THE CONCEPT OF A SHAM IN RELATION TO OFFSHORE TRUSTS, HOW SUCH A SITUATION CAN ARISE AND HOW IN PRACTICAL TERMS IT CAN BEST BE AVOIDED

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INTRODUCTION

An international trust[1] (which may have been created for asset protection and estate planning purposes) can be attacked as a sham[2] both under the proper law of the trust and under the law of any other state that has jurisdiction under its rules of private international law to entertain a claim concerning the settlor, trustee, and trust assets. In the event of a successful challenge, then, generally speaking:

(1) the terms of the trust cannot be relied upon;

(2) the settlor remains the owner of the property transferred by him to the trustee;

(3) any planned fiscal advantages will not be achieved; and

(4) the door is open to the bringing of claims against the settlor and the trustee for recovery of trust assets, compensation, and legal costs.

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1 This article focuses on the application of the sham concept to international trusts and is based on English Law. Unless otherwise stated all references to the court are to the English High Court. To illustrate the application of the sham concept in the context of international practice reference is also made to the Trusts (Jersey) Law 1984, available to view on www.jerseylegalinfo.je. Jersey is not an EU State but is a signatory to the Hague Convention on the Law Applicable to Trusts and their Recognition 1985 (the Hague Convention).

2 The dictionary definition of the noun is, '1. a person or thing that is not what they are claimed to be. 2. pretence' see the *Compact Oxford English Dictionary* (2nd edn, 2002).

Once a trust has been declared, the burden of proving the existence of a sham must be discharged by the claimant.[3] Commonly this will be a disappointed beneficiary or a creditor.[4] While there is no half-way house, because a trust either will or will not be a sham, there are prudent measures that a settlor can take to prevent creating even the appearance of a sham in order to deter any claims being made against him.

CONCEPT AND ELEMENTS

There is no clear set of rules regarding the application of the sham concept,[5] and the essential elements of a sham trust instrument are not settled. However, it is generally accepted that a document or a provision in a document is a sham if it is not intended to be acted on in accordance with its terms:[6]

> 'If [however] what is done is genuinely done, it does not remain undone merely because there was an ulterior purpose in doing it.'[7]

By definition, a trust cannot be created where a sham exists because at the time of creation there was no intention to fulfil the requirements for creation of a valid trust, which requires certainty of intention. [8]

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[3] The standard of proof is the balance of probabilities.

[4] Eg HM Revenue and Customs (HMRC). See *R v Allen (No 2)* [2001] UKHL 45, [2002] 1 AC 509.

[5] Which is a concept of general law.

[6] This proposition is derived from *Yorkshire Railway Wagon Company v Maclure* (1882) 21 Ch D 309, at 317, Lindley LJ stated:

'I understand that the view the learned judge took was this, that this transaction was a mere device or cloak to conceal a loan. If that had been the view I took of the facts, I should have come of course to the same conclusion. I should disregard or throw aside the cloak, and look at the real transaction alone. But ... I am satisfied that the purchase and hire transaction was the real transaction, in this sense – that the parties meant it to operate according to its tenor as comprised in the deeds. It was not intended by them as a mere blind or cloak for something behind, it was a transaction substituted for another, but bona fide substituted, and intended to be acted upon according to its purport and apparent effect.'

[7] *Miles v Bull* [1969] 1 QB 258, at 264 per Megarry J; and *Chase Manhattan Equities Ltd v Goodman* [1991] BCLC 897, where Knox J stated at 921: 'A deed of gift can only be a sham in my judgement if it is shown that the parties to it intended that [the donor] should remain the beneficial owner of [the property] comprised in it'.

[8] *Lewin on Trusts* (Sweet & Maxwell, 17th edn, 2005), at 4-27:

'If a finding of a sham is made in the context of an apparent trust, then an essential requirement of the validity of the trust will, ex hypothesi, be lacking: there will have been no necessary intention to create a trust. But a finding of sham makes it unnecessary for the court to consider the requirement of certainty of intention at all, because it has evidence before it that the settlor's documentation has been crafted to mislead.'

If, when declaring a trust, the settlor genuinely intends the documentation[9] to take effect according to the tenor of its terms, and those terms are such as to create a trust, then nothing the settlor or trustee do thereafter can render a valid trust a sham,[10] and the court will not enquire into the motive underlying the settlor's intention.

The court distinguishes between:

(1) a written document deliberately framed with the object of deceiving third parties as to the true nature and effect of the legal relations between the parties[11] – which is a sham; and

(2) situations where 'the [instrument] does precisely reflect the true agreement between the parties, but where the language of the document (and in particular its title or description) superficially indicate that it falls into one legal category, whereas properly analysed in the light of surrounding circumstances it can be seen to fall into another'[12] – which is not sham.

The fact that a deed has been executed with the benefit of legal advice does not affect the status of a transaction as a sham.[13]

A trust instrument will not be a sham simply because:

(1) the parties do not know its effects;

(2) it is uncommercial or even artificial (for example a tax-avoidance scheme that relies upon the individual steps making up the scheme to be legal);

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9 In addition to the trust instrument there may also be a letter of wishes, which is a non-binding document.

10 *Lewin on Trusts* (Sweet & Maxwell, 17th edn, 2005), at 4-22.

11 Variously described as 'put forward by way of disguise' in *Re Watson ex parte Official Receiver in Bankruptcy* (1890) 25 QBD 27, at 31 per Lord Esher MR; as 'a mere blind or cloak for something behind' in *Yorkshire Railway Wagon Company v Maclure* (1882) 21 Ch D 309; or as 'not intended to take effect according to its terms' as compared with deeds that, 'are genuine and carry an obligation according to their tenor' in *Inland Revenue Commissioners v Duke of Westminster* [1936] AC 1, at 29 per Lord Wright.

12 *Hadjiloucas v Crean* [1988] 1 WLR 1006. On the basis of this distinction the agreement in *Street v Mountford* [1985] AC 809 was held not to be a sham. While its description as a 'licence' was misleading its terms accurately reflected the intention of the parties.

13 *Midland Bank v Wyatt* [1995] 1 FLR 696, at 707, D.E.M. Young QC stated:

'It follows that even if the deed was entered into without any dishonest or fraudulent motive but was entered into on the basis of mistaken advice, in my judgement such a transaction will still be void and therefore an unenforceable transaction if it was not intended to be acted upon but was entered into for some different or ulterior motive. Accordingly, I find that the declaration of trust sought to be relied upon ... is void and unenforceable.'

(3) the parties have subsequently departed from its terms – the proper conclusion to draw may be that the settlor was authorised by the trust deed to vary the terms and the trustees have acted in accordance with the terms of the deed as varied. It does not mean that they never intended the trust deed to be effective and binding.

Trust cases where a sham has been found include those where the settlor:

(1) did not intend the trust deed to have effect when executed;[14] and

(2) retained power to appoint income and capital on such trusts as he should appoint with consent of the trustees subject to retained power by the settlor to appoint one third of the capital without the trustee's consent.[15]

If a trust is found to be a sham, then it will be a sham for all purposes.[16]

WHAT HAS TO BE PROVED?

Based upon the principles set out in the decision of the Court of Appeal in *Snook v London and West Riding Investment Ltd*[17] the court must find that

(1) while the settlor did not intend to part with beneficial interest in the trust property;

(2) he executed the trust deed with the apparent effect of doing so; and

(3) that the trustee knowingly or unwittingly went along with the deception (even where they did not intend to deceive and appear to have had no idea about what they were doing). [18]

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[14] *R v Allen* [1999] STC 340. The deed therefore failed to create a trust.

[15] *Abdel Rahman v Chase Bank (CI) Trust Company & Others* (unreported) 6 June 1991, Royal Courts of Jersey. The settlor referred to the trust fund as 'his assets'. The trustee made no independent investment decisions, and often the settlor controlled the trust funds directly, S Pryke, 'Sham Trusts' (Lecture to the London Branch of the Society OF Trust and Estate Practitioners, 2005), at p 4. This article was cited with approval by Singer J in *Minwalla v Minwalla and DM Investments SA, Midfield Management SA and CI Law Trustees Ltd* [2004] EWHC 2823 (Fam), [2005] 1 FLR 771.

[16] J Kessler, 'What is (and what is not) a sham' (1999) 9 OTPR 125, at p 10. If beneficiaries sue trustees for breach of trust, it will be a defence that the trust is a sham.

[17] [1967] 2 QB 786, at 802 per Diplock LJ:

'For acts or documents to be a sham, with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating.'

In assessing whether the necessary shamming intention of the parties existed, what matters is their intention at the time of execution of the instrument. This is an issue of fact, and what has to be established is their subjective, and not their objective, intention, which is why shams are difficult to prove. The court is, however, able to draw inferences of shamming intent from the evidence presented to it.[19] Where there is evidence of inappropriate trust administration this includes drawing the inference that the settlor was the sole beneficiary.

In its investigation into the facts, it is the duty of the court to discover the true nature of the transaction to see whether the documents are a genuine statement of the intended transaction or are entered into only to clothe the real transaction in a deceptive manner:[20]

> 'in the case of a document, the court is not restricted to examining the four corners of the document. It may examine external evidence. This will include the

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[18] *Midland Bank v Wyatt* [1995] 1 FLR 696, at 699: 'a sham transaction will remain a sham transaction even if the [trustee] ...merely went along with the [settlor] not either knowing or caring about what he or she was signing'. In *MacKinnon v Regent Trust Company Limited and Eight Others* [2005] JLR 198, Southwell JA (with whom the other two appellate judges concurred) stated in para 14, 'In *re Esteem Settlement*, the Deputy Bailiff had occasion to consider (2003 JLR, at paras 42–60) what were the necessary ingredients for a claim that deeds were shams. He held that it must be shown that both settlor and trustee had a common intention that the true position should be otherwise than as set out in the trust deed which they both executed. I agree. The Deputy Bailiff went on, in that passage, to consider whether an intention of both settlor and trustee to mislead third parties or the court, by giving the appearance of creating between the parties legal rights and obligations different from the actual rights and obligations (if any) which the parties intend to create , is a necessary ingredient. Again, I agree. He so held in reliance on the relevant English authorities, as did the Bailiff in this case; and in my judgment , this branch of the law, having been most fully developed in England and Wales (and also in Australia), it is entirely appropriate that Jersey law should take full account of English law in this regard'. In para 34 the judge referred to the judgment of Knox J in *Chase Manhattan Equities v Goodman* [1991] BCLC 897, at 921–922 where Knox J referred first to the passage from Diplock LJ's judgment in *Snook v London & W Riding Investments Ltd* [1967] 2 QB 786, and to Lord Templeman's use of the word 'pretence' in *AG Securities v Vaughan* where Knox J stated, 'it is not necessary for the parties affirmatively to intend to enter into a particular transaction once it is shown that the ostensible transaction was a pretence ... similarly it is not necessary that the parties to a transaction which is properly characterised as a sham should have the same motivation'. Southwell JA stated, 'In my judgment, first Knox J was dealing only with motive, which is not the same as intention, and secondly, if by "motivation" he meant "intention" his statement is not a correct one. The cases I have cited much earlier in this judgment show that a common intention to give a false impression to third parties is a necessary element in this head of claim, and must be pleaded'. In *Mackinnon* the claimant accepted that he could not allege any such common intention, and accordingly the Court of Appeal in dismissing the appeal held that the sham head of claim could not succeed, and that the Royal Court had been right in striking out the relevant paragraphs of the claim.

[19] A Levelle, 'Can anyone prove a sham?' (2006) 4 2 *STEP Trust Quarterly Review* 24.

[20] *Stoneleigh Finance Ltd v Phillips* [1965] 2 QB 537, at 560 per Sellers LJ.

parties' explanations and circumstantial evidence, such as evidence of the subsequent conduct of the parties.'[21]

After a trust has been declared, evidence about the parties' behaviour is not admissible in relation to construction of the trust deed, but is admissible to determine whether the instrument was genuine.[22]

CONSEQUENCES

When the legal criteria for establishing the existence of a sham are satisfied, in theory it is the trust instrument (and not necessarily the trust) that is a sham, and the assets vested in it are declared as belonging exclusively to the settlor. However, it does not automatically follow that the trust is entirely invalid;[23] the true terms intended by the parties must be ascertained and construed by the court.[24]

Nevertheless:

(1) the parties to the trust deed will not be able to rely on the trust deed as representing the true position as to the rights between the parties, and the court can ignore the trust deed in determining what those rights are; and

(2) as against an innocent third party, the parties to the sham may not rely upon the trust deed as being void in order to deprive the innocent third party of any rights.[25]

A successful sham attack does not by itself establish the claimant's right to the property held within the trust. Hence a claim for a declaration that a trust is a sham

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21 *Hitch v Stone (Inspector of Taxes)* [2001] EWCA Civ 63, [2001] STC 214, at 230 per Arden LJ.

22 *Lewin on Trusts* (Sweet & Maxwell, 17th edn, 2005), at par 4-22. J Kessler, 'What is (and what is not) a sham' (1999) 9 OTPR 125, at p 2, states:

'It is fundamental law that a settlement (as any gift) is irrevocable once validly made (unless there is a power of revocation): it cannot be revoked by subsequent conduct . The relevance of subsequent conduct is that it may shed light on the intention at the time of the settlement and show that it was not validly made.'

23 While the dispositive provisions may have been struck down the administrative provisions may have survived.

24 D Brownbill, 'Sham Trusts' (Maitland Chambers, 2004), at p 2.

25 Where an innocent third party is involved the trust may not be regarded as void and it will be for the court to define the rights of the parties involved depending upon the facts of the particular case. S Pryke, 'Sham Trusts' (Lecture to the London Branch of the Society OF Trust and Estate Practitioners, 2005), at p 11. He refers to the dicta of: DEM Young QC in *Midland Bank v Wyatt*, at 707; Neuberger J in *National Westminster Bank plc v Jones* [2001] BCLC 98, at paras [36]–[46], [59], [60], and [68]; and Charles J in *Carman v Yates* [2004] EWHC 3448 (Ch), [2004] All ER (D) 373 (Nov), at paras [219] and [220].

is likely to be accompanied by an alternative recovery claim, the nature of which will depend upon the particular facts of the case and the party bringing the claim. Possible claims could be made:

(1) against the settlor, on the grounds of:

(a) resulting trust (where he sought to conceal personal assets from creditors by placing them in trust);[26]
(b) s 660A of the Income and Corporation Taxes Act 1988,[27] to recover income from assets held in a trust which has generated income;[28]
(c) s 86 of the Capital Gains Tax Act 1979[29] in relation to gains realised by an offshore trust which under anti-avoidance rules are charged to tax as if realised by the settlor (if UK resident and domiciled);[30]

(2) against the trustee on the grounds of:

(a) constructive trust (where assets derived from a third party who has been defrauded remain under the trustee's control);[31]
(b) tracing;[32]
(c) dishonest assistance[33] (where such assets are not in the hands of the trustee and have been dissipated by the settlor).[34]

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26 R Parry, *Transaction Avoidance in Insolvencies* (OUP, 2001), at paras 27.43–27.54. Eg *Midland Bank v Wyatt*. An alternative basis where the statutory provisions apply is to bring a claim under either s 339 of the Insolvency Act 1986 (transactions at an undervalue), see *Butterworths Insolvency Law Handbook* (Butterworths, 6th edn, 2004), at p 214; or s 423 (transactions defrauding creditors), at p 272, which in spite of proper administration by the trustee could result in the trust being set aside.

27 By HMRC.

28 In reliance on s 660A of the Income and Corporation Taxes Act 1988, which treats income derived from a settlement as that of the settlor, unless the settlor has no interest in the property.

29 By HMRC.

30 Gains realised by the transfer of an offshore trust settled by a UK resident non-domiciliary are not brought into charge.

31 *Re Esteem Settlement, Grupo Torras SA and Others v Al Sabah and Others* [2003] JLR 188.

32 Dicta of Lord Millett in *Foskett v McKeown and Others* [2000] 2 WLR 1299, at 1322.

33 Where a person dishonestly assists in keeping assets away from a victim of fraud they are liable to make good the victim's loss. Criminal liability can also arise, eg conspiracy to defraud (at the instigation of HMRC compare the VAT carousel cases). In *Scott v Metropolitan Police Commissioner* [1975] AC 819, cited in DN Kirk and AJJ Woodcock, 'Serious Fraud Investigation and Trial' (Butterworths, 2003), at p 275, Viscount Dilhorne said:

'it is clearly the law that an agreement by two or more by dishonesty to deprive a person of something which is his or to which he is, or would be, or might be entitled and an agreement by two or more by dishonesty to injure the proprietary right of his, suffices to constitute the offence of conspiracy to defraud.'

Regarding costs of the professional trustee participating in actions arising from a finding of sham, the entitlement of the trustee to retain fees and expenses properly paid to it from the trust fund before the finding of sham will depend upon whether: (i) administrative provisions in the trust deed conferring any such entitlement survive the finding of sham; or (ii) fall by the wayside along with the dispositive provisions of the deed struck down by the court, and therefore are subject to tracing.[35]

SLAMMING THE DOOR SHUT ON POTENTIAL CLAIMS

Where a settlor:

(1) fully understands what a trust is, and in particular that (a) after the vesting of property in the trust he will cease to be the owner of it and (b) that it is the trustee who is in the driving seat;

and

(2) expresses a desire to create a trust for any lawful purpose (which is either documented or has been stated by him in the presence of a credible witness);

then as a matter of logic, a sham cannot exist. As a prevention strategy, a prudent settlor and trustee will also undertake the measures described below.

APPOINTMENT OF A SEPARATE TRUSTEE

The settlor should appoint a competent independent professional trustee.[36] A trust is less open to suggestions that it is a pure pretence when the settlor transfers the assets to a separate trustee rather than where he declares himself alone to be a trustee.[37] At the very least the existence of a separate trustee makes it harder for

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[34] Which would depend upon their state of knowledge concerning the origin of the assets *Twinsectra Ltd v Yardley and Others* [2002] 2 WLR 802 and *Royal Brunei Airlines v Tan* [1995] 2 AC 378.

[35] This will depend upon the determination of the true nature of the relationship between the settlor and the trustee once it has been established that the trust is a sham. It is arguable that only the dispositive provisions fall because the trustee holds the trust property either on bare trust for the settlor or as the settlor's mere nominee. However, as far as the author is aware the question has not yet been tested by the court. Whether the trustee will retain protection of any exculpation clause contained in the trust deed will also be of concern to him.

[36] And for respectability in the eyes of the court, a reputable firm.

anyone to show that the declaration was not intended to take effect according to its terms.[38]

ADMINISTRATION

The trustee must understand its duties and behave with diligence in their exercise.[39] A professional trustee must take all practical steps to ensure that he is aware of the true nature of the trust he is taking on, and, following its appointment, identify every person beneficially entitled to trust income and capital. The beneficiaries should also be informed of their entitlement in writing.

In late 2007[40] the EU Third Money Laundering Directive[41] will be transformed into English Law. Article 8 requires solicitors and trust service providers to identify beneficiaries[42] and to carry out ongoing due diligence about the 'ownership and

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37 *Lewin on Trusts* (Sweet & Maxwell, 17th edn, 2005), at 4-28, 'Where a settlor has declared himself to be a trustee ... it will be a great deal easier to regard what has been done as of no effect, than where he has instead transferred the trust property to a trustee and both of them have executed a deed declaring the trusts on which the trustee is to hold'.

38 J Mobray, 'Shams, Pretences, Blackmail and Illusion: Part I' [2000] PCB 28, at p 37.

39 These include: (1) upon accepting appointment as trustee reading the trust document to ensure that he understands it and, if necessary, seeking legal advice (this is not a duty but is common sense and best practice); (2) ensuring fairness between beneficiaries; (3) complying strictly with the terms of the trust and the law relating to trusts: failure can result in a claim for breach of trust. Section 1(1) of the Trustee Act 2000 also imposes a statutory duty of care. As a professional trustee a solicitor may have a higher standard of care than an unpaid trustee. *Bartlett v Barclays Bank Trust Co Ltd (No 1)* [1980] Ch 515, at 534, cited in *Jackson & Powell on Professional Liability* (Sweet & Maxwell, 2007), at 11-033.

40 15 December 2007. However, this will not apply to Jersey (which is not within the EU single market for financial services) unless they adopt these provisions when implementing standards set by the Financial Action Task Force on Money Laundering.

41 Council Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing (2005) OC J L309/15.

42 Although there is currently controversy about the meaning of this term. On 11 April 2007 the President of the Law Society wrote to the European Commission about the implementation of the Third Anti Money Laundering Directive in the UK in the area of trusts. They replied on 29 May 2007 stating: 'In your letter you consider that the definition of "beneficial owner" in relation to trusts (and arrangements of this kind) in the directive would create problems in English trust law if transposed verbatim into national law. The main problem would relate to the interpretation of when beneficiaries of a trust "have been determined" for the purposes of considering them as "beneficial owners" under the Anti-Money Laundering rules. I must concede in this regard that, legally speaking, there is no requirement to make a literal copy of a community directive when transposing it into national law. The content of the directive can be adapted to the national legal framework, provided that the obligations it sets are respected. This is indeed the very essence of a directive'. This was communicated to HM Treasury and on 4 June 2007 Ed Balls replied: 'I propose limiting identification requirements to legal control only ... We also propose removing the 25% limit for control ... vested interests should be calculated ... by reference only to capital ... the Directive does not envisage the identification (as

control structure of the customer'.[43] Constant vigilance will no longer be a matter of prudence; it will be a statutory duty backed up with criminal sanctions. Professionals who breach the rules could be sent to prison.

The trustee should therefore: (1) keep proper audited accounts; (2) hold meetings and keep minutes; and (3) study trust company reports and comment on them (if only in file notes).

It is perfectly in order for the trustee to pay close attention to the views of a settlor provided that each request is considered in good faith.[44] Distributions to the settlor

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beneficial owners) of discretionary beneficiaries who receive distributions from the trust (other than those who have vested interests) ... I propose at this time not including specific requirements [in respect of beneficiaries when added to the class or when they receive a distribution]'. He proposed a new definition of 'beneficial owner' which can be viewed at www.lawsociety.org.uk. Commenting on this definition in a letter to Ed Balls dated 18 June 2007, the President of the Law Society stated, 'The Law Society has reviewed the proposed new definition in consultation with our members, STEP and Counsel ... Whilst we welcome the further clarity with regard to the definition of 'beneficial owner' in the case of a body corporate, we consider that it remains insufficiently certain [also] the proposed definition applies where persons collectively exercise powers with other persons under law or the trust instrument. We are concerned that this will apply very widely and will include situations where beneficiaries have rights to act collectively with respect to the disposal or investment of trust property, meaning that every beneficiary would have to be individually identified'. The Law Society proposed a revised definition.

Ed Balls wrote to the President of the Law Society on 27 June 2007, stating, 'I have asked my officials to investigate what can be done to address the three situations you list ... [Regarding beneficial ownership of companies] Whilst we agree that there may be scope for a more restricted definition of the word "shares" this is not possible without further consultation with other Member States ... We do however, believe that the current draft is clear that the voting rights must be currently exercisable, not only exercisable if triggered by a future event. We would be happy to confirm this point in guidance submitted for Treasury approval'. Counsel in a legal opinion commissioned by the Law Society dated 26 March 2007 and available on the Law Society's website state at para 48, 'Such guidance would be taking the place of legislation and would accordingly be constitutionally prohibited. Our view would be unaltered even if, for example, the guidance were drafted by the Law Society and approved by HM Treasury'. The author has written to the Law Society requesting confirmation about the existence of any exchanges between the President of the Law Society and HM Treasury after 27 June 2007 and the Law Society have confirmed to the Author that no further exchanges have taken place between the President of the Law Society and HM Treasury since 27 June 2007.

[43] Ie, the trust. There are also record keeping requirements. Given the self-assessed risk analysis that professionals must undertake, to avoid the appearance of a sham, the more detailed and specific records that are kept on file by trustees the better.

[44] *Re Esteem Settlement, Grupo Torras SA and Others v Al Sabah and Others* [2003] JLR 188, at para 5.10, discussed in S Pryke, 'Sham Trusts' (Lecture to the London Branch of the Society OF Trust and Estate Practitioners, 2005), at p 9, where the author points out that, in many of the reported cases, the court has picked up on the fact that the trustee records refer to the settlor as the 'client' which looks particularly bad when the settlor is also the beneficiary. In a discretionary trust, for example, referring to one particular beneficiary as the 'client' and the other beneficiaries by name hardly indicates a balanced view on the trustee's part as to the importance of the different beneficiaries.

should only be made using the proper machinery.[45] Every now and again, the trustee should deny the settlor some request.[46] Under no circumstances should the trustee describe the settlor as their 'client'.[47]

DRAFTING POINTS

If sufficiently extensive powers are reserved by the settlor the cumulative effect could be to produce a bare trust[48] or nomineeship.[49] In practice the possession of such powers can also lead to a situation where the trustee fails to administer the trust in a prudent manner[50] and affords the settlor carte blanche access to income and capital. A course of conduct by the trustee showing a completely hands-off, passive or disinterested attitude to the trusteeship, will offer powerful support to a sham claim. That said, it is perfectly proper for a settlor to reserve certain powers to himself, and it is noteworthy that:

(1) Article 2 of the Hague Convention recognises that, 'the reservation by the settlor of certain rights and powers, and the fact that the trustee may himself have rights as a beneficiary, are not inconsistent with the exercise of a trust'.

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45 For example, if trustees have power in their discretion to distribute capital to the settlor they should properly minute the resolution supporting each distribution. The trustees should not allow a settlor to take money out of the underlying trust companies except in a properly authorised way, by salary, or after a dividend has been paid to the trustees, and then out as an income distribution.

46 *Shalson v Russo* [2003] EWHC 1637 (Ch), [2005] Ch 281. Rimmer J found that although some evidence existed that the settlor always dealt with the assets of the settlement as his own, there was also considerable evidence that the trustee (the respectable firm of Cantrust (CI) Limited) properly considered the exercise of its powers under the trust instrument and that they also took the settlor to task on some of his activities involving assets of the settlement. The judge concluded that:

'Cantrust was doing its best, if not always very cleverly, to control the affairs of the settlement ... they executed the document that created it with the honest belief and intention that it was creating a valid settlement, and was at no time a party to any understanding with Mr Russo that the settlement was merely warehousing his assets'.

47 J Mobray, 'Shams, Pretences, Blackmail and Illusion: Part I' [2000] PCB 28, at p 38. This is recommended in spite of the term 'customer' adopted by the draftsman of the European Third Money Laundering Directive.

48 Where property is vested in one person upon trust for another and the nature of the trust is not prescribed by the settlor but left to construction of law. A bare trustee is a mere passive depositary and can neither take any part of the profits nor exercise any control over the corpus of the trust property save at the instance of the beneficiary. *The Oxford Companion to Law* (OUP, 1980), at p 113.

49 In *Abdel Rahman v Chase Bank (CI) Trust Company & Others* (unreported) 6 June 1991, reserved powers were seized upon by the court as being indicative of sham intent. These factors are analysed in G Clarke, *Offshore Tax Planning* (Lexis Nexis, 2000), at p 457.

50 D Brownbill, 'Sham Trusts' (Maitland Chambers, 2004), at p 4.

(2) Increasingly offshore financial centres are passing legislation which provide that the reservation of such powers does not invalidate the creation of a trust in their jurisdiction.[51]

(3) A properly drafted arrangement giving the settlor the investment function can actually reduce the risk of the trust as a whole being considered as a total sham.[52] If the trustee confers powers of control on the settlor (typically appointing him as 'protector') an inference of sham is weakened or neutralised.[53]

The question in each case is whether the settlor intended to create a trust: if he had the requisite intention there can be no sham.

Any person whom there is no intention to benefit should not, however, be named in the trust deed.

CONCLUSION

Quite apart from the evidential obstacles that litter the path of any claimant alleging a sham, and the practical steps that can shut the door to future claims, nothing can actually prevent a claim from being made, even where it is mischievous and without any legal merit.

However, there is a highly effective way of protecting assets from sham attack which tactically will also deter claims: that is to transfer assets into an offshore asset protection trust. This trust should be created in a jurisdiction which has a developed trust law that confers jurisdiction on its own courts when a trust is validly created there. A good example is Jersey, where asset-protection trusts are commonly established by international clients.

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[51] For example: s 3, with s 81(2) of the Trustee Act 1998 in the Bahamas; ss 13–15 of the Trust Law (2001 Revision) in the Cayman Islands; s 13C of the International Trusts Act 1984 (as amended) in the Cook Islands; and recently art 9A of the Trusts (Jersey) Law 1984 (inserted by L 21/2006) in Jersey, which makes it clear that in spite of the Jersey maxim, *donner et retenir ne vaut*, a settlor may reserve powers and influence a trust without invalidating the trust.

[52] If there is specific provision for the settlor to be given a limited power of attorney to manage the investments by giving direct instructions to their custodian or others, then the instructions are given under the express terms of the trust instrument and through the machinery that it envisages, so it cannot be said to be evidence that the trusts were not intended to be carried out according to their terms. J Mobray, 'Shams, Pretences, Blackmail and Illusion: Part II' [2000] PCB 105, at p 111.

[53] J Kessler, 'What is (and what is not) a sham' (1999) 9 OTPR 125.

Jersey is a signatory to the Hague Convention as is the UK and, while there are reciprocal recognition and enforcement treaty arrangements in existence between the two States,[54] a foreign revenue law will not be enforced by the Jersey court.[55]

Under the Jersey Trust Law a trust created in accordance with Art 2 of the Hague Convention is recognised in Jersey as being valid and enforceable there. In which event Jersey law[56] governs: the validity and interpretation of the trust; the capacity of the settlor; the administration of the trust, as well as the existence and extent of the settlor's retained powers and validity of exercise. These questions are determined, 'without consideration of whether any foreign law prohibits or does not recognise the concept of trust'; or 'whether the trust or disposition defeats rights, claims, or interests conferred by any foreign law upon any person by reason of a personal relationship to the settlor' (eg, his wife) or 'by way of heirship' (forced heirship laws).[57]

Crucially art 9(4) of the Jersey Trust Law provides that, 'No foreign judgment with respect to a trust shall be enforceable to the extent that it is inconsistent with this Article irrespective of any applicable law relating to conflicts of law'. Therefore, if a sham attack is made in England against a trust that appears to have been validly created in Jersey (which under its express terms provides that Jersey Law is to govern the validity, construction, effects and administration of the settlement), then unless the parties have submitted to the jurisdiction of the English court, the Jersey court has jurisdiction as of right. This entitles the defendant to apply for a stay of the English proceedings on the grounds of the doctrine of forum non conveniens.[58]

Because Art 6 of the Hague Convention provides that, 'a trust shall be governed by the law chosen by the settlor' and the Convention governs recognition of trusts between Member States, then under English rules of private international law, in relation to validity, Jersey law is the proper law of the trust. Since art 9A of the Jersey Law provides that the reservation by a settlor of any beneficial interest and any of the powers listed under art 9A(1)(b) does not affect validity, a claimant can

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54 J Glasson (ed), *The International Trust* (Jordan Publishing, 2002), at p 84; the Judgments (Reciprocal Enforcement) (Jersey) Law 1960 and in particular art 3.

55 Article 3(2), eg, *Le Marquand and Backhurst v Chiltmead Limited (by its liquidator, Halls)* [1987-88] JLR 86.

56 Article 9(1).

57 Article 9(2). Eg, the Hanafi Law of Inheritance under Shari'a Law as applied in Saudi Arabia, see DFC Mulla, *Principles of Mahomedan Law* (1981), Ch VII.

58 Which enables a defendant to escape the clutches of the English Court, who will decide the question by applying the principles enunciated in *Spiliada Maritime Corp v Cansulex Ltd* [1986] 3 WLR 972. The defendant must first prove that there is another available forum (ie Jersey) which is clearly or distinctly more appropriate for resolution of the dispute. If he succeeds, the burden of proof passes to the claimant, who may resist a stay if he shows that it would be unjust to require him to sue overseas. J Glasson (ed), *The International Trust* (Jordan Publishing, 2002), at p 39.

only successfully challenge on the grounds of sham under Jersey law[59] or where Art 42 applies. Which both appear to cover the classic formulation of what amounts to a sham under *Snook*. However, and this is a crucial distinction, the reservation by the settlor of powers of:

(1) revocation and variation of trust terms and powers;

(2) removal of any trustee, protector or beneficiary;

(3) appointment or removal of an investment manager or investment advisor;[60]

(4) changing the proper law of the trust; and

(5) restricting the exercise of any powers or discretions of a trustee, by requiring that they shall only be exercisable with the consent of the settlor or any other person specified in the terms of the trust,

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[59] *In MacKinnon v Regent Trust Company Limited and Eight Others* [2005] JLR 198, Southwell JA (with whom the other two appellate judges concurred) stated in para 21, 'In my judgment, the position in Jersey law is clear. In order to succeed in showing that the three settlements are shams, [the claimant] must establish that:

(1) both [the settlor and the trustee] intended that the true position would not be as set out in the settlement deeds ...;and

(2) both [the settlor and trustee] intended to give a false impression to a third party or parties (including the other beneficiaries and the courts)...' and at paragraph 36, that 'There is no general power in the courts of Jersey to [look behind the trust documents to give effect to the allegedly true intentions of the settlor, as submitted by the claimant's counsel [2004 JLR 477, at para 26 et seq)].' Whilst stating in para 36 that '[he did] not find it necessary to ride the unruly horse of public policy, because in my judgment the answer to this head of claim is clear', earlier in para 6 the judge emphasised that where such a settlor-interested discretionary trust is created, the court will not readily conclude against the settlor that the trust was a pretence, 'These were trusts apparently established in favour of wide-ranging classes of family members. True it is that the range of potential beneficiaries had been narrowed, by exclusion, to Mrs MacKinnon and her descendants and James's [one of her two sons] wife. But it remains the position that that there were 10 potential beneficiaries (and the possibility of further beneficiaries yet to be conceived and born). Leaving Mrs MacKinnon out of account, that means that if she did not intend the settlements to operate as genuine trusts for the potential benefit of the other potential beneficiaries she could be said to have been pretending, from 1981 to 2002, to establish trusts for the potential benefit of family members potentially to be affected, and in the end the nine members, parties to this action, who would be affected if the three settlements were held to be invalid and intended by Mrs McKinnon always to have been invalid. The courts of Jersey would not readily conclude against a deceased mother and grandmother that she had acted in this way in relation to her children, her daughter-in-law and her grandchildren'.

[60] Which was a pertinent factor in finding a sham in *Abdel Rahman v Chase Bank (CI) Trust Company & Others* (unreported) 6 June 1991, where the settlor instructed the replacement of Chase Manhattan by Advicorp.

is entirely irrelevant, because such reservation has no bearing on validity. This is the logical result despite the fact that one or more of these factors could be relevant in establishing a sham under English Law.

The sustainability of such an attack has yet to be tested by the courts.

However in *Minwalla*, when the trustees applied to the Jersey court for directions as to the enforcement of the English action, the judge clearly distinguished between a situation where (as in that case) the trustee had submitted to the jurisdiction of the English Court and one where the question of jurisdiction was open. The words of Sir Philip Bailhache provide certainty to those involved in the setting up of international trusts. He said '[as] a general rule...it would be an exorbitant exercise of jurisdiction for a foreign court to purport either to vary the terms of a Jersey settlement or to declare it a sham'. This approach drives a further nail into the coffin of sham trusts. However, we will have to wait and see whether it has now been sealed closed.