CURRENT TRUST LAW ISSUES EMERGING FROM RECENT CASES

Hon. Mr. Justice David Hayton

Caribbean Court of Justice

1. Jurisdiction over internal trust disputes

The general rule under Article 2 of Council Regulation (EC) No. 44/2001 on Jurisdiction and Recognition of judgments in Civil and Commercial matters ("Brussels 1") and of the parallel revised Lugano Convention requires persons domiciled (in the broad residence sense) in an EU or EFTA State to be sued in the courts of that State.

Under Article 5 thereof, however, there are exceptions to Article 2, in particular,

> "A person domiciled in a Member State may, in another Member State, be sued …
>
> 6. as settlor, trustee or beneficiary of a trust created by the operation of a statute, or by a written instrument, or created orally and evidenced in writing, in the courts of the Member State in which the trust is domiciled."

Moreover, Article 23(4) states

> "The court or courts of a member State on which a trust instrument has conferred jurisdiction shall have exclusive jurisdiction in any proceedings brought against a settlor, trustee or beneficiary if relations between these persons or their rights or obligations under the trust are involved."

While both Articles are concerned with internal trust relationships, it is to be noted that Article 5(6) is restricted to a person sued in his capacity "as settlor, trustee or beneficiary", while

Article 23(4) extends to "proceedings brought against" a settlor, trustee or beneficiary, so that it seems it can be construed to cover a settlor or beneficiary not sued as such but as holder of a fiduciary power (e.g. to replace trustees with other trustees, to change the proper law of the trust and the accounting currency of the trust fund, to replace a protector), though a protector or other holder of a fiduciary power, not being a settlor or beneficiary, is not covered unless a broad meaning can be given to the word "trustee."

In *Gomez v Gomez-Monche Vives*[1] Lawrence Collins LJ (with whom Jacob LJ and Lewison J simply agreed) stated:

> "I can see no basis for extending Article 5(6) to such persons as appointors or protectors or to any other person with fiduciary powers who does not come within the normal meaning of the expression 'trustee'."

Thus the English Court of Appeal held that a Spanish-domiciled beneficiary, who in breach of trust had been overpaid, could be sued in England "as beneficiary" for the overpayments, the trust being domiciled in England due to English law having been expressly designated in the trust instrument as the proper law[2], but could not be sued in England in her capacity as holder of a fiduciary power.

How strange and incoherent is an allegedly rational system if all internal trust disputes cannot be resolved once-and-for-all in one jurisdiction because disputes against a protector or other holder of fiduciary powers have to be resolved in the courts of that person's domicile (often

[1] [2008] EWCA Civ 1065, [2008] WTLR 1623 at [99]
[2] Ibid [58] – [64].

a non-trust jurisdiction), while other internal disputes are resolved in the courts of the trust's domicile, being that of the proper law of the trust.

Why was the Court of Appeal driven to take a restrictive approach to interpreting Article 5(6)? Because the European Court of Justice[3] and then the English House of Lords[4] had taken a restrictive approach to the interpretation of Articles 5(1), concerned with contracts, and Article 5(3), concerned with torts, delicts and quasi-delicts.

To my mind, insufficient regard was had to the fact that Article 5(6) was a new provision added to the Brussels Convention to take account of trusts brought into the EC on the accession of the UK and Ireland in 1978. In his Report thereon[5] (that has to be taken into account[6] for interpreting the Brussels Convention and Brussels 1) Professor Schlosser pointed out that a new base for jurisdiction was needed to deal with internal trust disputes, this base being the domicile of the trust.

The new provision he said[7] "covers only a very limited number of cases and is therefore added to Article 5 [headed 'Special Jurisdiction'] rather than to Article 2 [headed 'General Provision']" even though it "does not, strictly speaking, create a special jurisdiction." It seems he envisaged the new provision as a general provision, but because the number of internal trust disputes would be infinitesimally small compared to the colossal number of defendants' domicile cases within Article 2 it would have been oddly disproportionate to add the new provision to Article 2.

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[3] *Kafelis v Bankhaus Schnoder* [1988] ECR 5565.

[4] *Kleinwort Benson Limited v Glasgow City Council* [1999] 1 AC 153.

[5] Report on the Convention on the Association of the Kingdom of Denmark, Ireland and the UK to the Convention[1979] OJ C59 p. 71.

[6] As in *Gomez* [2008] EWHC 259 (Ch) [2008] WTLR 1623 at [38], [39], [74].

[7] Op cit n 5 above at para. 114

It is to be hoped that if an appropriate case arises the House of Lords and the European Court of Justice will give a purposive interpretation to Article 5(6) so that it extends rationally to persons sued "as settlor, as trustee or other holder of a fiduciary power or as beneficiary of a trust" and to Article 23(4) so that it extends rationally to "proceedings brought against a settlor, a trustee or other holder of a fiduciary power or a beneficiary."

To avoid some wretched losing litigant having to pay the costs of this exercise and to avoid having to wait a likely lengthy period before the issues are satisfactorily resolved, it is to be hoped that the Articles may be expressly amended when the operation of the Regulation is reviewed pursuant to the report made under Article 73 of the Regulation.

Until then, where English law is the governing law and so England the domicile of the trust, it may be that a beneficiary, by taking proceedings against the *trustees*, may be able to obtain satisfactory resolution of most problems involving the non-resident holders of fiduciary powers by seeking declarations that the trustees are not bound to follow the directions of the fiduciary or to seek his consent or to accept the validity of his actions eg because the fiduciary was in breach of his fiduciary duties or had not been validly appointed to the relevant fiduciary office. There is no problem if the trustees are resident in England. Even if they are resident abroad, by CPR rule 6.36 the English court may assume jurisdiction and grant leave to serve defendants outside the jurisdiction, subject to any argument on *forum inconveniens,* where a trust ought to be executed according to English law and the person on whom the claim form is to be served is a trustee of that trust[8].

[8] See *Gomez* at [23] per Lawrence Collins LJ

2. Enforcement of foreign trust law judgments eg in Jersey and Guernsey

Trust judgments of courts of competent jurisdiction in EU and EFTA States can be straightforwardly enforced in such States via a registration or declaration process, no review on grounds of substance being permitted, though there are some limited grounds for claiming a judgment should not be recognized.[9]

At common law a final money judgment of a court of competent jurisdiction is enforceable as an established res judicata obligation (subject to some very limited grounds for claiming a judgment should not be recognized eg obtained by fraud, non-observance of principles of natural justice, public policy[10]). In 2006 in *Pattni v Ali*[11] the Privy Council, in an Isle of Man appeal, made it clear that at common law the order of a foreign court of competent jurisdiction (Kenya to whose jurisdiction the parties had submitted) can be enforced in personam as a res judicata obligation where it orders a person to transfer specific property (shares in an Isle of Man company) to the claimant. This decision has been applied in the Cayman and Jersey courts[12]. Where a legal obligation has been established in a foreign court of competent jurisdiction against a person, then the procedure for enforcing such obligation in a local court is to seek a summary judgment based on no defence being available to the defendant.

In Jersey such procedure is available[13] but there is also the Judgments (Reciprocal Enforcement) Jersey Law 1960 enabling judgments for payment of money in respect of

[9] Article 34

[10] *Adams v Cape Industries* [1990] Ch 433 (Scott J) and 513 (CA),*Reid v Reid* [2008] Caribbean Court of Justice 4

[11] [2006] UKPC 51, [2007] 2 AC 85

[12] *Miller v Gianne and Redwood Hotel Investment Corporation*[2007] CILR 18 and *Brunei Investment Agency v Fidelis Nominees Ltd* 2008 JLR 337

[13] *Showlag v Mansour* 1994 JLR 113 at 118 per Lord Keith for Privy Council, *Mubarak v Mubarak* 2008 JRC 136 at [37-38] and[61-62]

compensation or damages to an injured party to be registered and enforced if a judgment of superior courts of England and Wales, Scotland, Northern Ireland, Isle of Man or Guernsey. Judgments of the English High Court Family Division varying Jersey trusts and making property adjustment orders under the Matrimonial Causes Act 1973 are not such judgments under the 1960 Law.

In *Compass Trustees Limited* v *Barnett*[14] the Jersey Court, however, was prepared to take advantage of the doctrine of comity and Article 51 of the Trusts (Jersey) Law (which enables the court to make orders and give directions in connection with any trust matters e.g. as to how trustees may validly exercise their powers) to decide to what extent to give effect to decisions or recommendations of English divorce judges requiring variation of Jersey trusts to enable those judges to order what they considered to be appropriate divorce arrangements .

It is now clear that it is the theory of a res judicata legal obligation to pay a sum of money or transfer specific property established in a court of competent jurisdiction that enables foreign judgments to be enforced, not any doctrine of comity[15]. Furthermore, most significantly, under Article 9(4) of the Trusts (Jersey) Law (as amended) "No foreign judgment with respect to a trust shall be enforceable to the extent that it is inconsistent with" Article 9(1).

This Article requires domestic Jersey law and no rule of foreign law (eg one enabling judicial variation of trusts governed by foreign law) to apply to trusts created by settlors domiciled outside Jersey so far as concerns

[14] 2002 JLR 321. In view of the wife no longer ranking as "wife" after the divorce, it seems Art 51 could not be used to authorize an ultra vires exercise of a power in her favour when she was not a "beneficiary":*Mubarak v Mubarak* 2008 JRC 136 at[68]

[15] See cases cited in fn10 and fn 11 above

(a) the validity or interpretation of a trust;

(b) the validity or effect of any transfer or other disposition of property to a trust;

(c) the capacity of a settlor;

(d) the administration of the trust, whether the administration be conducted in Jersey or elsewhere, including questions as to the powers, obligations, liabilities and rights of trustees and their appointment or removal; or

(e) the existence and extent of powers, conferred or retained [presumably "by the trust instrument and its governing law"], including powers of variation or revocation of the trust and powers of appointment, and the validity of the exercise of any exercise of such powers.

Without adverting to any problem arising from the implicit words set out in the square brackets above which do not extend to overriding powers external to the law of trusts[16], the Royal Court held in *Mubarak v Mubarak*[17] that Article 9(1) "provides that questions of variation of a Jersey trust shall be determined solely in accordance with the law of Jersey". It therefore held that it would not enforce the English divorce court's alteration of the terms of a Jersey trust under powers in the English Matrimonial Causes Act 1973, so as to restore the settlor's wife to the status of a discretionary beneficiary to the extent that the trustee could then be ordered to pay her £4,875,000 pounds sterling plus interest and costs. Under Jersey law, the wife was not a beneficiary, so no directions in her favour could be given under Article 51 of the Jersey Law

[16] Further see P Matthews, 'Trusts and Divorce:the Enforcement in Jersey of English Nuptial Settlement Variation Orders' (2008) 22 Trust Law International 63 at 78

[17] [2008] JRC 136 at [71]

which enables the Court to authorize or direct trustees to act within the powers conferred upon them. If the wife had been a beneficiary, then the trustees could have applied to the Court under Article 51 and the Court in its discretion (having regard to the interests of all the beneficiaries) could then approve the trustees acting intra vires so as partly or wholly to achieve the objectives of the English judgment. After all, such conduct within Article 51 does not amount to enforcement of a foreign judgment, though it does give recognition to a greater or lesser extent to such a judgment[18].

As it happened, there were truly exceptional circumstances in *Mubarak,* based upon a letter from the settlor to the trustees which the English Court had demanded and obtained from him before it would hear an application from him after numerous defaults by him in complying with court orders. The Jersey Court, in the absence of the settlor deigning to appear and be represented before it, was able to treat this letter as a consent to a variation of the Jersey trust under Article 47 of the Jersey (Trusts) Law. This enabled the wife to be made a beneficiary so that appropriate approval could be given to the trustees under Article 51.

The Court of Appeal[19] heard an appeal from the settlor, restricting itself to the availability of Article 47. It was alleged that Article 47 did not permit approval of a variation on behalf of a wide class of unascertained beneficiaries who could be made beneficiaries under the exercise of a broad power to add beneficiaries that had not been released. This was rejected after exhaustive analysis of the authorities.

[18] Ibid at [72]
[19] [2008] JCA 196

It should be noted that for the Jersey trustees to have a wide discretion in the exercise of discretionary powers on which directions of the Jersey Court are to be sought, they should not submit to the jurisdiction of the English Court (as such submission will make it more difficult to argue against the approach of such court) unless there are exceptional circumstances as where a substantial part of the settled property is in England and so subject to the territorial might of the English courts.

On the other hand, it will be advisable for the trustees to ensure that necessary information is provided to the foreign divorce court for it to ascertain the true place in the trust scenario of a beneficiary being divorced, especially where the foreign court (eg the English Court) is empowered to take account of interests and expectations under offshore trusts as available resources. Trustees will make distributions to a divorced spouse to satisfy his needs, so that divorce judges concern themselves with making an ancillary relief order which will leave the payer in a situation where his needs are such as to encourage the trustees to act to allay them[20].

In Guernsey it seems the position will be the same as in Jersey, except that a variation of a Guernsey trust under a foreign law is not to be enforceable because domestic Guernsey law alone is to apply to "the validity, interpretation or effect of the trust or *any variation* thereof".

Other offshore jurisdictions have their own special protective legislation, but if under such jurisdictions' laws the trustee has an intra vires power available to be exercised to give full or partial effect to a foreign judgment the trustee can exercise it. Nevertheless, it will normally be prudent to obtain the approval of the court to such exercise.

3. Remedy of Appointment of Receiver of Trust Assets

[20] *SR v SR* [2008] EWHC 2329 Fam at [28], *Charman v Charman* [2007] EWCA Civ 503 at [53]

A further exceptional circumstance in *Mubarak* was that the family trust's asset was a 100% shareholding in a Bermudian holding company, "TFCH", with successful jewellery companies as subsidiaries (eg in Hong Kong, Jersey, Dubai, France, London), though TFCH owed US$ 35 million to the husband and US$ half a million to the wife. In order to frustrate the wife's divorce claims, the group had over ten times the amount of stock normally held in the jewellery business, while its trade receivables had risen to over 200 debtor days, about 7 times longer than for normal jewellery businesses. It seems the husband could not call for repayment of his loan till TFCH was in adequate funds for that purpose. However, if action were taken to obtain liquidity from the underlying companies so that repayment of the husband became possible, the wife as beneficiary under the trust entitled to over £8 million (including interest and costs) could then attach the debt due to the husband so as to obtain the money to which she was entitled.

The trustee, Craven Trust Co, was a small trust company already out of pocket for more than £200,000 and it did not have the resources or expertise to get involved in international litigation and the running of jewellery companies. To hire KPMG as agent would not be advisable due to possible uncertainties as to who had ultimate authority to authorise particular actions and as to where responsibility lay for such actions. Thus, under the court's inherent jurisdiction, KPMG, being willing, two of its representatives were appointed receivers to seek to become provisional liquidators of the various companies so as to realize liquidity from the reduction of stock and the gathering in of trade receivables - and to pay their own fees. Payments could then be made up to TFCH which could then pay the wife if proper steps were taken in Bermuda to attach the loan owed by TFCH to the husband.

4. **Binding letters of wishes under Saunders v Vautier rule & "Bowing" to Lex Situs of Land**

In *Re Turino Consolidated Retirement Trust*[21] the Royal Court was concerned with a retirement trust set up in 1993 for the benefit of a husband, "H", and wife, "W", in proportions according to contributions, so that H had 83.33% and W 16.67%. The sole asset of this trust was a Dutch farm where H & W lived. In 1996 H & W agreed in the event of divorce their assets would be shared equally. In May 1999 they signed a "Letter of Wishes" that, notwithstanding their unequal contributions, in the event of their divorce the property should be considered to be held within the trust for the benefit of them equally.

In April 2000 they separated, and in 2001 were granted a decree of divorce by the Dutch Court which in 2003 determined upon a financial settlement, rejecting H's claim that he had signed the Letter under duress from W when she knew he was suffering from severe depression. Thus it ordered that the Letter constituted a valid binding agreement.

An appeal was rejected, the appellate court confirming that the farm be sold to W for a valuation of 415,000 Euros (subject to adjustments for occupation rent and for occupier-related costs) so that the proceeds would be divided equally between H and W.

The trustee had not participated in the proceedings nor submitted to the jurisdiction of the Dutch Courts, though indicating that, if it was in the best interests of the two beneficiaries, it would abide by the Courts' decision. It was caught between W, who wanted effect given to the Dutch

[21] 2008 JRC 100

decisions as soon as practicable and H, who argued that 415,000 Euros was a gross undervalue (W, in occupation of the farm, not having allowed an up-to-date valuation) and that the proceeds of sale had to be divided 83.33% to 16.67%.

The Royal Court held that, in the absence of consent from both H and W, the trust could not be varied by Jersey or Dutch courts. H and W, however, had under the rule in Saunders v Vautier, reflected in Article 43(3) of the Trusts (Jersey) Law, terminated the trust of the farm and directed equal division of it as an agreed effective variation of the original shares.

Normally, to obtain the best price reasonably obtainable in accordance with trusteeship duties, sale of the farm on the open market with vacant possession would be ordered. Nonetheless, in the light of W's likely refusal to cooperate in a valuation of the property and the seemingly insuperable obstacle of having to get the Dutch court to evict W, the best price reasonably obtainable would be that achievable by proceeding with the sale to W in accordance with the order of the Dutch court, with equal division of the net proceeds (in the light of adjustments) and after deduction of the trustee's fees and expenses (in obtaining independent legal advice in Holland and Jersey and obtaining the sanction of the Royal Court).

As stated in *Mubarak*[22], "The trustee may nevertheless seek the comfort of an order from this Court that it may properly comply with an order of the overseas court notwithstanding that this would be inconsistent with the terms of the trust deed….As the Court said at [49(iii)] of its judgment in *Turino* 'A trustee should not be criticized for bowing to the inevitable by complying with an order of the court in whose jurisdiction the real property in question is situated'."

[22] 2008 JRC 136 at [79]

5. The rights of beneficiaries to information about trust affairs

In the light of *Schmidt v Rosewood*[23] not only do beneficiaries under fixed trusts or discretionary trusts have a right to seek information about trust affairs, so also do objects of fiduciary powers of appointment, as accepted in *Foreman v Kingstone*[24] and *Freeman v Ansbacher Trustees (Jersey) Ltd*[25]. Nonetheless, it is not every beneficiary or object of a fiduciary power (hereafter together "beneficiaries") who has this right. As *Schmidt* made clear, the right is available only to such a person who has a realistic possibility of benefiting as opposed to a person who merely has a remote or peripheral or theoretical likelihood of benefiting (eg where "any charity in New Zealand"[26] is an object of a fiduciary power in a family discretionary trust or a person is merely one of many within the scope of a power to add persons to classes of beneficiaries[27]). Courts, however, should be slow to decline disclosure of information and accounts because a trustee's fundamental obligation of accountability to beneficiaries is at the core of the trust obligation.

Another fundamental principle is that the autonomy of the trustees in the exercise of their fiduciary discretions must be ensured, so that the trustees are not obliged to give reasons for exercising their discretionary distributive powers and are not obliged to disclose documents used to further the inherently confidential process of exercising such powers, even if they are letters of wishes which trustees are obliged to take into account before exercising their discretions[28]. If they choose they can ,of course, make such documents available if they consider this to be in the

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[23] [2003] 2 AC 709
[24] [2005] WTLR 823, [2004] 1 NZLR 841 at [81-82]
[25] 2009 JRC 003
[26] [2005] WTLR 823 at [87]
[27] *Schmidt* at [54] and [67], though such a person exceptionally had a right to disclosure of information(at [33] and [68.4]) when the letter of wishes showed that he was to be added and become the primary beneficiary after the death of the settlor-beneficiary
[28] *Breakspear v Ackland* [2008] EWHC 220 (Ch), [2008] WTLR 777

interests of the sound administration of the trust and the discharge of their discretions[29].However, if they choose not to disclose such documents, without giving any reasons that the court can then examine (not being obliged to give reasons), or merely giving an anodyne decision ("We have decided not to make disclosure, having considered the relevant case-law and the particular circumstances") this is the end of the matter if a disappointed beneficiary cannot issue legal proceedings, whether for invoking the court's supervisory jurisdiction under *Schmidt* or for directly bringing a breach of trust claim. Such legal proceedings, however, must particularize grounds for impugning the fairness or honesty of a particular exercise of a discretion[30], because they will be struck out if merely amounting to a fishing expedition, making allegations designed to obtain information which may lead to obtaining evidence to support the allegations [31].

Once proceedings have been properly instituted, then liberal civil procedure rules come into play entitling claimants to have relevant documents disclosed to them. If the case then goes to trial, trustees may on cross-examination have to disclose their reasons for exercising discretions if adverse inferences are likely to be drawn in the absence of some reasonable explanation.

In *Wingate v Butterfield Trust (Bermuda) Ltd*[32] the plaintiff in his statement of claim made detailed complaints that the trustee had been in breach of trust in (i) its failure to provide any or any reasonably sufficient information and/or documentation in relation to the trustee's fees & expenses, the entertainment business of a company owned by the trust, property development in

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[29] Ibid at [62]
[30] Ibid at [70-71]
[31] "English law has developed a robust approach to fishing litigation" per Briggs J in *Breakspear v Ackland* [2008] WTLR 777 at [13], though diluted somewhat as concerns "conjectural documents" in divorce proceedings concerned with financial relief according to *Charman v Charman* [2005] EWCA Civ 1606 at [31] et seq in considering s 2 Evidence (Proceedings in Other Jurisdictions) Act 1975, though not accepted by the receiving Bermudian Court due to alleged inconsistency with the House of Lords in *Re Asbestos Insurance Coverage Cases* [1985] 1 WLR 331
[32] [2008] WTLR 357

New York in which the trust participated, and distributions to beneficiaries; (ii) its failure to use reasonable care & skill in relation to the underlying entertainment business: (iii) the amount of fees and disbursements. There were claims for such information/documentation to be provided to the plaintiff, for accounts of the trust property, for replacement of the trustee and compensation. The trustee filed a defence and the plaintiff filed a reply.

An application was then made by summons (with detailed supporting affidavit) for summary judgment (under Order 14 on the basis that the defendant had no defence) that the defendant make disclosure by affidavit exhibiting all material documents relating to matters raised by the London firm, Farrer & Co, on the plaintiff's behalf by letter of 25 Nov 2005 (providing the basis for the Bermudian claim) and that an account in common form be provided.

Bell J held that the application could have been made, as in *Schmidt,* by an interlocutory application invoking the court's supervisory jurisdiction in the administration of a trust. It was therefore appropriate to proceed on that basis and not to penalize the plaintiff for applying under the stricter principles applicable to Order 14 summary judgment applications[33].

The plaintiff was one of four children of the settlor and was acknowledged by the trustee as one of the principal beneficiaries: he was one of a class entitled to income insofar as not distributed within such class and was entitled in default of appointment to share in capital on termination of the discretionary trust, which was what the trustee intended shortly to achieve. As such, Bell J held[34] "the plaintiff is entitled to have reasonable questions answered" so far as the requisite

[33] At [28]
[34] At [35]

information is available to the trustee[35], though a significant discretionary beneficiary is not entitled as such to an order for a common form account, only being entitled to production of such accounts as the trustee may have prepared[36].

The basis for a court to order such an account depends on the court coming "to the view that such is necessary in the context of the court's jurisdiction to supervise the administration of a trust."[37] Bell J could not see that such order would provide any more assistance to the plaintiff and his advisers than an order for requisite disclosure of information and documentation, while it would be an extremely expensive exercise which would not be justified in terms of the benefit to be gained from the exercise[38].

Bell J held that "the questions which have been raised on behalf of the plaintiff in relation to these various matters are entirely reasonable and of the type which the Court in the exercise of its supervisory jurisdiction should require the trustee to answer"[39], there being no justification (as argued by the trustee) for disclosure not extending beyond distributive documents (as to what distributions had been made eg to the settlor's widow before her death) to documents relating to the management and transactional business of a trust[40]. There was also no justification for limiting disclosure to some limitation period, so that disclosure was required relating to some transactions as far back as 1980-81.

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[35] At [40], it being assumed that information and documents involving the activities of controlled subsidiary companies should be disclosed, almost all of the trust's activity having taken place in the underlying companies as indicated at [37]
[36] At [18], citing *Armitage v Nurse* [1998] Ch 241
[37] At [20]
[38] At [42]
[39] At [40]
[40] At [41]

Subsequently[41], the judge ordered the trustee to pay two thirds of the plaintiff's costs on the standard basis (the plaintiff having failed in his claim to accounts), and rejected the trustee's claim to be paid its costs out of the trust fund. It had not sought to protect itself by a Beddoe's application, had acted unreasonably in failing to provide information and documentation (especially as to its fees & expenses) and had ended as the losing party in hostile litigation.

While it did not fall to Bell J to consider them (though the trustee had liberty to apply), certain factors can limit the extent of disclosure. These include whether issues of personal or commercial confidentiality should lead to certain documents being withheld or produced only in redacted form and whether issues as to possible misuse of information or documents should lead to safeguards via undertakings to the court or via inspection only by professionals and not the claimant beneficiary[42].

6. <u>"Place of effective management" as the tie breaker for dual resident trust companies</u>

In *Smallwood v HMRC*[43] the Special Commissioners (Drs Brice and Avery-Jones) held that the "place of effective management" ("POEM") tie-breaker test in Double Taxation Treaties[44] for a person (other than an individual) resident in two Contracting States is different from the concept of "central management and control" ("CMC"). After all, POEM has to allocate a person to one State alone, requiring comparing and contrasting the position in the two States in question, while

[41] [2008] WTLR 543

[42] *Schmidt* at [54], [67], *Bathurst v Kleinwort Benson Trust Co* 4 Aug 2004 Guernsey Royal Court

[43] [2008] UKSPC 00669

[44] See Double Taxation Relief (Taxes on Income) (Mauritius) Order 1981 (SI 1981 No 1121) Article 4 (3) covering capital gains as well as income eg Art 13

CMC primarily focuses upon whether there is CMC in the forum in question to enable the investigated company to be taxed, it being possible for there to be CMC in two States[45].

The case concerned a scheme to avoid CGT devised by KPMG's Bristol office for the settlor, Mr Smallwood. Since there was no tax on capital gains in Mauritius, the idea was for a Mauritian trustee company of KPMG to be appointed trustee (replacing a Jersey trustee) and then to sell two major shareholdings before the trustee was replaced in the same tax year (200-2001) by English trustees, Mr & Mrs Smallwood. Reliance was placed upon Art 13(4) of the Treaty Order, "Capital gains from the alienation of property….shall be taxable only in the Contracting State of which the alienator is a resident", alleging this to be Mauritius so as to avoid English CGT.

The Commissioners, however, held that the factual residence of the trustee for part of the year in Mauritius and then part of the year in England resulted in deemed residence of the trustee in Mauritius for the whole tax year and deemed residence of the trustee in England for the whole year. The application of POEM then led to England as the POEM, so that English CGT was payable.

Mann J[46] allowed the appeal, holding that Art 13(4) gave the right to tax capital gains to the State in which there was residence at the date of the disposition, which was Mauritius. Hence no English CGT was payable, there being no tie to break via Art 4's POEM test. He stated[47] "In those circumstances, the POEM question does not arise, and I shall not decide it."

[45] At [111] – [112]
[46] [2009] EWHC 777 (Ch)
[47] At [47]

Until the POEM question is investigated further, one has to beware of the factors in *Smallwood* that led two experienced Commissioners there to find that England was the POEM. These factors were (with para references to their judgment)

(i) All actions of the KPMG Mauritius trust company, "PMIL", were carried out correctly by its locally resident directors and were well-documented.

(ii) Nevertheless, in the Mauritius period the influence of Mr Smallwood and the guiding hand of two KPMG Bristol office accountants were evident, the Bristol office seeing itself as tax advisers to PMIL, without any formal appointment as such, KPMG Bristol and KPMG Mauritius being "under the same umbrella", though independent profit centres.

(iii) The tax avoidance scheme was devised by the Bristol office approaching PMIL for it to be appointed late in 2000 (appointed 19 December) with "the confident expectation that the shares would be sold before 5 April 2001".

(iv) The Commissioners accepted there was no agreement that PMIL would behave in a certain way or make certain decisions: it would only act within its proper duties as trustee and so would not sell the shares if not in the best interests of the beneficiaries or if the share price dropped dramatically and the fund manager advised against a sale. The Commissioners accepted, however, that the whole point of the exercise was to sell the shares and realize the gain free from CGT. The shares were sold mid January 2001 (after the decision was taken at a telephone meeting between the

directors of PMIL on 10 January, one director being in India) and then Mr & Mrs Smallwood became the English-resident trustees on 2 March 2001.

(v) "The facts surrounding the appointment of PMIL lead us to the view that the real top level management, or the realistic positive management of the Trust, remained in the UK. We accept that the administration of the Trust moved to Mauritius, but in our view the 'key' decisions were taken in the UK [at [140]] …….We conclude that the State in which the real top level management decisions, or the realistic positive management of the Trust, or the place where the management and commercial decisions that were necessary for the conduct of the Trust's business were in substance made, and the place where the actions to be taken by the entity as a whole were, *in fact*, determined between 19 December 2000 and 2 March 2001 was the UK [at [145]]."

Essentially, the Commissioners considered that the strings were being pulled in England, albeit with some obeisance to the local PMIL directors having to observe their independent fiduciary duties. With substance prevailing over form, it is difficult to have the realistic positive management of the trust in Suntopoia unless the approach is made by a Suntopian trust company to Taxland trustees and their advisers and the company pulls the strings to achieve a tax saving.

7. Practicalities: effective retirement of trustee under s 39 Trustee Act and equivalents

Where a trustee purports to retire from a trust it is crucial that this is effective for, otherwise, the intended retiree remains a trustee who has to participate in the decisions and acts of the trustees if they are to be valid and whose residence may have tax implications.

By s 39 "Where a trustee is desirous of being discharged from the trust, and [1] after his discharge there will be either a trust corporation [being an EU corporation] or at least two persons to act as trustees to perform the trust, then [2] if such *trustee* as aforesaid *by deed* declares that he is desirous of being discharged from the trust, and [3] *if his* co-*trustees and such other person as is empowered to appoint trustees*, *by deed consent* to the discharge of the trustee, and to the vesting in the co-trustees alone of the trust property, the trustee desirous of being discharged shall be deemed to have retired from the trust, and shall, by **the** deed be discharged therefrom under this Act without any new trustee being appointed in his place."

Normally, retirement will be effected by the one deed executed by the retiring trustee and the remaining trustees - *and* any person (an "appointor") empowered to appoint new trustees, so one must check on this. If, by mistake, with the oral consent of his co-trustees, T simply retires by executing a deed retiring from the trust, can a subsequent deed executed by the remaining trustees and the appointor, if any, regularize matters as of its date of execution? Yes, as according to the Jersey Royal Court in *Re Epona Trustees Ltd and Pentera Trustees Ltd*[48], the last reference to "the deed" includes a reference to the deeds if more than one, taking account of

[48] [2009] WTLR 87

s 6 (c) of the Interpretation Act 1978 that words in the singular include the plural unless there is a compelling contrary intention (as stated by the English Court of Appeal in *Melville* v *IRC*[49]).

What happens if T2 and T3, blissfully unaware that T1 has remained a trustee despite T1 having executed a deed retiring from the trust, subsequently execute a deed in which they can only achieve what they intend to achieve by executing the deed if they alone are the trustees? At the date of this subsequent deed T1 is treated as effectively discharged by this deed with the consent of T2 and T3 who alone become the proper trustees, so that they achieve what they intended to achieve, as held in *Re Epona Trustees Ltd and Pentera Trustees Ltd* above, applying *Davis* v *Richards and Wallington Industries*[50] and *Re Morgan*[51].

While principles like these can bail out trustees, one should always check that the appointment, retirement or removal of trustees duly conforms with statutory and trust provisions. Otherwise, it can be a nightmare, involving excessive payment of tax, expensive difficulties unscrambling matters so far as possible and establishing who are currently the proper trustees of the settlement, and resolving negligence suits. See the salutary 2007 case, *Jasmine Trustees Ltd v Wells & Hind*[52], where the 1982 appointment by T1 & T2 of a Manx trust corporation and an individual as T3 & T4 in place of T1 & T2 did not discharge T1 & T2 from being trustees because s 37 (1)(c) of the Trustee Act 1925 allowed this only if the appointment left a "trust corporation" [being an EU trust corporation satisfying certain requirements[53]] or at least two "individuals" as trustees. This trap in s 37(1)(c) and s 39 was removed by the Trusts of Land and Appointment of Trustees Act 1996 prospectively replacing "individuals" by "persons."

[49] [2001] WTLR 887 at 896 G-H
[50] [1990] 1 WLR 1511
[51] [1857] 7 Ir Ch R 18
[52] [2007] EWHC 38 (Ch)
[53] Rule 30 (b) of Public Trustee (Custodian Trustee) Rules 1975 as amended, Underhill & Hayton 17th ed 79.5

8. Practicalities as to expenses out of income or capital

In *Commissioners for HMRC v Trustees of Peter Clay Discretionary Trust*[54] the English Court of Appeal clarified when trust expenses are properly deductible out of income (rather than capital) under the general law (ignoring any specific contrary provisions in the trust instrument) so as to reduce the amount of trust income subject to higher rate tax under s 686 (2AA) Income & Corporation Taxes Act 1988.

Expenses were trustees' fees (with fixed fees for two non-executive trustees), investment management fees, bank charges, custodian fees, and professional fees for accountancy and administration. The Special Commissioners had held that, except for the non-execs' fixed fees and investment management fees, expenses could be apportioned in accordance with the requirement to achieve a fair balance between income and capital beneficiaries. Allocation to a particular year of assessment was to be on the accruals basis. Lindsay J had rejected this fair balance approach but accepted the accruals basis.

The Court of Appeal largely upheld Lindsay J in laying down the following principles.

Expenses incurred for the benefit of the whole estate, being expenses incurred for the benefit of both capital and income beneficiaries, must be charged to capital.

Expenses incurred exclusively for the benefit of income beneficiaries alone are properly chargeable to income.

Where it can be proved that *part* of an expense was incurred exclusively for the benefit of income, then the expense can be apportioned between capital and income, even in the case of a

[54] [2008] EWCA Civ 1441

fixed fee. For purposes of proof it is necessary to keep records (eg as to time spent on particular activities) so that apportionment can be justified.

Thus, if satisfactory proof of exclusive incurrence for income beneficiaries was available (as was for some expenses) it was possible to permit apportionment in respect of the trustees' fees (even if fixed), investment management charges, bank charges, custodian fees, and professional fees.. Once the decision to accumulate income had been made then advisers' fees on investing such must be charged to capital as capitalized income benefits both capital and income beneficiaries.

9. Disputability of sham trusts

In *Official Assignee in Bankruptcy v Wilson*[55] the New Zealand Court of Appeal held that just as a settlor cannot allege that his trust in favour of beneficiaries is a sham so as to recover the trust property, so his assignee in bankruptcy, who stands in his shoes[56], cannot recover that property for the benefit of his creditors. "That finding effectively disposes of the case, but lest we are mistaken in that approach and in deference to the arguments presented with regard to the other issues, we"[57] find there was no sham trust.

There was no detailed explanation as to the reasons for the settlor, Mr Reynolds, being unable to recover the trust property. The Court merely asserted that it [58] "could never reach the point where there could be integrity or justification in allowing Mr Reynolds to seek relief which is

[55] [2008] WTLR 1235, [2007] NZCA 122
[56] At [19]: the Assignee "cannot, as a matter of law or logic, be in a greater or different position than Mr Reynolds"
[57] At [25}
[58] At [23]

effectively for his own benefit. The fact that the benefit might be able to be transferred to his creditors does not alter the analysis." But why not?

Let us first consider the position of the settlor ("S"). When S and his trustee ("T") have the common intention for T actually to hold the trust property on trust for S but to *appear* to hold it on trust for beneficiaries identified in the trust instrument, the purpose of this deceitful arrangement will almost always be illegal in, at least, enabling S to evade taxes on income and capital gains, while perhaps also enabling him to defraud creditors.

How then do we analyse this situation where S has a prior equitable interest under an oral trust of personal property[59] that on general principles ought to prevail over the subsequent apparent equitable interests of beneficiaries? Does S's illegal purpose have to come to light in his relying upon it in order to try to recover his property, thereby preventing him from recovering it? After all, he cannot simply claim that there is a resulting trust in his favour when he has apparently disposed of his equitable interest.

He can, however claim (i) that T first held the property on trust for S before, as a result of S's direction, holding it on trust for the beneficiaries in the trust instrument and (ii) according to *Vandervell* v *IRC*[60], this amounts to S disposing of his subsisting equitable interest to those beneficiaries, but such disposition is void without the requisite signature of S (as is commonly the case, S transferring assets to T who then executes a trust instrument declaring the trusts for the beneficiaries). Thus S is entitled to the equitable interest in the property.

[59] Trusts of land require to be evidenced in writing to be enforceable under English LPA s 53(1)(b) and equivalent legislation elsewhere

[60] [1967] 2 AC 291

Nonetheless, Equity will not allow a statute to be used as an instrument of fraud (especially a statute designed to prevent fraud) and so will surely prevent S from relying upon the statute. If S had complied with the statute then surely he would not be allowed to deny the objective effect of his acts by relying on any secret contrary intention of a dishonest nature.

A similar approach will surely be taken if it is simply argued that a sham transaction is a "void transaction"[61] and a sham trust is "wholly invalid and of no effect"[62], as Courts stated when dealing with successful claims by the Revenue and S's spouse respectively. If S himself, however, tries to claim that his sham trust should be wholly invalid and of no effect, surely he cannot be allowed to deny the objective effect of his conduct by relying upon a secret dishonest contrary intention, as held by the NZCA.

There is however, every reason why S's creditors should be able to claim S's trust is a sham so that the trust property is made available to ensure that they are fully paid what is due to them (in accordance with policy reflected in legislation, like Insolvency Act 1986 s 423, designed to prevent fraud upon creditors). They provided consideration (a quid pro quo) for their claims, unlike beneficiaries under trusts created gratuitously, and the benefit of the invalidity of the trust passes to them, not to S. Thus The Revenue or S's spouse can claim that certain alleged trust property is actually S's because his trust was a sham, so that execution can be levied against such property to satisfy the claims of the Revenue[63] or S's spouse[64].

Why should it make any difference if S has been declared insolvent, so that instead of particular creditors bringing claims, the trustee in bankruptcy (or Official Assignee in some jurisdictions)

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[61] *Hitch v Stone* [2001] EWCA Civ 63 at [87]
[62] *Rahman v Chase Bank (CI) Trust Co* 1991 JLR 103 at 115
[63] Cp *Hitch v Stone* (above)
[64] *Rahman v Chase Bank* (above)

in orderly fashion on behalf of the insolvent S satisfies S's creditors' claims? The NZCA seemed to think that this was for the benefit of S. With respect, this is surely for the benefit of S's creditors, whose interests should prevail over the interests of the beneficiaries under S's gratuitous sham trust.

Indeed, this would also seem to be the case if the personal representatives ("PRs") of S needed to pay off his creditors. As seen, if S had been alive he would not have been able to assert the validity of his sham trust against his creditors, and his PRs cannot be in any better position[65]. What, however, if there were no creditors (eg the PRs had paid the Revenue in respect of S's tax liabilities evaded via the sham trust), so that the conflict was between S's heirs entitled to his estate and the beneficiaries under S's sham trust? It would seem that if S could not recover the trust property without relying upon his illegal purpose and without undermining his objective actions by a secret dishonest intention, then his heirs ought to be in no better position.

[65] *Silverwood v Silverwood* (1997) 74 P & CR 453, CA accepted that donor's executor would not be able to recover property gifted to X for an illegal purpose if donor, if alive, would not have been able to recover the property.