. So, you know, within a matter of weeks or months, we'll know the answer to whether a bare right to be considered for discretionary distributions is enough and if so, how the court goes about about valuing it. So it's impossible to put in place things now that will deal with the circumstances that may concern you in the future because you don't know now exactly what those circumstances might be and the law might change in the meantime.
13:40	**Anna Hacker** The majority of the businesses that that I probably deal with and probably you see as well, within the family court and potentially also in estate litigation, the estate litigation space, most likely deal with trusts or have trusts as some form of structure within them. Certainly. Now, trusts don't go on forever unless they're a perpetual tradable trust, or potentially you're in South Australia, which doesn't have the rule against perpetuities.
13:57	**Lachlan Wraith** Yeah.
14:08	**Anna Hacker** So is that also something that we can set things up now, but they'll go for eighty years and then you have to rethink? I mean, is that something that's even coming up in the courts at the moment when it comes to
14:18	**Lachlan Wraith** It's not something that I've come across directly. The what you say is absolutely correct. In most jurisdictions in Australia and I think in most common law countries, there are limits to the duration of a trust and when the trust ends it vests is the term that's used, and the capital of the trust has to be distributed. And the trust deed might identify the recipient of that capital or it might be up to the pardon me the trustee to identify who it is or That will benefit from a usually from a class of discretionary objects. So if a trust comes to its end and the capital has to be distributed, then at that point there are two significant considerations. One is it's a highly likely to be a capital gains taxing event. The distribution of the assets from the trust may well trigger capital gains, and the property will potentially become property under the control of individual recipients, in which case it will almost certainly be considered property for the purposes of, for example, family court proceedings.
15:13	**Anna Hacker** And I think that what we're probably going to see in the next decade or or two decades is probably different approaches to

	trusts in that we're going to be trying to manage these vesting of trusts. You know, trusts were very popular in the 70s and eight and particularly the eighties, I believe. A lot of trusts were being established. There's certainly older trusts, but we will come to a point where they're they're all vesting. So I think that certainly for businesses, planning for what happens when. Is actually something we need to start doing probably decades in advance. Again, this is general. We're not saying for every
15:47	**Lachlan Wraith** One hundred percent. But I would also add that the one of the significant considerations there are tax considerations. What tax will be attracted and how will that be borne, particularly if, as you say, the trusts are the vehicle through which a trading entity is being operated and the transfer of the shares in that entity has to occur by virtue of the vesting of a trust, then how much will the tax be and where will it be paid from? Really important considerations, ones that you should speak to your accountant about, not me. Or at least a lawyer who specialises in providing tax advice and has insurance that covers them for doing so. But it is a yeah, absolutely a very real issue.
16:22	**Anna Hacker** What we are also seeing quite a bit of at the moment was this idea of a sixty year trust potentially that seemed like a long time in the future, trust going on for sixty years. Well, sixty years is almost over and we're trying to extend trusts quite a bit at the moment. I think that that's something that is also going to be coming up more and more, potentially also in the family law space, because if you have a trust that's meant to end soon, but actually could go for another twenty years, that's probably gonna have another effect potentially in the family law space.
16:47	**Lachlan Wraith** It can. The Family Court has pretty expansive powers under Part VIIIAA (that's Roman numeral eight, capital A, capital A), because the Family Law Act has its own peculiar nomenclature. Anyway, under that part of the Act, the Court has the power to intrude upon the interests of third parties in accessing what the court determines to be the property of the parties. So if you have a case where, for example, a trust is set up and the capital of the trust is divisible amongst the equally amongst the lineal descendants of the trust founder and there's no scope for the amendment of that provision under the trust deed, then the family court will probably view that entitlement as an existing proprietary right of the lineal descendants. And if the relationship of that person breaks down and if the court considers it necessary to do so and otherwise appropriate to do so, it's within the power of the court to accelerate the vesting of the trust so that that interest could be realized. Conversely, if the vesting of the trust was

	imminent and there was a concern from a party that the vesting date was going to be extended for the purposes of defeating what would otherwise be a claim under the Family Law Act, then the court would have the power to grant an injunction preventing a third party trustee from exercising that power. Now whether or not the court would exercise that power is a different question to whether or not the court has the power, but almost certainly the court has the power to do that for the purposes of accessing a party to the proceedings proprietary interest in the trust.
18:14	**Anna Hacker** And so moving on to a slightly different but similar topic, we've all heard of the bank of mum and dad. I'm assuming that this comes up quite a bit in family law proceedings. We have people saying, well, actually that was not a gift, that was something that mum and dad loaned us and they want it back now. But I don't have any documents and we haven't actually registered a mortgage or a caveat. How does the court look at that?
18:37	**Lachlan Wraith** Well, what you say is absolutely correct. It's almost universally the case that where there's been a substantial injection of capital from one party's parents, the party whose parents it was says that was a loan, and the other party says, no, no, no, it was a gift. And so the party whose parents it was says there's a liability on the balance sheet equal to the amount of money we receive, and the other one says, No, there's no liability. And then the court has a question of fact and law it needs to determine about whether or not there is, as a matter of law, a loan owing, firstly. And secondly, whether even if it appears on the documents that there's a loan owing, whether as a matter of reality that loan is an effective legal loan or whether it's just a sham created for the purposes of defeating claims in the event of a matrimonial breakdown. And the way the court determines those cases it really depends on the facts of every case, which is a glib lawyer's answer. But On one extreme you have a situation where there's a clearly documented loan that provides for interest-free payments which are in fact actively repaid on a periodic basis, where the existence of the loan is disclosed to third party lenders when someone's going to get finance and so on. So in in those cases there's no doubt about the existence of the loan, and the family court would almost always be expected to find that that was the loan. It's a debt on the balance sheet which need to be paid. On the at the other extreme, there are the cases you referred to where there are no documents and the money was advanced many, many years ago and there's never been any call for repayment and it's never been mentioned. And in in those cases it's obviously much less likely that the court will find that there's a legally effective agreement. And you can even have interesting issues of the limitation of actions periods where there's you know,

	whether whether times expired in circumstances where there's no date for repayment, which means that the limitation period runs from the date of the advance and so on. It does all depend. But If parents are considering giving money to a child but they are of the view that what they're doing is genuinely lending the money, then they ought to ensure that it is clearly and properly documented and that there is a requirement for periodic payments to be made, whether by way of interest or interest in capital. Or at the very least, perhaps the condition for repayment is that a particular property is sold and it's repayable upon the event of the sale. But there's no universally definitive way of saying what will be accepted as a loan and what won't, because the ultimate question for the judge is what is the reality of the situation, despite what the documentation might say or what the evidence of the parties might be, what the judge actually believes to be the case and whether there was an intention to create legal relations, which is one of the fundamental components of a binding contract, is an intention to create legal relations. And if the judge finds that it was all just an artifice to to avoid a matrimonial breakdown, then the court will find that there was no intention to create a legal relationship and there was effectively a gift. So yes, it depends. But if people's intention really is to make a gift with no recourse, but they think that it will help them in some way to pretend it's a loan, probably they're just going to be lining the pockets of lawyers down the track, because there'll be a fight about the legitimacy of the arrangements and lawyers will be paid to argue it.
21:47	**Anna Hacker** And presumably paid a lot less if the right documentation is put in place at the start.
21:52	**Lachlan Wraith** Yes, exactly. If it's if it's genuinely intended to be a loan, then make it so and behave as if it's a loan. You know, if there's a right to caveat under the document, actually lodge the caveat over the title. And if there's an entitlement to interest or capital repayments, make sure that they're made. And if they're not made, make sure there's correspondence about the fact that they haven't been made. And, you know, if circumstances change and parents aren't as nasty as banks, and if their child is in a position of financial difficulty because maybe there's some grandkids around now and they're prepared to agree to extend the period for repayments or whatever, just do it formally. Document it all. Treat it as if it was actually a loan because that's what it is. And if it's intended to be a gift, just let it be a gift. I think one of the things that drives a lot of people's concerns in this area is the assumption that family courts automatically divide assets fifty fifty between the spouses. And so they think if they give their kid a couple of hundred thousand to buy the first home, then automatically half of that's going to be going to the other spouse. And that's just not

	the case. The court takes into account the contributions the parties have made what they bring into the relationship, what the contributions they make during the relationship and after the breakdown of the relationship. And gifts from parents or inheritances or gifts from anywhere else that are intended to benefit one party to the relationship will be taken as being a contribution by that party. They won't get dollar for dollar recognition because over the course of the relationship there'll be, you know, thousands of other contributions made, both financial and non-financial, which the court's obliged to take into account. But it's not as if the fact of the gift will be ignored. It can't be ignored. It's got to be taken into account. So if, you know, you want to give your kid a leg up by giving them the deposit on their first home, maybe the easiest thing is just to treat it like a gift. And let them get on with their lives. And if the relationship doesn't work out, well, that's just part of life. But it's not the end of the world. And the fact of the gift won't be ignored.
23:41	**Anna Hacker** And so it sounds though along the way, the most important thing really is advice to make sure that what you want to do is likely to have the outcome that you want.
23:50	**Lachlan Wraith** Yes, and good advice will involve really trying to get to the heart of what your concerns are, what it is you're trying to achieve, and making sure that you're aware of what the potential downsides are of whatever it is that you're proposing, because there might be considerations that you haven't turned your mind to, which are really quite significant. And if you get good advice, that advice will draw those matters to your attention so you don't end up putting in place arrangements which ultimately come back to bite you.
24:16	**Anna Hacker** Is there anything else that you think the listeners would love to hear about in this space? I think that you probably always have a million questions thrown at you when you talk about what work you do, but is there anything that you think it might be nice to leave the listeners with?
24:29	**Lachlan Wraith** Well, just 'cause it's been front of mind of late, there's a case that will determine whether the interest that a husband has in a business which was created by his great grandfather in nineteen seventeen, which was held through a series of trusts and which came under arguably came under his control when his father died at about the time that his twenty year relationship with his wife broke down, whether the assets of those trusts ought to be treated as his assets. And it's a very important case from the clarity that it will give to an earlier

	decision of the High Court in a case of Kennon and Spry, where the High Court said that where someone controls a trust and has a right to benefit, that the court can treat the assets of that trust as if it's property of the parties to the marriage. And this case, which is published under the name of Caldwell, will determine, at least at the level of the full court, whether the control of a trust and the right to benefit is enough. Or whether other considerations such as the history of the trust and its assets, the purpose for which the trusts were created, whether provisions in trust deeds which limit beneficiaries to being lineal descendants of the trust founder and so on, the question of the relevance of those sort of considerations to whether the court treats the assets as if it were property of the parties
25:44	**Anna Hacker** And so Lachlan, is there anything that listeners should consider as they're setting up their succession plans for their business and I guess that linking that into them personally? I know that's a big topic, so you don't need to Well it is.
25:55	**Lachlan Wraith** And so really the most important thing they should be doing is getting good advice because it's not just me trying to generate work for accountants and lawyers. The fact is that every family situation is different and bespoke arrangements are going to be required if you've got significant assets that need to be dealt with. If it's just you know, a house and a bit of super or whatever, then it's not too hard to provide advice. But if you're dealing with a particularly a trading corporate entity and there is a concern about how that's to pass. You know, if it's you just have to look at the Murdochs recently. If you intend to divide control equally amongst children, then you're potentially setting them up to be in conflict with one another. If you intend to consolidate control with one child so they can carry on the business, then there's the issues of how you treat the other children fairly. And the importance of the structure through which the business is operated really comes to the fore there because if For example, the business is held by a company in which the person whose estate planning has been considered holds all the shares. So effectively what you're asking is how will the shares in that company be left by the will of the person who will then be deceased. The jurisdiction of the court to make orders that it considers just and equitable to effect adequate and proper provision for family members will be engaged. So that if all the shares are left to one person but that leaves other children with next to nothing, then those other children will be able to go along to the Supreme Court or the county court and say that the deceased failed to make adequate and proper provision for me and I want a chunk of the estate. Different considerations apply if you're talking about passing the control of assets that are held through trusts, because those trusts won't directly fall within the remit

	of the assets of the estate to be distributed and to be dealt with in a family provision claim, but a second set of issues can arise in relation to the exact mechanisms that you use to confer the control of the trust on the next generation. And if you concentrate that control too much, well, that arcs back to what we were talking about earlier about control and right to benefit being a key indicator of assets being treated as property in the family court. So if you leave one child with complete control, then it's more likely that the assets of the business will be considered their property for the purposes of the family court proceedings. If you leave the control amongst various siblings, less likely that if it's through a trust, less likely that the trust assets will be considered the property of of that child, but their right to benefit might be considered property. If it's just shares in a company, then a child's shares in that company will be considered their property. And if you're introducing other siblings, then there's the potential problems of intra sibling rivalry and conflict and so on. So, you know, there's just a lot to consider and when engaging in estate planning in this space, it's just important to sit down with people who are experienced in the area and talk through all the permutations and combinations and come up with something which works for your particular circumstances.
28:54	**Anna Hacker** We will put the links to each of the cases you've referred to in this episode in our show notes. Because I think that the listeners their interest will have been piqued. They'll want to know more. So I thank you so much, Lachlan, for being on the show today and for all sharing all of your knowledge and wisdom.
29:10	**Lachlan Wraith** Please, thank you.
29:14	**Anna Hacker** You've been listening to Navigating the Middle Market. This podcast is brought to you by Pitcher Partners Melbourne. To learn more about how Pitcher Partners can help you scale your business, head to our website, pitcher.com.au. To make sure you don't miss an episode of Navigating the Middle Market, be sure to subscribe to or follow the show in your podcast app. And while you're there, leave us a five-star review. It really helps others to find the show. I'm Anna Hacker, and I'll see you in the next episode.