The International Family Offices Journal

Editor: Barbara R Hauser

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STEP ADVISING FAMILIES ACROSS GENERATIONS

Globe Law and Business

The International Family Offices Journal

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Globe Law and Business would like to congratulate Barbara Hauser on being listed in *Spears 500* again in 2021 for Family Offices Services.

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Volume 6, Issue 3, March 2022

Welcome to the March 2022 issue of The International Family Offices Journal

Barbara R Hauser, Editor-in-Chief

Again, continuing thanks for all the positive feedback on our Journal. We love hearing that you look forward to each issue, and that many read it cover to cover. Remember, this is for the entire family office community – we solicit contributions and comments! As the word continues to spread, we enjoy receiving great offers to write for us. For this issue we received more excellent articles than we could fit in, so we are already starting to fill the June 2022 issue. We are now in the sixth year of the Journal! We did manage, in spite of covid, to have a small in-person celebration reception at the Pitcairn New York office in mid-December. We hope for more in 2022.

The focus of the Journal

We continue to feature articles from leading experts in the field on a range of topics including the variety of family office models and structures, governance, investment approaches, succession planning, charity projects, family communication and consensus, and next generation issues among others. A key feature of the Journal is its international approach. We value our independence and our commitment to offering valuable content without any conflicts of interest.

In addition to heavyweight substantive articles, we regularly feature in-depth country reports, profiles of family offices, interviews with industry leaders, a luxury corner, technology tips, book or film reviews, relevant news alerts from the Society of Trust and Estate Practitioners (STEP), and reflections by those who have grown up with wealth or advise those who have done so and what it has meant to them or their clients.

In this issue we are proud to include another fascinating variety of in-depth articles. We hope you enjoy them!

We begin with an excellent summary of the landscape of privacy, transparency and confidentiality. This is a topic of great concern to wealthy families all around the world. In their article "From privacy to transparency – an update on global steps to improve tax compliance and prevent money laundering", the authors, Henry Brandts-Giesen and Daniel McLaughlin, from New Zealand, begin with an acknowledgement of how much our privacy has been encroached upon in recent times:

> *What this wholesale erosion of privacy means for our society as a whole remains to be seen. This article is intended to provide some historical context and weave together the various strands to provide an overview of the current compliance landscape and offer some thoughts as to what might happen next.*

They cover the history of the various rules including the current complicated situation and some predictions of what might happen in the future.

Next we have a collection of practical insights from working directly with a number of families by Raimund Kamp, from the Netherlands – who is also a member of our editorial board. He offers his own three mandate advisory concept: an expert adviser, facilitator and coach. This concept offers specific guidance for each role and connects the dots between hard and soft issues in multigenerational families. He ends with a detailed description of client games he has developed including 'walk on feathers' which involves a series of large tiles on the floor. The client steps on each tile in turn … and you can read the rest. Some very deliberate changes in approach from his early days as a tax adviser.

For the increasing number of global families that include trusts in their portfolios, Dawn Goodman from the United Kingdom contributes a thorough legal analysis of the extent to which a settlor can retain control over the trust assets. This is an issue that is always of great interest to settlors. As she notes at the beginning: "There is almost no limit to the ingenuity which can be applied to the draftsmanship of a trust but it is always worth going back to basics to consider what the essential components of a valid trust are. If these are not borne in mind, the 'trust' may not be valid …". She details the cautions and ends with this advice:

> *Trustees and lawyers around the globe should be considering the structures they manage or advise on in light of these risks and take specialist advice on what, if anything, can be done in the particular circumstances of the trust. Such a review could well be combined with assessing the suitability of the structure to provide for the next generation or generations to whom assets will likely be transferred from the baby-boomer generation within the next 30 years.*

A frequent Journal topic is to evaluate various jurisdictions in terms of locating a family office in that jurisdiction. In this issue we have an interview in support of using the Cayman Islands. In this interview with Sue Nickason of the Dart Family Office, we began with a question about the origin of the Dart office, learning that the Dart Family Office was established in the Cayman Islands in 1993. She explained that Ken Dart and his family first visited Grand Cayman in the late 1980s and fell in love with the island. Recognising the opportunities Cayman could offer, both as a place to make his family home and base his family office, he opened a small investment office in 1993 with three employees. Some 28 years later that investment office has grown to become the base of Ken Dart's global operations and Grand Cayman continues to be home to his family.

In the interview there is genuine enthusiasm for Cayman as a jurisdiction. The Dart office itself has grown to some 1,000 employees counting the Dart company operations based in Cayman.

The Dart office is considering forming a Cayman Islands Family Office Association, and welcomes inquiries.

In terms of operating a family office, our next article, by Andrew Keyt and Greg McCann from the United States, promotes a view that the family should be of central importance. In "Putting family at the core of the family office", they begin with the observation that for family offices: "The purpose of a family office often centres on wealth management, investment advising, wealth transfer and tax management". While these are undoubtedly important services, they ask "are they a reason for being?" They warn that family offices without a sense of purpose may not survive. They offer tools for creating a family purpose for the family office. They suggest applying "design thinking" to develop a purpose that "cannot be outsourced". The result? "Developing a strategy of putting the family at the core of the family office – instead of investments alone – helps both the family and the family office survive."

Another frequent issue for family offices is the stewardship of family wealth, and how to instil that value in the following generations. Gina Pereira, from Bermuda and Philip Marcovici, from Hong Kong, present a detailed model of "Responsible Stewardship of Wealth" (RSW) and cover this subject in detail, based on extensive research. Of particular interest in their article is the focus on how the family office can assist in this endeavour. In "The role of family offices in the responsible stewardship of wealth" they describe some of the work that has been done recently by STEP (Society of Trust and Estate Practitioners) in its Thought Leadership Group on RSW that resulted in a Guide that is being used to generate additional conversations on this subject in the community. They would welcome input on this important topic.

Next we turn to a more technical subject – the taxation of trusts in Italy, by Nicola Saccardo and Gabriele Colombaioni both based in the United Kingdom. In "The new draft guidelines on taxation of trusts", the authors explain three crucial topics covered by the draft:

- the inheritance and gift tax treatment of trusts;
- the income tax treatment of distributions from non-resident opaque (i.e. not looked through and not transparent) trusts to resident beneficiaries; and
- the reporting obligations for resident beneficiaries of non-resident trusts.

The authors hope that many of these critical issues will be addressed in the final guidelines.

The next article addresses an interesting strategy. The author, Myriam Soto, proposes that there are advantages to bringing many offshore structures to the United Sates. In "Onshoring your offshore trust to the United States", she argues first that in light of the increasingly aggressive disclosure and enforcement efforts and fears around safety in certain countries, the United States has become a relatively more appealing jurisdiction. Reasons to have a trust situated in the United States include: as a result of the death of a non-resident trustee all of the beneficiaries are US taxpayers; a number of states within the United States have attractive trust legislation; obtaining credit from a US institution is made easier; and the avoidance of negative publicity that often attaches to offshore entities. The article steps through the numerous tax and regulatory issues. The author concludes that:

> *However, as appealing as such onshoring may seem, whether doing so by decanting or migrating the trust, the devil is in the detail. Experienced counsel is critical in order to avoid incurring unnecessary taxes, professional fees and even litigation among family members.*

Finally, we have our first contribution from Africa: an interview with Tsitsi Mutendi, the co-founder of African Family Firms (AFF). She grew up in an entrepreneurial family. As a third-generation family business owner she had additional roles upon her father's death in 2018 – leading to her view of the need for an organisation. Currently they hold three major annual events and hope to have AFF chapters in each of the 54 countries in Africa. We will look forward to more updates in future issues.

We hope you enjoy this issue. We love getting feedback so let us know!

Barbara Hauser

Trusts and settlors – can a settlor have too much power?

Dawn Goodman

The continuing popularity of the trust

The Anglo-Saxon trust, with its origin in medieval knights departing for foreign wars (perhaps never to return) entrusting their assets to a bishop to look after for the benefit of wives and children, remains one of the most commonly used wealth planning tools 800 years or so later.

In spite of unwelcome – and often misguided – publicity associating trusts with tax evasion or concealing assets for nefarious purposes, the trust is alive and popular. Perhaps this is because of the comfort derived from the court – at any rate in a common-law jurisdiction – having a supervisory function which can be called upon to guide trustees, determine issues of difficulty, give comfort on momentous (ie, seriously difficult or contentious) decisions and hold trustees to account. It is more likely due to the trust's ability to be framed to meet an almost infinite variety of circumstances (provided those purposes are not unlawful) and to adapt over the years to the needs of the family or the purpose for which it was intended to provide. As some of England's oldest trusts attest, they can keep up with the times or be changed by the court to enable them to do so, for example to enable modern forms of investment (as in *Anker-Petersen v Anker-Petersen*[1]), shield young adults from the dangers of accessing too much capital too soon (*Wyndham v Egremont and others*[2]), be varied to include same-sex relationships and illegitimate and adopted children in the beneficial class (*In the Matter of the Representation of the Y Trust and Z Trust*[3]), allow the structure to be fundamentally redesigned when the family is pulling in different directions, or to pass the interest on to a similar charity when the charitable purposes for which the trust was made are no longer practicable.

Whatever the advantages of foundations, family investment companies, family limited partnerships, companies, limited liability partnerships and other modern asset-holding structures, the trust retains its attraction, not least with settlors in regions with little or no common-law heritage such as Russia and the CIS, Central and Latin America, the Gulf and South East Asia. They value the trust's potential to help them provide business succession and assist in protecting them and their families from personal and political pressure. A key element of the trust's attraction in achieving these aims or minimising risk is the division between the legal and beneficial ownership of the assets.

It is by no means exclusive to settlors from such regions that they like to retain control. But when taking into account the lack of familiarity with the concept, experience of abuse of power in their own or neighbouring countries, the single-minded ambition which has often driven the creation of the wealth and the absence of an established relationship with trust service providers in far-off jurisdictions, it is hardly surprising that some settlors have difficulty parting with legal title, possession and particularly control of their assets to their trustees.

The framework within which flexibility can be achieved

There is almost no limit to the ingenuity which can be applied to the draftsmanship of a trust but it is always worth going back to basics to consider what the essential components of a valid trust are. If these are not borne in mind, the 'trust' may not be valid or may be incapable of withstanding pressure. Any inventive solution must always be tested against a list of the trust's essential components – certainty of intention, of subject matter and of objects, accountability of power holders, not ousting the jurisdiction of the court and not being for an unlawful purpose or contrary to public policy. While there are cases dealing with certainty of subject matter and objects, such as the unhappily named *re the Double Happiness Trust*[4] where an attempt to introduce a letter of wishes into the provisions of a fully discretionary trust resulted in the Jersey court not being able to work out what the trust meant and so it failed, the issue which is at the centre of the control versus invalidity debate is the issue of an intention to settle a valid trust.

At its most basic the trust entails the settlor parting with legal title, possession and control of his assets to a trustee or trustees to manage according to the trust's terms and relevant statutory and case law for the benefit of the beneficiaries to whom (as well as to its supervisory court) the trustee is accountable for the exercise of its powers.

As to English law trusts or those in jurisdictions which have taken the English trust as their model and adapted it to their circumstances (the Bahamas, the Cayman Islands, Canada, New Zealand, Australia, Hong Kong, British Virgin Islands, Bermuda, Jersey, Guernsey, Isle of Man, Cyprus, Mauritius, Gibraltar, to name a few):

- The settlor must intend to part with his assets

In the United States a revocable trust such as that envisaged by Article 6 of the US Uniform Trust Code is used primarily as a will substitute to avoid probate.

at the time he puts them into trust.
A trust which springs into life only on the death of the settlor is a will by any other name and is not a trust during the lifetime of the settlor (*Cock v Cooke*[5]; the Canadian case *Re Pfrimmer*[6] and more recently *re AQ Revocable Trust*[7]). This latter case is interesting because it entailed a trust agreement in New York form being created under Bermudian law by a US settlor who, the court decided, had not intended to part with control of his assets and as a matter of fact did not do so. The court also considered that as a matter of construction the deed did not create a valid trust under Bermudian law: in particular a clause common in US trusts seeking to absolve the trustee of liability to the beneficiaries if the settlor agreed with the course of action which would otherwise be a breach of trust was contrary to the principle that trustees are accountable to the beneficiaries and the supervisory court.

The trust could not operate as a will either because it would have been revoked by remarriage: indeed, in most cases an attempted trust will not have been executed in a way which would enable it to stand as a will if it fails as a lifetime trust. This can result in failure to have accomplished any planning for succession.

Re AQ Revocable Trust[8] was a salutary lesson against not intending to part with control (made worse by the settlor appointing himself trustee and continuing to behave as though nothing had changed) and also of expecting concepts in one jurisdiction to work, without more, in another. In the United States a revocable trust such as that envisaged by Article 6 of the US Uniform Trust Code is used primarily as a will substitute to avoid probate. Such a trust is not intended to be effective against creditors – it does not achieve the passing of assets to another to that extent – but it is still regarded as valid in the United States. Revocable trusts are not invalid *per se* in Anglo-Saxon trust jurisdictions following the English model but, if it is really intended that the trustee has no powers until after the settlor dies, or that the trustee's obligations can be overridden by the settlor, it will not be a valid trust. Further, revocable trusts are vulnerable to divorcing spouses, fiscal authorities and other claimants as discussed below.

- Has the settlor given sufficient powers to the trustee such that he has not retained overall control? It is possible to create a 'thin' trust where the trustees have few powers and the remainder are held by the settlor or his appointees but care needs to be taken to ensure that the trust is not too thin and that the conclusion may be that the settlor has too much power and the trustee not enough duty – there has to be an irreducible core of obligations: "there is an irreducible core of obligations owed by trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust. If the beneficiaries have no rights enforceable against the trustees there are no trusts" (Millet, LJ, *Armitage v Nurse*[9]).
- The absence of intention is also apparent in cases where the trust – or rather the documentation in which it is set out – is intended to be a cloak, a device or a mask to deceive others as to the true nature of the relationship. The true relationship may be that the assets are actually held by the trustee as nominee for the settlor instead of for the express beneficial class or that the trustee holds the powers but it is always intended that it will be the settlor who directs how they are exercised. It is generally recognised to be a point of vulnerability if the way in which the trust operates is not in conformity with the way it is supposed to operate: anyone with an interest in upsetting the trust (whether a creditor, divorcing spouse, disappointed heir or fiscal authority seeking to take the assets of the trust) will point to such inconsistencies in the management of the assets and allege that the trust is a sham.

If the trust is a sham then there was no intention to create a valid trust. But that does not mean that in every case where there is a lack of intention there is a sham. For example, the lack of intention could be due to lack of mental incapacity (an issue we can expect to come up quite frequently with increasingly elderly and/or frail settlors), lack of understanding on the part of a settlor who does not have a knowledge of trusts or has not read a copy in the language with which he is most familiar, one who does not understand the effect of what he is reading or simply that the settlor has a shaming intent but the trustee knows nothing of it. For a trust to be a sham there must, as matters stand at present, be a common intention on the part of the settlor and trustee not to act in accordance with the terms of the express trust but in some other way – usually as nominee for the settlor. It is a document conceived dishonestly to distract from the true relationship between the parties. Mere artificiality of arrangement or a sense of general dodginess is not sufficient (*Hitch v Stone*[10] and *A v A*[11]).

As such a sham is difficult to sustain in regulated jurisdictions where a finding of sham against a regulated entity will almost certainly result in the regulator investigating and the trustee being at risk of losing its trust licence. But it is by no means impossible, as the recent decision in *JSC Mezhdunodniy Promyshelenniy Bank v Pugachev & Ors*[12] has shown, where the court considered that the respected lawyer who was a director of the trust company had gone along with the settlor's intention to retain control. Birss J was clear that if the powers retained by Mr Pugachev were to be construed as fiduciary powers then the trust was a sham, he having no intention to part with control and the trustee going along with his intention. The issue of fiduciary or non-fiduciary powers is discussed later in considering the principal ground on which the creditors succeeded in *Pugachev* – that the true effect of the powers retained or granted by Mr Pugachev was such that he had not intended to part with control sufficiently to create a trust.

Designer trusts and control

In response to a desire on the part of settlors to have more control, legislation has been introduced by many of the trust jurisdictions to enable the settlor to retain a high degree of influence (if not control) without *per se* invalidating the trust. Perhaps the first major innovation in this area was the introduction of the British Virgin Islands VISTRA trust[13] which not only permitted the trustees to adopt a hands-off approach to the running of an underlying company but also enjoined them not to interfere except in specific circumstances.

The Cayman Islands STAR trust[14] addressed different issues: it enabled purposes to be mixed with benefit to human beneficiaries. It also transferred the accountability to beneficiaries to an enforcer, an attractive option to some settlors.

Although reserved powers are nothing new (as demonstrated by *Lord Vestey's Executors v IRC*[15]), numerous trust jurisdictions have specifically introduced reserved powers legislation in response to the market's need to clarify the position of those settlors who wish to retain certain powers (usually to direct or consent to certain acts of the trustee) or to confer them on other non-trustee power holders. Some of the main players in the offshore world which have sophisticated reserved powers legislation in place are Bahamas, Bermuda, Cayman Islands, BVI, Jersey and Guernsey. Singapore and Hong Kong have more limited provisions focusing on the retention by the settlor of investment powers.

The general tenor of the legislation is that the retention by the settlor of such powers or the conferring of such powers upon another will not of itself render the trust invalid. In each jurisdiction the legislation differs in its treatment of the trustee's response to a direction from such a power holder: most seek to absolve the trustee from liability for loss if they follow such a direction or fail to take action in the absence of a direction.

Some legislation seeks to characterise the powers so held or conferred as personal or fiduciary or to provide a default position where the trust deed does not specify whether the powers are personal or fiduciary. For example, in Guernsey the default position is that the powers are personal.[16] This can create difficulties for trusts created before the 2007 law came into force, given that as a matter of construction at least non-settlor powers were generally considered fiduciary unless specified as personal, although even then the court could decide that they were fiduciary, ie to be exercised solely in the interests of the

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beneficial class. The Bermudian legislation has dealt with this differently: by providing that the default position is personal where the power holder is the settlor or a beneficiary provided that he is not also the sole trustee.[17]

Given that the appointee could be protector with hire-and-fire powers normally regarded as fiduciary powers (*Re Skeats Settlement*[18]), a default position of the power being a personal power could be regarded as problematic, particularly following *Pugachev*[19] and *Webb v Webb*,[20] discussed below.

The range of powers that can be retained or conferred is generally also set out in the statute but often include the power to:

- revoke the trust in whole or in part;
- appoint and remove trustees;
- vary the trust deed;
- direct/consent to distributions of trust assets;
- direct addition or removal of beneficiaries;
- restrict trustee powers;
- change governing law; and
- manage/direct investments.

It is generally inadvisable for a settlor to retain all these powers and they should be encouraged to choose only those which are most important to them. Power sharing between different power holders is possible: for example, the settlor might wish to retain the power of revocation, give the protector the power to hire and fire trustees and make/consent to/veto major dispositive decisions and appoint a management committee or investment adviser to direct or manage investments. It is probably better to power share than for a wide range of powers to be retained by the settlor but this will not suffice to protect the settlor from being found to hold all such powers if a court decides that the other power holders are mere cyphers.

At face value it is very attractive to a settlor to retain significant powers and put other powers in the hands of trusted advisers and friends. For various reasons (protection of the trust assets aside – and the very real risk following *Webb*[21] that the assets may no longer be protected for the beneficiaries in such a structure) this may not be wise, particularly if the powers so retained or granted are described in the trust deed or by default provided by the relevant legislation to be personal powers. It may result in a situation where the trustees – undoubtedly owing fiduciary duties – are little more than custodians and the real power holders are lay people who do not (or at least, may not) have to use their considerable powers under the constraint of having an obligation of loyalty to the beneficiaries. Stretched to the limit such a situation may give rise to concerns as to whether the accountability principle has been breached.

There is also the potential for a disconnect between the place where any loss may be felt should a poor decision be taken and where any right to pursue a loss may lie. Take, for example, the position of a friend of the settlor who is appointed investment adviser with power to direct investments and the trustee is obliged to carry them out. He gives a direction which is based on advice he has received but which he does not communicate to the trustees, having no need to do so. The investment is one that should never have been recommended and fails spectacularly.

As is common in such a situation, the investment adviser, the settlor and the beneficiaries all urge the trustee to do something about the loss. But what is the trustee to do?

The real villain of the piece is the (presumably) professional investment adviser who gave the advice. However, the trustee has neither a contractual nor tortious claim against him – the trustee may not even know of his existence. He has definitely not seen his advice, nor relied on it. All the trustee has done is to comply, as required by the trust deed, with a direction of the investment adviser.

Is there a claim by the trust against the investment adviser? There might be if the investment adviser is exercising a fiduciary power but if it is specified as personal or is considered personal by default what is the claim? Besides, the investment adviser may have taken sensible precautions in engaging a reputed, professional investment adviser who nonetheless gave poor advice.

Can the investment adviser sue the professional adviser? He has the contractual relationship and if there was negligence, it is a failure of duty to him. But can he establish that he has suffered a loss in consequence? It appears not.

There may be a sophisticated answer to this conundrum but it is not immediately obvious.

Take the situation where the power holder is also a

At face value it is very attractive to a settlor to retain significant powers and put other powers in the hands of trusted advisers and friends.

Power without responsibility – or considerable power with limited responsibility – is not a great combination.

beneficiary. The way in which he acts will be influenced by his personal interest which may not be in the interests of the trust.

If on the other hand the power holder is undoubtedly exercising fiduciary powers, a direction he gives will not be a valid direction if given in breach of fiduciary duty, ie of his duty of loyalty to the beneficiaries. But how does the trustee know whether the direction is valid? And if the trustee has a suspicion, should it take the risk of making an application to the court to ask for a direction as to whether it should comply, possibly losing and/or facing a claim for losses alleged to have been sustained by not complying with the direction?

These are just some of the complications which can arise with such arrangements. They need to be thought through very carefully at the drafting stage and in making the choice as to who should fulfil the various roles. The settlor may be content that close friends or advisers are running the trust but it may not work out well for the beneficiaries. Power without responsibility – or considerable power with limited responsibility – is not a great combination. Indeed, for the first time at a major offshore trust conference last year I noted with interest that a number of speakers were saying that they thought reserved powers trusts could be problematic. And this year I am far from being alone in actively working on restructuring or reforming trusts where the power within the structure is giving rise to concerns that the assets in the trust may not be adequately protected from attack by a third party.

New Zealand, the Cook Islands and reserved powers

Given that trusts in these two jurisdictions have given rise to some of the most important cases in the last five years on the risks of excessive settlor control, it is perhaps useful to look at their reserved powers provisions.

Notwithstanding that a comprehensive new Trusts Act was passed in 2019, the New Zealand trusts legislation does not contain reserved powers provisions as such, although it does provide (at Section 94) that a person with power to remove/appoint a trustee must act honestly, in good faith and for a proper purpose. Further, Sections 74 and 75 cater for a Special Trust Adviser to be appointed either under the trust deed or by the court. The trustee is not, however, obliged to follow the advice of the Special Trust Adviser but if the trustee decides to do so it will not be held liable in the absence of dishonesty, wilful misconduct or gross negligence.

Section 13C of the Cook Islands' International Trust Act 1984 (as amended) does provide for the retention or acquisition of the following powers by the settlor:

- to revoke the trust;
- disposition over property;
- to amend the trust;
- to remove/appoint the trustee/protector; and
- to direct the trustee on any matter.

The consequences for the trustee of complying do not appear to be spelled out but as to the trust it is provided that the retention of control and benefits by the settlor shall not result in the trust being declared invalid or a disposition declared void or be affected in any way. It also specifically provides that a settlor can be a beneficiary, trustee or protector.

Following the highly significant decision in *Webb*[22] it is clear that even with the benefit of such provisions the settlor can retain too much control.

Vulnerability of the trust and the settlor if he retains powers – *TMSF v Merril Lynch*; *Pugachev and Webb v Webb*

While it is preferable for the settlor to retain powers he firmly intends to use rather than risk allegations of a sham (affecting not only him but also the trustee), a settlor wishing to retain considerable power should be aware that this may render him and the trust vulnerable for several reasons.

Retained power used as a pressure point

First, that level of control can be turned against him. The Andersons learned this to their cost as long ago as 1999. At the time it may have appeared to be a particularly egregious case where the result was richly deserved or that this was unlikely to happen outside the United States. But it is clear that, even leaving aside for a moment the risk in some jurisdictions of a settlor with power over assets being forced against his will to sign them over, courts in other jurisdictions are increasingly resorting to steps designed to exert maximum pressure on settlors in appropriate cases or to decide that the powers retained by the settlor are such as to vitiate the intention to create a trust.

The settlor learned this to his cost in *TMSF v Merril Lynch Bank & Trust Co*.[23] He had settled two Cayman

Much of the world has forced or entrenched heirship, where it is not possible to prevent certain members of families from receiving fixed shares in the patrimony of a deceased person.

Islands discretionary trusts for the benefit of himself, his wife and descendants, reserving to himself an unfettered power of revocation. Two years later a significant judgment was given against him in Turkey in favour of a bank. The bank failed to persuade the Grand Court or the Court of Appeal of the Cayman Islands that the power of revocation was such that a receiver could be appointed over it (because the power was not considered to be property). But on appeal to the Privy Council the bank succeeded: the Privy Council decided that being an unfettered power of revocation the settlor was entitled to call for the assets at any time and so, for practical purposes, this was tantamount to ownership. It further confirmed that a power of revocation is not a fiduciary power and so was assignable/delegable and ordered the settlor to delegate his power of revocation to the receivers appointed by the bank. (It is understood that they promptly revoked the trusts with the result that the assets were returned for the benefit of the settlor's creditors.)

That a power of revocation can render a trust vulnerable to the claims of creditors would come as no surprise to those in the United States where it has long since been understood (and reflected in the Uniform Trust Code which has been adopted by some 34 states) that a revocable trust does not provide protection against creditors.

Settlor is regarded as still owning the assets for entrenched heirship purposes

Much of the world has forced or entrenched heirship, where it is not possible to prevent certain members of families from receiving fixed shares in the patrimony of a deceased person. For settlors who wish to make alternative provision for their families (such as a discretionary trust rather than the family members having fixed shares determined by the relevant Civil Code provisions of his jurisdiction), it is important that the trustee is regarded as the owner of the assets he settles.

There are numerous issues associated with this kind of planning – of which the risk of clawback is probably the best known – but one that is perhaps less well known is that the relevant civil law jurisdiction may not regard the settlor as having parted with the assets at all if he has retained significant powers under the trust deed. The extent to which (if at all) powers can be retained by the settlor needs to be checked with lawyers in the relevant jurisdiction before planning the trust structure.

Retained powers damage the trust's integrity illusion giving effect to the trust's terms

Secondly, the powers the settlor retains may be so extensive that the court concludes the trust is illusory or rather that on its true construction the settlor did not divest himself of control of the trust and its underlying assets. This is a particular risk where the settlor is also a beneficiary in whose favour he can as power holder direct distributions.

This trend seemed first to develop in the English family court dealing with financial relief claims: trusts where the financially superior spouse held very significant powers became known as 'Dear me' trusts. The trust deed in *AAZ v BBZ*[24] was so described by Haddon-Cave, J as:

> *a remarkably candid and pellucid document which makes no pretence to be anything other than what it is, namely what is colloquially called a 'Dear me' trust for H for his lifetime.*

The consequence was that the trust assets were treated as though belonging to the husband and a swingeing divorce award made accordingly.

Clayton v Clayton[25] was another family case in which the wife sought a matrimonial property order against the husband, including against assets held in a discretionary New Zealand law trust that he had created and of which he was a beneficiary. Mr Clayton was, somewhat unwisely, the settlor, principal family member, and trustee of the trust. The New Zealand Supreme Court decided that the combination of powers he retained was such that he could make himself the sole beneficiary of the trust. As such he was considered to have powers amounting in effect to a general power of appointment over the assets.

This idea of an illusory trust, concentrating on what the effect of the trust truly is (rather than the trust deed being a sham document intended to deceive) resulted in the seminal decision of the Privy Council in *Webb*.[26] While this was – again – a matrimonial property case, few would doubt that its implications are wide-ranging and will affect trusts in a range of circumstances, including where there are claims by creditors other than a spouse.

The case is also important because it deals with two discretionary trusts governed by the law of the Cook Islands which, as noted above, has inserted reserved powers provisions in its trust legislation. It is particularly noteworthy that, notwithstanding the continued marketing and perception of the Cook Islands as an impregnable jurisdiction for asset protection trusts, both the judge at first instance and the Court of Appeal of the Cook Islands found that the trusts failed to record an effective alienation of the beneficial interest in the assets and so were invalid. (The first instance judge, however, found for Mr Webb in accepting his claim that any interest his wife might have in matrimonial property would be absorbed by the significant fiscal claim which was being made against him.)

Aside from the apparent absence of consideration of the efficacy of the reserved powers provisions in Section 13C of the Cook Islands' International Trust Act 1984 (as amended), the result on the trust issue was unsurprising. Mr Webb was the settlor, trustee (able to exercise powers notwithstanding conflict of interest), a beneficiary and had the power as trustee to (and did) appoint himself as consultant. The consultant held powers akin to that of a typical protector: he had power to remove the trustee (without giving reasons) and appoint a new trustee; he could also consent to a variation of the trust.

Mr Webb appealed to the Privy Council which was unable to conclude that Mr Webb would voluntarily pay his debts, so addressing the problem of the fiscal claims which Mr Webb had suggested made Mrs Webb's matrimonial property claim nugatory. Noting the extent of Mr Webb's powers (including, as settlor, to nominate himself as sole beneficiary in place of existing beneficiaries and as trustee to apply capital and income to himself to the exclusion of other beneficiaries or resettle assets (with the consent of himself as consultant) on new trusts, provided that one beneficiary of the old trust was beneficiary of the new) the Privy Council, relying on *TMSF*[27] and *Clayton*,[28] concluded that he had retained a bundle of rights tantamount to ownership: he had retained the power to secure the benefit of all the trust assets to himself regardless of the interests of other beneficiaries. The fact that his girlfriend became trustee too at some stage did not alter the position.

As with quite a number of ideas which started life in the family court – stemming from its emphasis on the reality of the situation – it is now clear that 'Dear me' trusts (while not described in quite such terms) have reached Chancery and appeal courts.

The most significant area of crossover in this regard is perhaps the case of *Pugachev*.[29] Mr Pugachev, who was known as Putin's banker, fell out of favour with Putin after allegations that funds contributed by the Russian state to bail out his bank (Mezhprom) during the 2008 crisis had been misappropriated by Mr Pugachev. When proceedings were commenced against him in Russia he fled to England and judgment was entered against him in Russia. A few months after the Russian judgment Mr Pugachev set up the first of five New Zealand law discretionary trusts, the others following a couple of years later after renewed pressure from Russia. The trusts, drawn up by his lawyer (who became a director of the private trust company which became trustee of the trusts), provided that Mr Pugachev was the first protector as well as a member of the beneficial class: the other members of the discretionary class were his cohabitee and his children. The power conferred to benefit them or any of them enabled distributions to a sole beneficiary to the exclusion of all others.

A liquidator was appointed over Mehzprom and its insolvency recognised by the English court. Mezhprom's liquidator then issued proceedings in England claiming (in addition to the transfer of assets into trust being with the intention of defeating the claims of creditors) that the trusts were illusory: that on the proper construction of the trust deeds their terms were insufficient to divest Mr Pugachev of beneficial ownership. Mezhprom also alleged that the trusts were shams.

The powers that Mr Pugachev held were not that unusual, although unwise. He was permitted to reside in trust property of which he could direct the sale. His consent as protector was required for various powers to be exercised by the trustee including distributing capital/income, investment, a beneficiary ceasing to

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be such, the trustee releasing powers and the variation of the trusts.

The protector held the power to add and remove trustees without cause, a power which Birss J recognised was usually regarded as fiduciary (following *Re Skeats*[30]) but which in all the circumstances he concluded was a personal power. The trusts contained a somewhat unusual clause not only releasing the trustees from an obligation to pursue a former trustee for breach of trust but also providing that the trustee was not liable to a creditor. These provisions were regarded by Birss J as significant. His conclusion was as follows:

> *I conclude therefore that on their own terms these trusts do not divest Mr Pugachev of the beneficial ownership he had of the assets transferred into them. In substance the deeds allow Mr Pugachev to retain his beneficial ownership of the assets.*

As to the claim of sham, he decided that in the event that he was wrong about the power to hire and fire trustees being a personal power – the trust deeds were shams: he was convinced that Mr Pugachev – described by a witness as a control freak – had no intention of relinquishing control.

This Chancery decision is very much along 'Dear me' trust lines. Relying on dicta in *re AQ Revocable Trust*[31] in Bermuda and *Clayton*[32] in New Zealand it sent shock waves around the trust world. At first some regarded it as an aberration by a member of the judiciary who was not steeped in trust law, that it was a case where bad facts made bad law (Mr Pugachev was in contempt of court and had fled to France) and/or that Birss J was wrong to conclude that the power to remove and appoint trustees was a personal power.

The Privy Council determining *Webb*[33] included members of the judiciary highly respected in trust law circles: it reached its conclusion along similar lines. Although the Privy Council decision is only binding in the Cook Islands it will be highly influential elsewhere. So not only is the asset protection reputation of the Cook Islands in some disarray (which may cause consternation among some settlors and lawyers in the United States where such anti-creditor trusts are popular) but the rest of the common-law world needs to sit up and take notice.

Wearing too many hats

It will be apparent that one of the common threads that runs through these cases is the settlor not only being a member of the discretionary beneficial class but also holding some key powers as protector, trustee or (in the case of *Webb*) consultant. Clearly, this sort of combination should be avoided. Equally clearly is the situation where those who hold significant powers – whether trustee, protector or another power holder by whatever name – are subservient to the settlor. In such a case the exercise of their powers risks being attributed to the settlor.

Vulnerability of power holder and, through him, the trust

As is clear from the position taken in *Pugachev*[34] with regard to his lawyer/director of the trust company and *Webb*[35] with Mr Webb's girlfriend becoming a trustee, having a trustee/trustee director/protector or other power holder will not save the settlor from being regarded as having failed to alienate the assets or as owning the assets beneficially if the other power holder is considered to be the settlor's cypher or otherwise under his control. So, for example, the frequently-used arrangement in trusts in the United States whereby the power of revocation is subject to the consent of a person subservient to the settlor will be unlikely to work to save the settlor from being regarded as having unfettered power.

If power is to be shared or split it must be with an independent, robust person or entity if the integrity of the structure is to be preserved.

Another issue needs to be given serious consideration when choosing power holders: are they in a jurisdiction which risks making the trust vulnerable?

This is a matter of grave importance for settlors from jurisdictions where political or personal pressure can be brought to bear on power holders. So if, for example, a protector with the power to hire and fire the trustee and/or change the governing law of the trust comes under such pressure the trustee could be changed to a trustee in the affected jurisdiction; moreover the change could be to one who is sympathetic to the aims of the person or entity exercising the pressure. In any event, moving the trustee into the jurisdiction will render them susceptible to a judgment against the assets which

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they may be ordered to bring into the jurisdiction. Such orders may be backed up by the risk of imprisonment if not complied with. Changing the governing law may result in the loss of creditor protection or firewall legislation in the offshore jurisdiction, the latter seeking to protect the trust against succession and divorce claims.

Where the power holder is situated may also result in reporting obligations by reason of his or its location and may also be of critical importance for tax reasons. If the non-trustee power holder is considered the real source of power over the trust and its underlying assets then the trust may be regarded as resident in or otherwise appropriate to be charged to tax in the jurisdiction where the power holder is located.

A power holder who fears that he will be subjected to such pressure should immediately retire to avoid risk to the trust and its beneficiaries. This is, however, problematic if he is being pursued by creditors and the powers he holds are personal – giving up his powers may be regarded as a disposition made with the intention of defeating the claims of creditors. If he fails to retire, another power holder – perhaps the settlor or the appointor – may have and can exercise power to remove him. If all else fails, an application can be made to the court to remove him. Whether his powers are personal or fiduciary, the court will act in the best interests of the beneficiaries. But it is not always possible to gauge precisely when such power needs to be exercised and it can be too late before steps are taken.

It is possible to draft decapitation or trigger clauses into the trust deed so that the power holder's powers are removed or suspended if certain events occur in order to prevent the trust being damaged if the power holder succumbs to pressure. Indeed, such mechanisms can assist in discouraging such pressure from being exerted if known to the pressurising party. Whether they will work if tested depends on their drafting and the attitude of the court in question: in the Anderson case *FTC v Affordable Media*,[36] the trusteeship of the Andersons over their Cook Islands trust was designed to fall away in the event of an 'event of duress' such that they were unable to repatriate the trust assets as ordered to meet a fraud claim. The first instance court and the United States Court of Appeal of the Ninth Circuit simply ordered their committal to prison until they should find a way of repatriating the assets.

It is generally better to avoid such a situation, if possible, by sharing power with those who are not politically or by reason of location likely to be exposed to such pressure or influence.

Conclusion

It is clear that the landscape for reserved powers has changed radically within the last decade. We should now be under no illusion that an unfettered power of revocation may be used to the detriment of the settlor and the beneficiaries. Courts in England, New Zealand, the Cook Islands and – most influentially – the Privy Council have made it clear that the powers retained (at any rate personally) by a settlor will be viewed collectively to see if they amount to him or her being able to secure all the assets to him or herself. While the decisions to date have categorised the issue as one of failure to divest the beneficial ownership/retention of the beneficial ownership without explicitly declaring the trust invalid from inception, that remains a possibility. Such findings would likely give rise to tax and other issues. Of course, the sophisticated reserved powers legislation in key offshore jurisdictions seeks to prevent that outcome, so it may be that judgments may not focus on this particular issue.

While it might be thought that the real test will come if a reserved powers trust thought to be permitted and protected by specific legislative provisions in a regulated and well-respected jurisdiction proves vulnerable, it is worth bearing in mind that *TMSF*[37] was determined on appeal from the Court of Appeal of the Cayman Islands and that, even though the Cook Islands has reserved powers legislation stating that the validity of a trust is not to be affected by the reservation of powers, all three courts determining *Webb*[38] concluded that Mr Webb had kept rights tantamount to ownership, so allowing the claim of his wife and possibly opening the door to the fiscal authorities to claim what remained of the assets.

Trustees and lawyers around the globe should be considering the structures they manage or advise on in light of these risks and take specialist advice on what, if anything, can be done in the particular circumstances of the trust. Such a review could well be combined with assessing the suitability of the structure to provide for the next generation or generations to whom assets will likely be transferred from the baby-boomer generation within the next 30 years.

Clearly, the issue of proceedings by someone with an interest hostile to the trust will be too late for anything to be done about the numerous trusts at risk of a *TMSF*[39] or *Webb*[40] analysis. Such structures need to be reformed now (assuming the trustees have sufficient power or the court so authorises) if they are to have a hope of surviving such an onslaught.

Dawn Goodman founded Withers' trust and succession dispute practice and is a well-known trust lawyer. Previously a divorce lawyer she advises on the interaction between trusts and divorce. She is also a CEDR accredited mediator, a fiduciary and works closely with trustees and family offices. Dawn applies her practical experience of trusteeship and issues which give rise to disputes to advising clients proactively on planning or restructuring to create robust succession structures tailored for their family. She also advises trustees and family offices on problem solving and crisis management.

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