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Abstract
[extract] One popular form of business structure is the unit trust. Is there a business situation to which the unit trust structure is optimally suited? The other popular form of business structure is the corporation. The corporation can be used as the business structure for most business situations. Is there situation in which use of the unit trust would be more suitable? This will compare the unit trust structure and the corporate structure to determine if there is a business situation to which the unit trust structure is optimally suited.

Keywords
rights of investors, rights of management, unit trust, corporations, corporate law

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THE UNIT TRUST
A COMPARISON WITH THE CORPORATION

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Many modern businesses would not exist unless their management and capital came from different sources. Many persons with capital to invest are not able to manage a business or do not desire to manage a business. Similarly many competent managers do not have sufficient capital to establish or maintain a successful business. Both groups require a form of business structure which will allow capitalistic investors and managers to come together to establish a joint business.

Within any such business structure the rights of both parties must be protected. The investor will only wish to invest his money in a viable business operated by trustworthy managers. Protection must be given to the investor to ensure that he receives accurate information regarding the business before he gets involved. While the investor is involved in the business he will require periodic information updates so that he can continually assess whether or not he trusts the business venture. If he loses trust in the business then he should be able to intervene in management to re-establish that trust or if that is not possible to terminate his involvement with the business. While his trust in the business exists he should not be able to interfere with management and his ability to withdraw his investment should be limited. Management has agreed to manage the business for the benefit of investors. As long as management acts for the benefit of investors they should be permitted to operate the business without any interference from the investors. This will protect management's right to have a business to operate. Therefore a balance must be struck between the rights of investors and the rights of management. Pre-defining the rights of each group will assist in preventing conflict between the groups. This will protect the continuation of the business as a going concern and will ensure that maximum resources are used for profitable purposes instead of for dealing with internal conflict.

Different balances of these interests will be appropriate for different situations. For example an investor who contributes substantially all of the assets to be used in a business with which he is very familiar will want to have substantial involvement in the management of the business. In contrast involvement in management (except in extraordinary situations) will not be desired by an investor who only wishes to pool his funds with other persons so that the pooled fund may be efficiently and profitably invested by
professional investment managers who are familiar with the financial markets. Therefore prior to establishing a business the founders must consider what balance will be appropriate and based on this assessment must choose a business structure which will meet these requirements. Of course the chosen structure must also accommodate any other requirements that the founders may have.

Different business structures are dealt with differently under the law. Different business structures may strike different balances between the rights of investors and the rights of management. Therefore for any given business there may be a structure which provides an optimal balance between the rights of investors and the rights of management.

One popular form of business structure is the unit trust. Is there a business situation to which the unit trust structure is optimally suited? The other most popular form of business structure is the corporation. The corporation can be used as the business structure for most business situations. Is there a situation in which use of the unit trust would be more suitable? This paper will compare the unit trust structure and the corporate structure to determine if there is a business situation to which the unit trust structure is optimally suited.

The Historical Development of the Unit Trust

The unit trust had its beginnings in the nineteenth century. At that time it was known as a 'management trust'. The management trust was one type of a 'deed of settlement company'.\(^1\) Unincorporated trading companies were common in England at the end of the eighteenth century. These were also organised as trusts with the property of the company held by trustees for the benefit of investors pursuant to a 'deed of settlement'. This structure became the model for registered companies under legislation regulating these companies enacted in the middle of the nineteenth century.\(^2\) As such the unit trust is a forerunner of the modern company.

Section 4 of the Companies Act of England enacted in 1862 provided:

No company association or partnership consisting of more than twenty persons shall be formed after the commencement of this Act for the purpose of carrying on any other business' (that is to say any other business other than banking) 'that has for its object the acquisition of gain by the company association or partnership or by an individual member thereof unless it is registered.\(^3\)

In *Sykes v Beadon* Jessel M.R held that a unit trust was an illegal association of more than twenty persons carrying on business for gain contrary to this section of the Companies Act. As a result of this decision the unit trust virtually disappeared.\(^4\) However the unit trust was saved by a

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2. Ford HAJ 'Unit Trusts' (1960) 23 MLR 129 at 130.
3. *Smith v Anderson* (1880) 15 Ch D 247 (CA) at 273.
4. (1879) 11 Ch D 176.
5. Above n 1.
decision of the full Court of Appeal in Smith v Anderson.6

In Smith v Anderson the Court held that the unit trust with which it was dealing did not contravene this section. The Court gave four reasons for this. The first reason as stated by James LJ was:

I cannot find that this deed constitutes any association whatever between the persons who are supposed to be socii. One man...buys from the trustee a...certificate with all the chance of profit attaching to it. Another man goes the next day...and gets...another fund which they have in their hands. The first man knows nothing of the second and the second knows nothing of the first; they have never come into any arrangement whatever as between themselves. There never has been anything creating any mutual rights or obligations between those persons. They are from the first entire strangers who have entered into no contract whatever with each other nor has either of them entered into any contract with the trustees or any trustee on behalf of the other there being nothing in the deed pointing to any mandate of delegation of authority to anybody to act for the certificate holders as between themselves and nothing as it appears to me by which any liability could ever be cast upon the certificate holders either as between themselves or as between themselves and anybody else. Therefore I cannot arrive at the conclusion that the certificate holders form an association within the meaning of the Act...7

The second reason given was that if they were an association then they were not formed for the purpose of carrying on business. James LJ stated:

I am unable to conceive any state of circumstances in which it could be averred that any contract had been made by or on behalf of the body of certificate holders either by any member of themselves or by any other agent or manager for them. Now people cannot be said to carry on business when it is utterly inconsistent with what they have done and with what they have said and inconsistent with the nature of the whole transaction that they should be parties directly or indirectly either by themselves or through any agent for them to any contract or be liable for any act of misfeasance or neglect of any manager agent or servant.8

The third reason given by James LJ was that:

...if there is any business at all it is to be carried on by the trustees. Whatever is to be done is to be done by the trustees.... A trustee is a man who is the owner of the property and deals with it as principal as owner and as master subject only to an equitable obligation to account to...his cestui que trust.9

The fourth reason given by James LJ was that:

...nothing that is to be done under this deed by the trustees comes within the ordinary meaning of 'business'...The deed appears to me to be merely a trust deed of property for investment the investment being spread over a number of

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6 (1880) 15 Ch D 247 (CA).
7 Above at 274.
8 Above at 275.
9 Above.
different securities so as to enable persons who choose to invest their money in
this way to avail themselves of...the doctrine of averages that is to say that if a
large number of different independent securities of a hazardous description are
held together the loss upon some will be compensated by the gain on others....

The decision is important in more than a merely historical context as s 112
of the Australian Corporations Law is of similar effect to s 4 of the
Companies Act 1862 of England. Therefore in accordance with this decision

... it is not possible to allow unit holders to have that degree of control over the
trustee or the manager. [To give detailed directions as to the day to day
conduct of the business] The conferment by the trust instrument of a power of
detailed direction would make the unit trust an unincorporated joint stock
company.11

If a unit trust were organized so that the trustee was subject to such a degree of
control by the beneficiaries that he could be said to occupy the dual positions of
agent and trustee it might not be possible to deny that the unit holders
constituted an association on the ground that there was no contractual relation
between the unit holders inter se.... The manager in making contracts with each
investor would be acting as agent for all the previous investors and would bring
all investors into contractual relations with each other.

Given that the manager was agent and given that the manager was required to
traffic in investments in such a way that it could be said that a business was
being carried on the carrying on of that business could be imputed to the
principals - the unit holders.12

Each of the reasons for the decision in Smith v Anderson (except for the
last) is based on the lack of a contractual link between the unit holders and
the independence of the trustee to manage the trust. These bases depend
upon the trustee not also being the agent for the unit holders.

The effect of s 112 and the decision in Smith v Anderson is that if the trust
carries on a business then the trustee (and any manager) cannot be under the
direct control of the unit holders. This is a major difference from a
company. The board of directors of the company is always subject to
possible interference and direct control by the shareholders.

Continuing with the history of the unit trust the popularity of the unit trust
made a resurgence in the 1960’s and 1970’s mainly for income tax reasons.

One income tax advantage of the unit trust is that a distribution from the
trustee will maintain its character in the hands of a beneficiary. A dividend
in the hands of the shareholder does not. In Charles v Federal
Commissioner of Taxation13 the High Court of Australia held:

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10 Above at 276.
11 Ford HAJ 'Public Unit Trusts' The Law of Public Company Finance The Law Book Co
   (1986) at 411.
12 Above n 2 at 134-135.
13 (1954) 90 CLR 598.
252
A unit held under a trust deed is fundamentally different from a share in a company. A share confers upon the holder no legal or equitable interest in the assets of the company; it is a separate piece of property; and if a portion of the company's assets is distributed among the shareholders the question whether it comes to them as income or as capital depends upon whether the corpus of their property (their shares) remains intact despite the distribution. But a unit holder under the trust deed before us confers a proprietary interest in the property which for the time being is subject to the trust of the deed; so that the question whether moneys distributed to unit holders under the trust form part of their income or of their capital must be answered by considering the character of those moneys in the hands of the trustees before the distribution is made.  

Capital gains were not taxed at that time and therefore a distribution by the unit trust of a capital gain would not be taxable income to the unit holder. Distribution of the same capital gain by a corporation would have been a taxable dividend. With the advent of the capital gains tax provisions under Part IIIA of the *Income Tax Assessment Act* the effect of this benefit is diminished. However this advantage remains in effect for any capital gain earned on an asset which was owned by the trust before the capital gains tax came into effect.

A second income tax advantage of the unit trust over the corporation was that income earned by the corporation was taxed once in the corporation and again when it was distributed to the shareholder. This led to double taxation. Conversely income earned in a normal trust was only taxed once. Basically income distributed during the taxation year to the beneficiaries was income of the beneficiaries and not of the trust. Undistributed income was taxed in the trust and was not taxable income of the beneficiaries. There was no double taxation. This benefit has been diminished by the introduction of the imputation system and dividend franking. Payment of a fully franked dividend by company eliminates the effect of double taxation by giving the shareholder credit for taxes paid by the corporation. In this manner income distributed by the corporation is effectively not taxed within the corporation. The franking system only eliminates corporate taxation if the taxpayer has other taxable income against which to offset the 'franking tax credits'. Therefore income earned from the unit trust will be preferred by a non-taxable entity or by a person who earns all their income from investments.

Any income tax benefit available to unit holders of unit trusts is removed in relation to income earned from two types of unit trusts. The *Income Tax Assessment Act* treats 'Corporate Unit Trusts' and 'Public Trading Trusts' as if they were corporations for income tax purposes.

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14 Above at 609.
15 CGT is not payable on capital gain earned before the provision came into effect (ie 19 September 1985) See ITAA s 160L.
17 ITTA s 97; also see Grbicich above at 663.
18 Above n 16 at 728; also see ITAA s 160APA - 160ASE.
Prior to 1980 public corporations began transferring income earning assets to unit trusts so as to avoid paying income tax on the income earned from the assets. Division 6B of Part III was added to the *Income Tax Assessment Act* to control this situation. This division basically defined a 'Corporate Unit Trust' as a 'Public Unit Trust' which was formed as a result of any corporate reorganization under which shareholders of the company were given the opportunity to become holders of units in the unit trust. As a result of this section income earned by the 'Corporate Unit Trust' was taxed as though the income was still earned by the corporation.

As part of its tax reform in September 1985 the Australian Commonwealth Government added Division 6C of Part IIIA to the *Income Tax Assessment Act*. This division taxed income earned by most 'Public Unit Trusts' as though it was earned by a corporation. This division applied to all 'Public Unit Trusts' except those with a business which consisted 'wholly of eligible investment business'. Pursuant to s 102M:

'eligible investment business' means either or both of -

(a) investing in land for the purpose or primarily for the purpose of deriving rent; or

(b) investing or trading in any or all of the following -

(i) unsecured loan (including deposits with a bank building society or other financial institution);

(ii) bonds debentures stock or other securities;

(iii) shares in a company;

(iv) units in a unit trust;

(v) futures contracts;

(vi) forward contracts;

(vii) interest rate swap contracts

(viii) currency swap contracts;

(ix) forward exchange rate contracts;

(x) forward interest rate contracts;

(xi) life insurance policies;

(xii) a right or option in respect of such loan security share unit contract or policy;

(xiii) any similar financial instrument.

This encompasses what most people describe as 'investing in securities'. It is the pooling of money to take advantage of the 'doctrine of averages' described in *Smith v Anderson*.

These two sections had little effect on the growth of unit trusts. At the end of 1987 $20.6 billion was under the management of 447 different unit trusts. Unit trusts form an important segment of Australian public investment institutions.

This resurgence in the popularity of the unit trust has resulted primarily from income tax considerations. Are there any other sound reasons why the...
unit trust should be favoured as a form of business structure? If there are not
then are there any reasons why it should not be used as a business structure?
If there are disadvantages to using a unit trust then the founder of a business
must consider these before deciding to use the unit trust structure purely for
income tax reasons. A tax effective structure is of little use if it does not
function well in its business environment.

Before proceeding to consider non-tax considerations it is important to set
out the situation under which a tax advantage is obtained by using the unit
trust structure.

Firstly, ITAA s 102M is important as it describes the only situations under
which a 'Public Unit Trust' can be more income tax effective than a
 corporation. The business of the unit trust must be wholly 'eligible
investment business'.

Secondly, divisions 6C and 6B only disadvantage 'Public Unit Trusts'.
Therefore the potential income tax benefit will apply to any private unit trust
(that is one that is not a 'Public Unit Trust'). A 'Public Unit Trust' is defined
under ss 102G and 102P as one which has its units:

(a) listed for quotation in the official list of a stock exchange in
Australia or elsewhere;
(b) offered to the public; or
(c) held by not fewer than 50 persons.

Thirdly, any tax advantage occurs only if the unit trust distributes all of its
income before the end of the taxation year. If the income is not distributed
then the provisions of ITAA ss 97, 98 and 95A(2) tax the income in the trust.
For a normal unit trust s 99A would tax this income at 50% which is a higher
tax rate than the corporate tax rate. If the unit trust does not distribute all of
its income then there will be an income tax disadvantage to using the unit
trust instead of the corporation. Therefore the unit trust structure normally
should not be used for a business which will require income which it will
generate internally for expansion or for other business purposes.

Comparison of the Unit Trust and Corporate Structures

To compare the unit trust and corporate structures will require an
examination of each structure in light of the following questions:

1. What are the formal requirements for the formation of each structure?
Which is easier to create? What is the effect of the structure? Does the
structure pose any legal difficulties? How flexible can the structure be
to meet future requirements?

2. How are the internal affairs of the structure managed? What system
exists to protect management and the investors?

3. How are the external affairs of the structure managed? Is management
free to deal with outsiders? What protection exists for management
from personal liability for debts of the business?
4. Does the investor receive the protection of limited liability?

5. Does the investor receive adequate protection as an investor?

**Formal Structural Requirements**

Section 118 of the *Corporations Law* sets out an easy procedure to follow for the formation of an incorporated company. A 'memorandum of association' and 'articles of association' (if any) are lodged with the Australian Securities Commission. When the Commission registers these, an incorporated company comes into existence pursuant to s 123. Section 123(2) enables a company to perform 'all the functions of a body corporate'. Section 161 gives a company the 'capacity of a natural person'. Under s 125 the articles of association prescribe regulations for the company. If no articles of association are filed for a limited liability company, then the articles of association set out in 'Table A' schedule of the *Corporations Act* will apply to the company.

The unit trust is constituted by a deed of trust. Under the terms of the trust deed certain property is to be held in trust by the trustee for the benefit of persons known as 'unit holders'. Each unit holder owns a 'unit' in the trust fund. The beneficial interest of the trust is made up of a number of units. Each unit is equal to every other unit. When an investor purchases a unit from the trustee or manager, the money paid for the unit becomes part of the trust property and is invested by the trustee. The deed of trust regulates the rights, powers, and duties of the trustee, unit holders, and if applicable, the manager. In this manner it serves the same purpose as the memorandum of association and articles of association of a company.

In the case of a public unit trust, s 1065 of the *Corporations Law* requires that:

A person shall not issue to the public offer to the public for subscription or purchase issue invitations to subscribe for or buy any prescribed interest unless at the time of the issue offer or invitation there is in force in relation to the interest a deed that is an approved deed.

A unit of a unit trust is a prescribed interest under s 9. Under s 1065 the Commission must approve the trust deed. Section 1069 sets out a list of requirements that must be contained in a trust deed required under s 1065. Among the requirements is the requirement for the administration of the trust by a separate trustee and a separate manager. Under s 1066(1)(b) the Commission must approve the trustee under the deed. Section 1064 prohibits a person from issuing units or offering them for subscription or purchase unless the entity is a public corporation. A prescribed interest is included under the definition of 'security' under the securities chapter of the *Corporations Law* and therefore the manager will also require a licence pursuant to ss 783 and 785 of the law.

Establishing a unit trust and especially a public unit trust is a very involved
The Unit Trust

and complicated procedure compared with the incorporation of a company.

When a trust is established no new legal person is created. The trust is not a distinct entity from the trustee and the beneficiaries. The trustee owns the legal title to the trust assets (subject to the beneficial interest of the unit holders). This is distinctly different from a corporation. A corporation is a legal person. It owns its corporate assets. Management does not own any interest in the corporation's assets. Also the shareholders only own a share in the company. They do not have any interest in the assets either. Conversely the unit holders of the unit trust own a beneficial interest in the trust property. However usually under the terms of the trust deed

...a unit does not confer any interest in any particular part of the trust fund or in any particular part of the trust fund of in any particular investment but only such interest in the trust fund as a whole as is conferred on a unit under the deed.24

The fundamental difference has a number of important ramifications which will be dealt with later in this paper.

Section 180 of the Corporations Law creates statutory contracts between the shareholders and the company and its officers in the terms of the memorandum of association and the articles of association. These statutory contracts may be amended under the law. Sections 172 and 173 permit the memorandum of association to be amended by special resolution under certain circumstances. Similarly s 176 permits the articles of association to be amended by special resolution. Under s 253 a special resolution requires the approval of the holders of 75% of the company's shares.

In contrast (as set out above) the trust deed does not and cannot form a contract between the unit holders. The general rights of a unit holder as a beneficiary under a trust are not subject to a contract with any other person. However any additional and further right given to the unit holder under the trust deed is subject to the terms of the trust deed. In this manner rights can be created which belong to the unit holders as a whole and which can only be enforced with the approval of the majority of the unit holders. Further it is usual to permit amendment of the trust deed by ordinary resolution.

In Gra-Ham Australia Pty Ltd v Perpetual Trustee W A Limited 25 the court dealt with a complaint regarding the amendment of a trust deed by ordinary resolution pursuant to a term in the trust deed. The principal submissions were that the amendment was not for the benefit of the members as a whole; that it destroyed the real bargain between the parties and that it had retrospective effect.26

The court's finding was consistent with the statements of Pidgeon J. He stated:

24 Above n 11 at 400.
26 Above at 87.
The power to modify the deed is contained within the deed itself and the question arises as to whether there are any restrictions at law in exercising this power. I would agree that one would look to the company cases and the building society cases to determine what restrictions there may be.\(^\text{27}\)

Therefore the power of the shareholders to amend the constating documents of the company and the power of the unit holders to amend the trust deed are identical. The only difference is that the majority required to amend a company's memorandum and articles is determined by statute to be the holders of 75% of the value of the company's shares. Conversely the majority required to amend the trust deed is determined by the trust deed. Most trust deeds only require an ordinary resolution.

The relevant limitations on the ability to amend were set out by the court as follows:

\begin{quote}
\text{(iii) Where the rights of members of the company depend only upon the articles it is possible to alter the rights of the members or of some only of the members by altering the articles.}

\text{(iv) The power to alter articles must be exercised bona fide.}\n\end{quote}\(^\text{28}\)

One final structural consideration is the effect of the 'rule against perpetuities' on the structure.

A company is a legal person with all of its corporate assets vested in it. Further s 123(2)(c) gives a company 'perpetual succession'. The share of a company only comes into existence when it is issued. Further it must be issued to a registered holder in whose name it vests. The rule against perpetuities has no relevance to a company.

The unit trust is different. The trust property is held in trust for present and future unit holders. Every unit holder has a beneficial interest in the trust property. This equitable interest will not vest until the unit is issued. Therefore units issued when the trust is formed will absolutely vest within the perpetuity period. So will future trades of those units.\(^\text{29}\) However units that may be issued after the establishment of the trust could vest outside the perpetuity period and could be invalid because of the rule against perpetuities.\(^\text{30}\) To overcome this problem two solutions exist.

First the issue of future units can be prohibited. This would severely limit the trust's ability to fund future operations. This is especially severe when it is remembered that a trust should not accumulate income to fund future operations either. Also prohibiting the issue of future units is not always possible and will be impractical if the trust is a public unit trust. Section 1069(1)(c) requires a 'buy-back covenant' to be contained in the trust deed of a public unit trust. This means that external trading in units will usually not exist. Instead old unit holders will retire and their units will be bought-back.

\(^{27}\) Above at 91.
\(^{28}\) Above at 90-91.
\(^{29}\) See above n 2 p 137-138.
\(^{30}\) See above n 1 p 60-61.
by the trust and cancelled. New investors will purchase newly issued units.

Second the trust can be set up so that it will terminate within the perpetuity period. In this way the rule against perpetuities cannot be offended.

Either option will severely restrict the ability of the trust to operate a business as a going concern. Therefore a corporation will be required to operate any business which can be expected to operate as a going concern (for example a trading or manufacturing business). However the unit trust could be used as a structure which is only intended to hold investments in securities.

**Regulation of Internal Affairs**

The unit trust and the corporation have developed as two structures which allow for the separation of ownership (beneficial) and management. One important difference between these two structures is that in the corporation a legal fictional person has been interposed between the shareholders and the board of directors whereas in the unit trust no new interposing legal person is created. The common law imposes fiduciary duties on directors and trustees. How well do these fiduciary duties protect the investor? Does the distinct legal personality of the corporation make a difference?

The office of director is a fiduciary one. This means that directors and other officers in fiduciary positions must act with utmost good faith towards the company in all their dealings with or on behalf of the company. Fundamentally the director is a fiduciary to the company the separate body or entity.

These common law fiduciary duties provide protection to the company from the abuse of directors. However these duties are owed to the company and not its shareholders. In fact the directors owe no fiduciary duties of any kind to their company’s shareholders. In *Percival v Wright* the contrary view would place directors in a most invidious position...which might well be against the best interests of the company. I am of the opinion that directors are not in that position.

The position of the shareholder at common law is further diminished by the so-called rule in *Foss v Harbottle*. This rule has been set out by Lord Davey in *Burland v Earle* as:

It is an elementary principle of the law relating to joint stock companies that the Court will not interfere with the internal management of companies acting within their powers and in fact has no jurisdiction to do so. Again it is clear

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32 Above.
33 [1902] 2 Ch 421.
34 Above at 426.
35 (1843) 2 Hare 461; 67 ER 189.
36 [1902] AC 83 (PC).
law that in order to redress a wrong done to the company or to recover monies or damages alleged to be due to the company the action should prima facie be brought by the company itself. 37

Therefore under this basic common law doctrine no protection is given to the individual shareholder. If the directors control a majority of the shares in a company then they can breach their fiduciary duties to the company without fear of retribution. To control the abuses which could result from this rule and to provide the minority with some protection the courts have developed exceptions to the rule in Foss v Harbottle. The Privy Council in Burland v Earle described the exceptions as follows:

But an exception is made to the...rule where persons against who the relief is sought themselves hold and control the majority of the shares in the company and will not permit an action to be brought in the name of the company. In that case the Courts allow the shareholders complaining to bring an action in their own names. This however is mere matter of procedure in order to give a remedy for a wrong which would otherwise escape redress and it is obvious that in such an action the plaintiffs cannot have a larger right to relief than the company itself would have if it were plaintiff and cannot complain of acts which are valid if done with the approval of the majority of the shareholders, or are capable of being confirmed by the majority. The cases in which the minority can maintain such an action are, therefore, confined to those in which the act complained of are of a fraudulent character or beyond the powers of the company. 38

The most important exception is the so-called 'fraud on the minority exception'. If the wrongdoing directors control the company then a derivative action may be commenced by an individual shareholder if the conduct of the directors amounts to 'equitable' fraud against the company. For the purpose of this exception 'equitable' fraud includes ordinary fraud the use of a power for a purpose that was not intended and negligent or reckless breaches which benefits the wrongdoer. 39

Section 232 of the Corporations Law also imposes duties on the directors of a company which are similar to their common law fiduciary duties. Section 232(7) gives only the corporation a right of recovery against a delinquent director. Therefore these s 232 duties are owed to the company and are not owed to the shareholders. Also the Act provides no direct mechanism for a shareholder to comprehensively enforce these duties on behalf of the company. (Although indirect or partial enforcement may be possible through ss 260 or 1324 of the Corporations Law).

Therefore the rule in Foss v Harbottle would require that the company commence any action to rectify any breaches by the directors of these common law or statutory duties. Any individual shareholder will be precluded from commencing an action on behalf of the company to enforce these duties unless the action can be framed as an exception to the rule in

37 Above at 93.
38 Above.
39 See above n 31 pp 163-169.
Foss v Harbottle or additionally in the case of the statutory duties unless a remedy is available under either s 260 or s 1324. These provisions allow the court to give directions regarding the conduct of the affairs of a corporation.

In addition to the limited protection given to minority shareholders by the derivative action the legislature has provided protection through the so-called 'oppression remedy' (pursuant to s 260) and the provisions for injunctions (pursuant to s 1324) to prevent certain abuses.

Section 260 (1) (a) allows for an application:
by a member who believes:
(i) that affairs of the company are being conducted in a manner that is oppressive or unfairly prejudicial to or unfairly discriminatory against a member or members or in a manner that is contrary to the interests of the members as a whole: or
(ii) that an act or omission or a proposed act or omission by or on behalf of the company or a resolution or a proposed resolution of a class of members was or would be oppressive or unfairly prejudicial to or unfairly discriminatory against a member or members or was or would be contrary to the interests of the members as a whole:

Under s 260(2) the court can '...make such order as it thinks fit...'. A list of possible orders includes an order authorising a member or members of the company to institute, prosecute, defend or discontinue specified proceedings in the name and on behalf of the company.

Section 1324(1) also gives protection to the shareholder. It provides that:

Where a person has engaged in engaging or is proposing to engage in conduct that constitutes or would constitute:
a. a contravention of this Law;
b. attempting to contravene this Law;
c. aiding abetting counselling or procuring a person to contravene this Law;
d. inducing or attempting to induce whether by threats promises or otherwise a person to contravene this Law;
e. being in any way directly or indirectly knowingly concerned in or party to the contravention by a person of this Law; or
f. conspiring with orders to contravene this Law.

The Court may, on the application of the Commission or of a person whose interests have been or would be affected by the conduct grant an injunction on such terms as the Court thinks fit. If in the opinion of the Court it is desirable to do so requiring that person to do any act or thing.

Section 1324(10) allows the court to order damages '...either in addition to or in substitution for the grant of the injunction...'. This section combined with the duties imposed on management under s 232 effectively permits the court to review management's decisions and actions to ensure that they are not in breach of management's duties to the company. If they are an injunction can be issued to restrain the conduct. Also damages can be issued.
to compensate the shareholder for any loss.

The effect of these provisions and the common law derivative action is to provide the shareholder with comprehensive personal protection for his investment in the company from possible abuses of management.

Is the protection given to the unit holder of a unit trust equally comprehensive?

The trust developed during the middle ages. Under a trust the trustee had legal title to the trust property and therefore could deal with the trust property as legal owner. This led to the abuse of some beneficiaries by their trustees. In response the courts of equity developed doctrine which forced the trustee to deal with the trust property only for the benefit of the beneficiaries. From this doctrine the modern trusts of today developed.\(^40\)

Trust doctrine permits the beneficiary of the trust to bring an action directly against the trustee to enforce the trustee’s fiduciary duties and duties imposed on the trustee under the trust instrument. The duties of the trustee are owed directly to the beneficiaries\(^41\) and not to some fictional interposed entity. This is a significant advantage which a shareholder does not have at common law. Also the common law and statutory rights of the beneficiary are not subject to majority rule. Trustees must act impartially in the administration of the trust and must be impartial in the management of and dealings with the interests of the beneficiaries.\(^42\) The trustee could not fulfill his fiduciary duties by merely acceding to the wishes of a majority of the beneficiaries. He must act for the collective benefit of all beneficiaries.

However as has been seen earlier in this paper the trustee is not (and should not be) under the direct control of the beneficiaries. The trustee acts in his own right and not as an agent for the beneficiaries. The absence of an ultimate power of general control by the majority of unit holders means that it is open to a single beneficiary to seek an order for general administration of the trust.\(^43\)

Further s 8 of the Trusts Act 1973 (Queensland) for example provides that:

(1) Any person who has directly or indirectly an interest whether vested or contingent in any trust property and who is aggrieved by any act omission or decision of a trustee or other person in the exercise of any power conferred by this Act or by the instrument (if any) creating the trust or who has reasonable grounds to apprehend any such act omission or decision by which he will be aggrieved may apply to the Court to review the act omission or decision or to give directions in respect of the apprehended act omission or decision....

41 Above n 11 at 241.
42 Above n 40 at 235.
43 Above n 11 at 407; also see McLean v Burns Philp Trustee Co Pty Ltd (1988) ACLR 926 (NSWSC) which dealt with a unit trust. An order for general administration was refused because it was not appropriate under the circumstances of the case.
Controlling the actions of the trustee may not provide sufficient protection to the beneficiary. Replacement of the trustee with someone more appropriate may be necessary. According to *MacDougall v Gardiner* jurisdiction to apply to the court for the removal of a trustee may come from three sources:

Firstly the terms of the trust instrument are applied. A trustee may be removed under an express power contained in a trust instrument...

Secondly the statutory provisions as to replacement of trustees may be applied to remove a trustee.

Thirdly the court may intervene to remove trustees. Apart from statute the court has an inherent jurisdiction to remove a trustee the prime test in such questions is the welfare of the beneficiaries. For this reason as a general rule a breach of trust does not necessarily lead to an order from the court to remove the trustee. A trustee however will be removed if the breach is a negation of the trust or conduct likely to jeopardize the trust property...

The statutory authority in Queensland to remove a trustee is contained in s 80 of the *Trusts Act* which reads:

(1) The court may whenever it is expedient to appoint a new trustee or new trustees and if it is found inexpedient difficult or impracticable to do so without the assistance of the Court make an order appointing a new trustee or new trustees either in substitution for or in addition to any existing trustee or trustees or although there is no existing trustee.

By virtue of s 98 such an order can be made on application of '...any person beneficially interested in the property [subject to a trust]...'.

Therefore in these ways the beneficiary will receive protection from breaches by the trustee and the beneficiary can exercise some indirect control over the management of the unit trust. However the beneficiary must convince the court that any interference is warranted. The individual unit holder must rely on the court for protection.

This is distinctly different from the common law position of the shareholder. Under the common law generally the court had no jurisdiction to interfere in the internal management of the corporation. At common law the shareholder had to depend on the actions of the general meeting of shareholders to provide him with protection from management. If the majority of shareholders chose not to act he had no remedy unless he could commence a derivative action. As Mellish LJ stated in *MacDougall v Gardiner*:

...there can be no use in having a litigation about it the ultimate end of which is only that a meeting has to be called and then ultimately the majority gets it wishes. It is not better that the rule should be adhered to that if it is a thing which the majority are the masters of the majority in substance shall be entitled to have their will followed? If it is a matter of that nature it only comes to this

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44 (1875) 1 Ch D 13.
45 (1875) 1 Ch D 13.
comes to this that the majority are the only persons who can complain that a thing which they are entitled to do has been done irregularly... 46

Majority rule gives the power to oversee management primarily to the majority. They elect the board of directors and pursuant to s 227 of the Corporations Law they can remove directors by ordinary resolution. Further by amending the articles of association they can directly control management.

However jurisdiction to interfere in the internal management of a company has been given to the court by ss 260 and 1324 of the Corporations Law. In this manner the individual shareholder must also ultimately rely on the court for protection.

Some question exists as to whether majority control and the position taken by the court in MacDougall v Gardiner also applies to unit trusts.47 These may be applicable to breaches of rights which are given only under the trust instrument. Such rights must be subject to the terms on which they are given. However it is doubtful that the court would permit a trust instrument to oust its inherent jurisdiction to oversee the administration of trusts or to compensate beneficiaries for losses resulting from a breach of a duty placed on the trustee at common law or under statute.

With regard to a public unit trust s 1069(1) of the Corporations Law requires the trust deed to contain:

(a) a covenant binding the management company that it will strive to carry on and conduct its business in a proper and efficient manner and to ensure that any relevant undertaking scheme or enterprise is carried on and conducted in a proper and efficient manner;...

(e) covenants binding the trustee or representative:

(i) to exercise all due diligence and vigilance in carrying out his her or its functions and duties and in protecting the rights and interests of the holders of the prescribed interests;...

This places the trustee in an onerous position. The directors of a company can seek ratification from a majority of the shareholders for most breaches or contemplated breaches of their duties. The trustee cannot do this under all circumstances. To alleviate this onerous position the trustee is given the right to apply to the court for directions.

For example in Queensland s 96 of the Trusts Act states:

(1) Any trustee may apply upon a written statement of facts to the Court for directions concerning any property subject to a trust or respecting the management or administration of that property or respecting the exercise of any power or discretion vested in the trustee.

This section deems a trustee acting under such directions '... to have discharged his duty as trustee... so far as regards his own responsibility...'.

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46 Above at 25.
47 See above n 11 at 407.
Under the *Corporations Law* s 1069(1)(m) requires a covenant to be included in the trust deed for a public unit trust allowing for the requisition by the unit holders of a meeting of unit holders to have financial statements of the manager or the trustee laid before the meeting and '...for the purpose of giving to the trustee...such directions as the meeting thinks proper'. Section 1069(13) provides that the trustee is to comply with the direction unless it is inconsistent with the deed or the *Corporations Law* and that the trustee is not liable for anything done or omitted to be done by him or it pursuant to that direction. If in doubt the trustee can apply to the court for directions under s 1069(4).

In *Equitable Group Ltd v Pendal Nominees Pty Ltd.* the court held that such directions given by the unit holders must relate to the financial statement laid before the meeting. This provision does not allow the unit holders to give directions regarding any matter: 'If such wide and unusual powers were to be conferred it is unlikely that this would be done at the tailend of a clause dealing with other matters....'

This position is consistent with the fact that fundamentally the members of a trust should not be able to directly control the management of the trust. If the unit holders did give directions to the trustee under this section then the unit holders could make the trustee their agent and become personally liable (as principal) for the actions of the trustee in pursuance of that agency. The unit holder would be better advised to rely on the court to oversee the trustee.

Finally it should be noted that both the trustee and the director are permitted to apply to the court to be excused for breaches of their duties on the grounds that they acted 'honestly' and 'reasonably' and 'ought fairly to be excused'. This protection is given to the trustee by statute for example s 76 of the Queensland *Trusts Act* and is given to the director by s 1318 of the *Corporations Law*.

In summary the regulation of the internal affairs of both the corporation and the unit trust provides similar fundamental protection to the investor. The investor in each must ultimately rely on the court for protection. The grounds for relief under ss 260 and 1324 of the *Corporations Law* may cover more situations than the fiduciary duties owed by the trustee to the unit holder beneficiaries. Further the shareholder is given additional protection through the general meeting of shareholders. If the unit holders were to attempt to obtain protection by directly controlling the trustee they could face unlimited liability and could constitute an illegal association contrary to s 112 of the *Corporations Law*. Protection through direct control is not viable for the unit holders. Also any right given only by the trust deed can be limited by the trust deed. In particular the trust deed may allow these rights to be eliminated by the majority. Of course fundamental rights provided by the common law or by statute cannot be limited by the trust deed. The shareholder is in a different position. Section 260 provides protection from the majority.

Therefore both the unit holder and shareholder receive virtually identical

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48 (1985) 3 ACLC 546 (NSWSC).
49 Above at 551.
fundamental protections. However the shareholder does have additional protection that the unit holder may not have. An investor will receive more protection if he invests in a corporation.

Relations with External Entities

If a structure truly has separate management and ownership then management will operate the business and the owners will provide all capital required by the business. Therefore the business structure must allow management to deal freely with outsiders without interference from the owners. Also management must not be personally liable for the business debts. The owners are taking the business capital risk not management.

Section 164 of the Corporations Law permits any person dealing with a company to make certain assumptions regarding their dealings with that company. These assumption are:

(a) that...the company's constitution has been complied with;
(b) that a person who appears from returns lodged...to be a director the principal executive officer or a secretary of the company has been duly appointed and has authority to exercise the powers and perform the duties customarily exercised or performed by a director by the principal executive officer or by a secretary...of a company carrying on a business of the kind carried on by the company;
(c) that a person who is held out by the company to be an officer or agent of the company has been duly appointed and has authority to exercise the power and perform the duties customarily exercised or performed by an officer of the kind concerned;
(d) that an officer or agent of the company who has authority to issue a document on behalf of the company has authority to warrant that it is genuine...
(e) that a document has been duly sealed by the company if -
(i) it bears what appears to be an impression of the seal of the company; and
(ii) the sealing of the document appears to have been attested by 2 persons being...a director...and a director or...a secretary...
(f) that the directors the principal executive officer the secretaries the employees and the agents of the company properly perform or performed their duties to the company.

These assumptions basically allow anyone dealing with the company under normal business circumstances to assume that:

1. the company has the capacity to enter into any transactions; and
2. the person with whom they are dealing has the authority to enter into any transaction on behalf of the company.

Under s 164(4) these assumptions cannot be made if the person knows or ought to know that the assumption is false. Therefore outsiders can deal freely with the apparent management of a company and can be confident that the company will be bound by the acts of its apparent management.

An outsider cannot be as confident when dealing with the trustee (or any
manager) of a unit trust.

Unless a trust deed gives extended borrowing powers to a trustee the trustee will have only the power given by the Trustee Acts to raise money to preserve assets or to advance capital money. A lender to a unit trust will have as his borrower not the trust as an entity but the trustee, he will need to ascertain that the trust deed authorises the trustee to borrow and to charge the trust assets.

If the trustee acts outside these powers the transaction will be voidable at the instance of the beneficiary. There is no protection equivalent to s 164 of the Corporations Law to assist the creditor and thus the latter should examine the trust instrument very carefully. Therefore the unit trust structure does not permit the trustee to freely manage the business of the trust. Power to do so must be given by the trust deed. This represents an unnecessary imposition on an outsider who wishes to conduct business with a trust. Before business can be conducted the outsider must first be satisfied that the trustee is authorised to act. The corporation is a much more convenient structure for operating a business. A business environment necessarily requires constant dealings with outsiders.

The corporation as a legal person is liable for its own debts. Its management and shareholders are not liable for those debts. All that management must do to exclude personal liability to third parties when management acts on behalf of the corporation is to state that they are the management of the corporation.

The trustee is in a different position. The trust is not a legal person. Further the trustee can only deal with trust assets in accordance with the terms of the trust. Any dealings by third parties with the trust which are inconsistent with the terms of the trust can be set aside by the beneficiaries of the trust. Therefore to protect third parties from trustees who act in breach of trust the trustee’s:

...liability for debts he contracts and torts he commits includes those incurred and committed in the course of performance of the trust and his liability is not limited by or quantified by reference to the extent of the trust assets.

The personal liability can be eliminated but this can only be accomplished if clear language is used. In Muir v City of Glasgow Bank the position taken by the court is consistent with the following statements of Lord Penzance:

...to exonerate the trustee something more is necessary beyond the knowledge of those who deal with him that he is acting in that capacity. To exonerate him it would be necessary...that upon a proper interpretation of any contract he had made...the intention of the parties...was apparent that his personal liability

50 Above n 11 at 412.
52 Above n 11 at 414.
53 Above n 1 at 582.
54 (1879) 4 App Cas 337.
should be excluded; and...the creditors should look to the trust estate alone.  

However if the trustee is acting in accordance with the terms of the trust when the liability is incurred then it is not proper that the trustee should bear the personal burden of a liability incurred solely for the benefit of the beneficiaries. To provide the trustee with some protection the trustee is entitled to be indemnified in relation to these expenses.

First the trustee is entitled to be indemnified out of the trust assets:

If the trustee has incurred liabilities in the performance of the trust then he is entitled to be indemnified against those liabilities out of the trust property and for that purpose he is entitled to retain possession of the property as against the beneficiaries. The trustee's interest in the trust property amounts to a proprietary interest.  

Second the trustee is entitled to be indemnified by the beneficiaries. In J W Broomhead (Vic) Pty Ltd v J W Broomhead Pty Ltd 57 the court considered the position of beneficiaries under a private unit trust and stated:

...general principle is that a trustee is entitled to an indemnity for liabilities properly incurred in carrying out the trust and that right extends beyond the trust property and is enforceable in equity against a beneficiary who is sui juris. The basis of the principle is that the beneficiary who gets the benefit of the trust should bear its burden unless he can show some good reason why his trustee should bear the burden himself.  

Under this principle the court held the beneficiaries of the unit trust to be personally liable for the debts of the trustee properly incurred under the terms of the trust.

As a result the trustee can be placed in a position that is similar to the position of a director of a company. The terms of the trust may provide the trustee with powers that are identical to the powers of directors of corporations. The trustee can contract with third parties and incur no personal liability (although this is not easily accomplished). Any personal liability he properly incurs under the terms of the trust will be indemnified out of trust assets. To the extent that the trust assets are insufficient to cover his personal liability the trustee will be entitled to a personal indemnity from the beneficiaries. However this right of indemnity can be limited and it will only be useful if the beneficiary is solvent. The trustee can be exposed to risks to which a director is not exposed.

The corporation is therefore a superior structure for use in a business environment in which management must deal with third parties.

55 Above at 368.
56 Octavo Investments Pty Ltd v Knight (1979) 144 CLR 360 (HC of A) at 371-372.
57 (1985) 3 ACLR 355 (Vic S C).
58 Above at 393.
Limited Liability of the Investor

The creditor has no direct claim against the beneficiary under a unit trust. The creditor's claim is against the trustee. The trustee has personally incurred legal responsibility for the debts. However the creditor is subrogated to the trustee's right of indemnification against the trust assets and the trustee's right to be indemnified by the beneficiaries. In *McLean v Burns Philp Trustee Co Pty Ltd* the court stated:

...the question would be if the borrowing trustee did not have the assets to meet the claim whether the lender could be subrogated to the rights which the trustee...had against the unit holders....That this right is one of subrogation is quite clear....

This means that the investor in a unit trust is exposed to unlimited liability. However it is significant that this potential unlimited liability arises through subrogation of the rights of the trustee. If the trustee has no right of indemnity then a creditor can have no claim against the beneficiary either. The trustee can lose his right to an indemnity in a number of ways.

First the trust instrument can provide that no right of indemnity exists. In *McLean v Burns Philp Trustee Co Pty Ltd* the court said:

It is clear that by the appropriate clause in a trust deed or contract a person may limit his liability to a specific fund....The effect of a clause such as cl 48 operates so as to deny the trustee rights against the beneficiary so that there is no right for which the creditor can be subrogated....Whereas here there is a perfectly proper reason for limiting the liability of investors in a unit trust a reason which is not contaminated by any fraud of creditors there is no reason in public policy why the court should not give effect to it...

A provision in the trust deed excluding the trustee's right of indemnity against the beneficiaries will give the unit holder limited liability unless the clause is used for fraudulent purposes. An example of a fraudulent limitation would be 'a...trust which is so geared to enable a person to avoid his creditors by hiding behind the vehicle of the trust...'.

The court held that protecting investors from unlimited liability is a proper (and not fraudulent) purpose.

Second a form of estoppel may exist which would prevent the trustee (or a subrogated creditor) from asserting that the unit holder owed an indemnity to the trustee:

If the promotional literature suggests that an investor will be hazarding only the amount of his investment that may be enough. In a public unit trust a statement in the prospectus that the liability of the unit holders will be limited to their

59 (1988) ACLR 926 (NSWSC).
60 Above at 939.
61 Above at 939-940.
62 Above at 940.
investment could be tantamount to a statement that neither the manager nor the
trustee will look to the unit holders for indemnity. Such an estoppel would protect the unit holder from unlimited liability.

Third for the indemnity to exist the trustee must not be in breach of trust. If a creditor deals with the trustee in a manner which is contrary to the terms of the trust then the creditor eliminates the trustee's (and therefore the creditor's) ability to claim an indemnity from the beneficiaries. It is crucial from the creditor's point of view that the trustee have the requisite authority since the latter's ability to claim an indemnity to which the creditor will want to be subrogated is dependent upon his acting within the terms of the trust.

The terms of a unit trust will usually give the trustee (and any manager) very wide powers to manage the trust property. Therefore it would be difficult for the trustee to act in breach of trust provided that he acts in the ordinary course of business. This limitation on the trustee's indemnity will not provide much protection to the unit holders. However any power given to the trustee under the terms of the trust must be exercised for the benefit of the unit holders. Therefore any transaction which will only benefit the trustee (or manager) or any transaction which will obviously render no benefit to the trust will be a breach of the terms of the trust. Any creditor could not claim an indemnity from the unit holders for such transactions.

In J W Broomhead (Vic) Pty Ltd v J W Broomhead Pty Ltd members of a private unit trust were held liable to indemnify the trustee. Does this decision apply to public unit trusts? In Wise v Perpetual Trustee Co Ltd the Privy Council dealt with the question of indemnity of trustees of a club by members of that club. The Court stated:

The right of trustees to such indemnity...by no means applies to all trusts and it cannot be applied to cases in which the nature of the transaction excludes it.

Clubs are associations of a peculiar nature. They are societies the members of which are perpetually changing. They are not partnerships; they are not associations for gain; and the feature which distinguishes them from other societies is that no member as such becomes liable to pay to the funds of the society or to any one else any money beyond the subscriptions required by the rules of the club to be paid so long as he remains a member. It is upon this fundamental condition not usually expressed but understood by every one that clubs are formed...

Their Lordships feel no difficulty in making this choice. The trustees of a club are the last persons to demand that the fundamental conditions on which their cestuis qui trustent have become such shall be completely ignored.

Similarly public unit trusts have 'perpetually changing' members and it can
be that 'everyone' will understand that a unit holder invests in a public unit trust only on the 'fundamental condition not usually expressed' that he will have limited liability. Therefore the unit holder should similarly have limited liability. However the Privy Council did make a distinction based on the non-profit organisation. The unit holder invests with the intent of undertaking a business risk. Should he not protect himself if he wishes limited liability? Therefore the liability of the unit holder without reference to the terms of the trust or the circumstances of the case is unclear.

As has been set out earlier in this paper the unit holders can lose their limited liability if their relationship with the trustee involves such a degree of control so as to constitute the trustee the agent of the unit holders. If the trustee becomes the agent of the unit holders then any limitation of the trustee's rights as trustee will not be relevant in regard to the position of the trustee as agent. Further if an agency exists then the unit holders are primarily liable to creditors for the debts incurred by the agent pursuant to that agency. The creditor does not rely on a right of subrogation to claim against the principal. Any protection provided by the trust deed would be of no avail to the unit holders.

What is the position of the beneficiaries if the degree of control which they exercise over the trustee is not sufficient to create an agency? Under these circumstances the beneficiaries can still become liable to indemnify the trustee even if the terms of the trust exclude the trustee's right of indemnity: If a trustee incurs a liability at the request of a beneficiary who is of full age and capacity there would be an implied promise by the beneficiary to indemnify the trustee.67

Although the trust deed may provide protection to the unit holders under certain circumstances (for example the approval of unauthorised borrowing by the trustee68) the unit holders must be careful. Detailed instructions given outside the terms of the trust deed would not be protected by an exclusion of liability contained within the trust deed.

Therefore if the unit holders are passive they may be protected from unlimited liability. However if they attempt to directly control the trustee they may lose this liability. Protection provided by the trust deed or by the law generally will be of no avail to them.

This position of the unit holder is distinctly different from the position of the shareholder. Sections 124 and 516 of the Corporations Law give the shareholder limited liability.

Therefore from the perspective of limited liability only the corporation provides assured protection to the investor. The unit holder cannot presume that he will always have the protection of limited liability. The only certain protection that the unit holder can have must be given to him under the terms of the trust. Further the unit holder may even lose that protection if he attempts to directly control the trustee.

67 Above n 11 at 416.
68 Above.
Other Investor Protection

The Corporations Law provides additional investor protection for unit holders in a public unit trust. This protection is similar or identical to the protection provided to investors in a company.

1. The requirement of s 1066 for the trust deed to be approved by the Commission and the requirement of s 1079 for a statement (that is deemed to be a prospectus) to be issued prior to offering units to the public will provide protection to the unit holder that is similar to the protection that a shareholder receives under the prospectus provisions of the Law.

2. Section 1069(1)(e) requires a covenant to be contained in the trust deed that proper books of account must be kept and that these accounts must be audited by a registered company auditor. This gives the unit holder audit protection which shareholders are given pursuant to Chapter Three of the Law.

3. Under s 14 of the Australian Securities Commission Act the Minister may direct the investigation of any contravention of the Corporations Law. Under s 1064 the manager must be a company and therefore the Minister may order an investigation into the affairs of the manager pursuant to s 14. This protection is the same as that given to shareholders.

4. The definition of security in s 92 of the Corporations Law includes both shares and prescribed interests. Both shareholders and unit holders are afforded the protection of the Securities Industries provisions in Chapter Seven.

A divergence between protection given to shareholders and unit holders occurs with regard to the return of capital.

The capital of a corporation is protected from being diminished except in the ordinary course of trade by certain provisions of the Corporations Law:
- s 190 - restricts the issuance of discount shares;
- s 195 - restricts a reduction of capital;
- s 205 - prohibits investment by a company in its own shares;
- restricts financial assistance being given by a company to any person for the purpose of purchasing shares in the company; (subject to Division 3A) and
- s 201 - prohibits the payment of dividends from capital.

These restrictions do not apply to a trust. The trustee of a unit trust can freely distribute capital to the unit holders at anytime. In fact ss 1069(1)(c) and (d) require that adequate buy-back arrangements be in place for a public unit trust.

Whether any protection is actually afforded by maintenance of capital

69 Above at 409.
restrictions may be questioned. If a structure does not require a portion of its
capital then that capital should be returned to the investors so that they can
profitably invest that capital for themselves. This logic is especially
applicable to a structure that only invests in securities.

However one aspect of the maintenance of capital rules is important. This
is the restriction on paying dividends out of capital. If dividends are paid out
of capital then an investor could be led to believe that the company is
profitable when it is not. Requiring dividends to be paid only from profits
prevents a false sense of profitability being conveyed to the shareholder.
The holders of units in a unit trust do not receive this protection.59

These different approaches protect different needs of the investor. The unit
holder's financial needs are protected by allowing the return of capital to him
so that he may invest the capital more profitably than the trust. The
shareholder's information needs are protected by not allowing a false sense
of security which may be communicated by a continuous flow of dividends.

Summary and Conclusion

In effect the unit trust and the corporation are dealt with similarly under the
law. However the unit trust does have the following disadvantages which
the corporation does not have:

1. Establishment of the unit trust is complicated.
2. The unit trust usually will only exist for a limited period of time.
3. The unit trust is penalised through the income tax system if it does not
distribute all of its income.
4. The unit holders usually are not and should not be permitted to directly
interfere with the management of the trust. The unit holders must rely
solely on the court for protection under the trust. This protection is not
as extensive as protection given to shareholders under s 260 of the
Corporations Law.
5. The unit holder may not have limited liability unless limited liability is
given to him under the terms of the trust or the circumstances of the
situation. Limited liability can be lost if he exercises control over
management.
6. A return of capital to the unit holder can induce him to believe that the
trust is profitable when it is not.

Many of these difficulties can be overcome. Further if the trust only invests
in securities or property then the unit holder may not wish to interfere with
management. Also if the trust only invests in securities or property then:

1. The ability to return capital will be desirable if the trust cannot
efficiently invest the trust money. The unit holder would be permitted to invest the returned capital to obtain a better return.

2. A fixed life span will not be detrimental. Securities and property can be easily liquidated (unlike a trading or manufacturing business).

3. The inability to accumulate income will not be detrimental. The nature of an investment business requires a turn-over of securities and the re-investment of existing capital. The provision of new capital is usually not required.

4. The ability to 'buy-back' units can create a ready market for units in the trust. The 'buying-back' of units can be easily funded by the liquidation of some securities held by the trust.

The unit trust can therefore be suited to an investment business. However a corporation can also be used for such a business. If the corporation is publicly listed the shareholder will have a ready market for his shares and will be able to easily liquidate his investment. In the case of any private unit trust the parties will be able to structure the trust so as to protect their interests. If they cannot structure a suitable trust then they should not use the unit trust structure. The above disadvantages should not affect private situations. Public unit trusts which invest in rental property or securities and private unit trusts will receive beneficial treatment under the Income Tax Assessment Act. These types of unit trusts will be least affected by the disadvantages of the trust structure and will be able to take advantage of the benefits of the trust structure. The unit trust came to prominence because of favourable income taxation treatment. The advantages of the unit trust may not overcome the extra problems connected with such a structure and it would appear that the present treatment of the unit trust under the Income Tax Assessment Act is the only reason that the unit trust should maintain this position of prominence.