The five golden rules when trading with a Trust

By Rhett Kipps and Karl Hill*

Trading trusts have become increasingly common in Australia.

The term “trading trust” refers to an entity (trustee) that is conducting a business under the authority of a trust instrument in its capacity as trustee of a trust.

Trust structures create confusion and many legal issues for trade creditors. Often, trade creditors may not even realise they are trading with a customer as trustee of a trust.

This article provides a broad overview of trading trusts, how trading trusts apply in the context of trade credit, and some important pointers to trade creditors.

1. A trust is not a separate legal entity

At its most fundamental, a trust is a relationship where a person or legal entity such as a company (being the trustee) holds and deals with property for the benefit of others (otherwise known as beneficiaries).

There are three essential features of a trust:

(a) One or more persons or entities called a trustee;
(b) Trust property or assets; and
(c) One or more beneficiaries.

The trustee holds the property ‘on trust’ for the beneficiaries. At law, the person entitled to deal with the assets of the trust is the trustee. When you are dealing with the trust, you are actually dealing with the trustee as the legal entity.

The beneficiaries have an interest in the trust property (which in the case of a trading trust includes a business), and repose great trust in the trustee to exercise legal rights over their property.

A trust deed often documents the nature of the relationship between the trustee, the beneficiaries and how the assets may be dealt with. Ordinarily, the following documents are proof of a trust relationship:

(a) A deed of trust;
(b) If the trustee is a company, company minutes confirming that the company is acting in its capacity as trustee of the trust; and
(c) A separate bank account for trust money.

2. You sue the trustee, not the trust

Generally, the trustee is personally liable for its acts and omissions as trustee, including ordinary trading debts incurred.

As the trustee is the one exercising legal rights on behalf of the trust, it is legally responsible for unpaid liabilities. The trustee is the proper defendant in respect of any proceedings or claims arising out of the activities of the trust. The trustee’s personal liability to the trust’s creditors is generally unlimited, unless that liability is modified or excluded by contract.

For example, if a trust has ordered goods or services then it is the trustee who bears liability to complete the order and pay the debts, even if the credit application nominates the trustee “as trustee”.

The creditor’s remedy is against the trustee personally and not the trust (or the beneficiaries), as the trade debts are deemed to be the trustee’s own debts.

However, trustees have what is referred to as a “right of indemnity” and an associated lien over the assets of the trust to recoup the liabilities and pay the debts the trustee incurred whilst lawfully acting on behalf of the trust. This valuable right creates a lien and charge (security interest) in favour of the trustee that takes priority to any of the beneficiaries or later appointed trustee.

3. Trust assets cannot be attacked directly

Ordinary unsecured trade creditors cannot attack trust assets directly.

As the trustee is the entity that incurs liabilities in the course of trade, the trustee is personally liable to be pursued by creditors.

Insolvency proceedings may be taken against a trustee, if it does not pay the debts.
If this occurs, the person appointed to the trustee (trustee in bankruptcy or liquidator) will call upon the right of indemnity in order to realise trust assets for the benefit of creditors.

This means that in the ordinary course, when the trustee incurs debts, it realises trust assets with which to meet the liabilities which it incurred in its capacity as trustee.

Usually, a trustee has a right of indemnity from trust assets to recoup payment of liabilities which it incurred in its capacity as trustee, unless the trust deed specifically excludes such trust assets from being recouped. This has become rare because the law now provides that directors of corporate trustees will be personally liable for the debts incurred in the event that the trust deed provides that a corporate trustee cannot realise trust assets to meet its liabilities.

A creditor pursuing a trustee may face the following problems:

(a) insufficient assets of the trustee or in the trust;
(b) the trustee’s right of indemnity being excluded by the trust deed; or
(c) the trustee’s right of indemnity being lost by misconduct on the part of the trustee.

In some instances, the creditor may be able to subrogate into the trustee’s right of indemnity to the trust’s assets where a claim against the trustee itself would be fruitless.

While a trustee can limit their liability to others by providing in a contract that their trustee’s liability is limited to the assets of the trust. In practice, this is rare and is mainly used by large institutional trustee companies.

The use of language such as “as trustee only” or “as trustee but not otherwise” might indicate an exclusion of the trustee’s personal liability to the creditor. This should put you on notice and prompt you to take specialist legal advice. A properly drafted credit agreement will avoid a lot of these issues by conferring the maximum protection available to the creditor.

To avoid a situation where the trust assets are insufficient to meet your claims, you should consider obtaining security from the trustee both in its own right and as trustee. For example, your terms of trade should include something to the effect of “the guarantor charges all property, whether held in its own right or in its capacity as trustee”.

A trustee can also, in some instances, pursue beneficiaries to enable it to meet liabilities of the trust. If trust assets have been distributed to beneficiaries in an attempt to defeat creditors, then they may be pursued to repay the trust assets received.

4. Get your PPSR registrations right

The Personal Properties Securities Act 2009 (PPSA) imposes significant obligations upon trade creditors seeking to enforce security interests.

Trading trusts often hold an Australian Business Number associated with the affairs of the trust (as taxation law treats trusts are separate entities, despite the true legal position).

Although all dealings are with the trustee in reality and the trustee becomes liable for any debts incurred whilst trading, the existence of a trust may alter how you are to register any security interest you may have under the PPSA.

The PPSA provides that registration of security interests in respect of trust property may need to be registered against the ABN of the trust (rather than the trustee’s ACN or individual name) in order to be effective. Some creditors elect a conservative course of registering their security interest against both the ABN of the trust and the ACN of the trustee.

The following checklist may be useful to tick off when trading with a trust:

(a) Who is the trustee? If the trustee is a company, what is its ACN?
(b) What is the trust’s ABN?
(c) Does the credit application confer a security interest? Does it extend to both assets held in the trustee’s own right and on trust? Should I seek advice on how to register this security interest on the PPSR?

Conclusion

The law regarding trusts is complex. Likewise complexities often arise when dealing with a trust. Creditors should take considerable care to be aware of the above to ensure that their interests are protected and take specialist legal advice when required.

5. Know who you are trading with

In our experience, it is not unusual for trading trusts to apply for credit by identifying only the name of the trust (as opposed to the trustee), and for the trade creditor to not possess a copy of the trust deed.

This creates considerable difficulty for the creditor in pursuing an unidentified trustee.

A properly drafted credit agreement will require a customer to complete the necessary fields to capture the required information.

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