Do offshore trusts really confer asset protection in this day and age?

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April 2020

Introduction

This is an analysis of asset protection trusts and related court cases globally. It is not, however, by any means an exhaustive or conclusive review, rather, a call to arms to ensure objectives setting up trusts are met, and that due care and attention is provided in their implementation and administration.

Offshore asset protection trusts sound wonderful to those seeking to safeguard their fortunes and to pass them onto next generations without worry about the future. Headline features of offshore trusts conjure up romantic ideals of invincible nest eggs from a crime thriller novel where the protagonist, and indeed his whole family, can retire on her or his winnings happily ever after.

Life is not as kind in practice and we will see here that bankruptcy, divorce, forced heirship, settlor reserved powers as well as documentary issues can easily uproot the best laid plans. Public perception, data sharing agreements like the CRS and 'trials by media' are also not helping settlors' odds of success. For while many jurisdictions have changed their tune, and now allow tax evasion or fraud or divorce to 'break' a trust, even long after the expiry of lenient sounding time bars to claim on a trust.

Certain 'onshore' jurisdictions, especially the US and UK, are often more than happy to disregard entirely the application or recognition of trust laws to serve their own aims. Remember, such laws have been upheld frequently since the Crusades from the 12th Century AD in the United Kingdom and elsewhere since. Finally, we propose some approaches which should reduce the risk substantially of successful trust attacks.

Strong asset protection nexus – on paper

Asset protection trusts are folklore in legal and crime dramas where the often-villainous stash their loot in offshore trusts and enjoy a life of opulence derived from the trusts without anything to fear forever more. Certain lowly populated jurisdictions like Nevis, the Bahamas and the Cook Islands, all of which have two-year statutory bars on claims being made against their trusts, the shortest period in the global industry, have built good business on this promise. Added to this boon, consider that offshore trust jurisdictions have sound international banks to hold the funds (Cayman), large firms of lawyers (think, BVI) to structure and protect the funds, auditors and accountants to keep the company directors in check, fund managers to manage the cash professionally and such on their shores - and you have a powerful selling prospect.

What's tax? And none of your business!

In the recent past (up until the Global Financial Crisis – well, the last one in 2008 anyway), islands such as Cayman, were strong in defending their trusts. The Cayman Islands, had no tax and so refused to recognise

any request for information let alone enforcement on legal persons involved in tax evasion as the enquiries lacked dual criminality in both countries in question. Settlors felt safe with their assets in Cayman. Further, numbered bank accounts of the kind mentioned in John Grisham books were the rule not exception, often scuppering any investigation into anything 'offshore'. Until very recently, nearly all offshore jurisdictions did not allow the identity of shareholders or directors to be known to the public under almost any circumstances -most Overseas Territories like the BVI and the Crown Dependencies like Jersey have still yet to commit to open their books. So far so good.

"I'm not in charge"

On the face of it, offshore trusts are usually only ever administered at the trustees' discretion and beneficiaries are by the very nature of the 'irrevocable' trust left without any control over the trust's assets. When pulled into court, countless settlors of trusts - or their spouses - have pleaded that the assets do not belong to them as they have been given away, and critically, they have no means of getting their money back! For those living under forced heirship rules in civil law countries like France and Germany, where usually half of a deceased person's estate must be divided according to shares prescribed by law, many jurisdictions covenant to ignore any claim made on their trusts for that reason (this was upheld in Bermuda, in 1994 for example in *Schindler v Garner & Bermuda Trust*). And a final moment of joy for the settlor of an offshore trust, perhaps, arose from the idea that personal bankruptcy would not affect their nest egg safely hidden on some often warm, foreign shore run by their friendly team of lawyers, bankers and so on.

So, what's new?

Politics, enforcement law changes – and perception. The Panama Papers, and the subsequent Paradise Papers were perhaps a logical next step after the 2009 OECD and G8 (as it was) proclaiming the death of the 'offshore' world. While the politicians in 2009 set the tone, the Panama Papers which were released in April 2016 led to a unique form of global censure of offshore, namely in perception and trial by media. It was perception, and the public shaming of famous individuals and institutions which brought many to account and it has since become vogue voluntarily to 'onshore' one's assets – even if you live in, say, Monaco and such offshore arrangements make good practical sense and are entirely legal. As a result, what I've called 'onshore offshore' centres since 2008 have become extremely popular – think US (Delaware, Wyoming, South Dakota), UK, Singapore, New Zealand - to the detriment of the 'dodgier' exotic sounding smaller places like Samoa, the Marshall Islands, Vanuatu, Anguilla and (now) Panama.

Has the law changed since then?

Yes and no. Certainly the UK has enacted fierce legislation to convict anyone who even should suspect of a tax evading scheme's existence. Fines for deliberate non-reporting of offshore funds in the UK include 200% penalties plus unpaid tax and interest! The US is renowned for severe treatment of anyone helping US tax evaders: think of Bank Wegelin in Switzerland which was a quality bank, family owned for centuries, and which was destroyed by the US' criminal investigations. Consider also the multi-billion-dollar fines levied by the US on other Swiss, Liechtenstein and French banks in the post-2008 period.

Yet, the global marketplace for high net worth individuals' wealth continues unabated and many financial hotspots such as Singapore, Hong Kong, the UK (for the first 15 years under the famous 'non dom' regime) allow offshore structures to prosper over generations. However, while the letter of the law as in statute permits offshore trusts and the like, court cases often demonstrate how officers of the law, such as judges and tax authorities, are now far heavier handed with offshore trusts.

The tide has turned

One such case illustrating this is *TMSF v Merrill Lynch Bank & Trust Co* (2011) from Cayman. Here, certain powers reserved to the settlor were deemed by the Court of Appeal to be tantamount to property of the settlor! Arguably this has been the position since the Pricy Council's decision in *Wright v Morgan* (1926) (England and Wales) however this has not always been considered definitively the legal position, otherwise why would offshore centres like Nevis actively promote such settlor reserved powers? As mentioned, the Zeitgeist, especially in 'onshore jurisdictions (see *Clayton v Clayton* (2017) (New Zealand) which affirmed the position from TMSF) is flowing against settlors reserving non-fiduciary powers without recourse to trusts' assets. Settlors are now being forced more frequently to use their *in personam* powers against their personal wishes such that they will unwind trust assets to satisfy a litigant's financial (or other) claims.

Added to this change in legal enforcement and perception, trustees and their advisers have another obstacle to confront in new Anti-Money-Laundering rules as well as automatic exchange of information. The Common Reporting Standard is an OECD initiative which forces cross-border reporting of all material financial assets held by citizens of third-party countries. It has led to the prospect of huge amounts of paperwork for banks, customers and advisers as well as potential criminal penalties for non-observance. Trustees' appetite for anything non-vanilla is further diminished by extra-territorial laws such as FATCA, imposed by the US on anyone knowingly or not hiding ownership or assets of US persons from the IRS. Consider also the Criminal Finances Act 2017 where turning a blind eye to anything involving tax evasion results in jail for trustees and their advisers. Contrast this position with a mere 15 years ago when some offshore trustees, bankers and lawyers were notorious for being intentionally ignorant of clients' financial affairs - should one mention Switzerland here? What is fascinating here is that the CRS, by the OECD's own admission, slows business and has led to very few convictions even though directors of banks, trustees and law firms may be held liable personally. The CRS has been a failure on paper but has certainly gained in its battle for global consciousness on making transparent the taxation and ultimate 'ownership' of wealth structuring vehicles like trusts.

London, the divorce centre, setting the tone

No discussion of asset protection trusts should ignore the threat of divorce, especially from the UK which has been used as a global platform to launch matrimonial disputes against globally wealthy couples' assets. Yes, UK courts are 'generous' and after any marriage of any length initially presume a sharing of assets 50:50. What is so noteworthy is that UK family courts arguably are violating trust and company laws of foreign jurisdictions to obtain what they deem as fair outcomes. While wealthy spouses may largely disinherit their spouse by will in the UK, divorcing spouses are able to claim huge stakes in offshore trusts a wealthy spouse has legitimately settled for future generations, disregarding the usually legally binding nexus of a trust structure.

Offshore trusts, in their opacity, have a head start, of course. Divorcing spouses first require disclosure of the assets they are claiming and if a usual disclosure request is rejected (eg if they are not a beneficiary), courts have often to use the power to order disclosure not only from the spouse but also third parties. Further, beneficiaries are in contempt of court if the trustees do not comply, opening up the trustee with potential civil or criminal penalties in their home jurisdiction eg Jersey.

Another route of breaking a trust to trace assets to a settlor used by divorce lawyers all over the world is by arguing the arrangement is not genuine (eg *Minwalla*), for example where trustees blindly take instructions from one person without exercising genuine power and discretion. Alternatively, as in Chase Bank v Rahman, a settlor may also be protector and beneficiary and exert too much technical control on a trust. Nervous spouses, beware!

A perhaps more common way of claiming offshore trust assets is by claiming them as a 'resource' of a spouse if a court believes the trustee will likely provide the assets if issued a court order.
Some cases show that even where a settlor and spouse is seen to be remotely connected to a trust eg never receiving trust benefits (*Charman v Charman* (2007) England and Wales), or if a spouse merely has the power to be added to the trust later (*Whaley v Whaley* (2016) England and Wales) or in a non-binding letter of wishes asks for funds to be provided for business at a future date (*Charman*), the court will order the trust to distribute a share of those assets as if they in the hands of that spouse! Ouch.

Courts may even offer binding orders varying trusts – or even companies (*Prest v Prest* (2013) England and Wales) using Matrimonial Causes Act s37 (2) (b) or Insolvency Act s423 to set aside dispositions. In the *Prest* case, the courts famously pierced the (Isle of Man) corporate veil. So be warned of claims that divorcing spouses won't get a look in…and this trend of transparency and regarding such trusts as part of a settlor's estate (still) is only on the increase.

The US's approach, especially with bankruptcy

So, you think your offshore trust allows you to benefit from a trust even if made bankrupt? Is that what your offshore trustee told you in the sales pitch?

Not in the US, often, and this has been laid down in cases for decades already (*In Re Lawrence* (1999) under Judge Jay Cristol's stewardship). In this case a Mauritian trust's assets were clawed back in bankruptcy as 1) the settlor could change trustee 2) common sense dictated that as 90% of the settlor's wealth was in trust, the settlor wanted some control 3) the burden of proving a settlement is not recoverable is on debtor/settlor and the threshold was deemed to be set high as asset protection trusts are often designed to be charade to defeat later creditors!

Perhaps the effusion of time between settlement and the settlor's subsequent bankruptcy are the most remarkable feature of this case. The trusts had been settled 7 years earlier in 1991! Other US cases, such as *Duttle V. Bandler and Kass* (1992) had already proven that offshore trusts would be set aside in personal bankruptcy if the settlor still benefitted and, in this case, as the settlor had tried to hide assets.

Even the Cook Islands, with its famed ability to ignore foreign courts allowed one of its trusts to be broken (*FTC v Affordable Media and Others* (2007), in this case the element of fraud was also extant. A final case of note is *In Re Brooks* (1998). Here, a wife had settled cash into Jersey and Bermuda trusts, both governed by local law. Each trust was irrevocable and to be managed at the trustee's sole discretion. The judge here recognised that Jersey and Bermuda law would often apply however, due to public policy that this was a 'spendthrift trust', Connecticut law was invoked and the trust was ordered to be unwound:

"spendthrift trust is one which provides a fund for the benefit of another, and which secures it against his own improvidence, and places it beyond the reach of his creditors."

Let it be known that as of these early cases in dismantling offshore trusts, US courts give settlors a few days, up to two weeks usually, to return funds – or face incarceration - and slap huge fines on them. Not such a pretty outcome after all.

<u>What can the well advised to counter these threats?</u>

Well, for one, there's bad news for anyone whose trust comes before the courts anywhere with 'unclean hands', as the law of equity in common law jurisdictions define. If you're involved in tax evasion, fraud, money laundering, hiding money from an ex-spouse and so on, your offshore trust will not work. Practically, follow these steps as a start.

<u>1. Make sure trust deed is properly settled, drafted and works holistically</u>

It is an obvious point, but it's so often neglected. The law of equity by it nature – and name – seeks to uphold fairness. You'd be surprised how often trusts aren't signed as deeds if there is no consideration or, in many cases, the consideration promised is not actually given which endangers the trust itself! In a case with some dark angles, even though not a typical offshore trust case, consider Singapore case of *Bom v Bok* (2018). Please read this if you can as the facts read like a domestic thriller! A wealthy man was married to a lawyer who drafted him a deed of trust to settle any inheritance from his mother to trust for their son. The problem was this happened just after his mother had died so it was a tasteless proposal from the outset. From a legal point of view, however, it itemises cases when a court can set aside a deed of trust, in Singapore at least. It includes the following factors which go beyond the obvious crimes mentioned above, like fraud. In Bok, a trust will fail if it is a mistake, or involves misrepresentation, undue influence, or unconscionability. Beware in these modern times with how public perception is amending the rules as to what might be 'unconscionable'! As an aside, had the purported settlor in Bok taken formal legal advice, the trust may have been settled – to his detriment. Another reminder to use a good lawyer!

<u>2. Review and consider deeply how the trust will be used</u>

As you've already read here, the 'resource argument' works rather well in breaking 'asset protection' trusts in divorce and bankruptcy proceedings, even where the liability did not exist or was not foreseeable at the time of settling the trust! So, if you are a settlor, understand what the ultimate purpose will be and ideally, ensure you

have no financial benefit from the trust to maximise your chances the trust will continue for your aims. Please don't try and hide behind 'irrevocable' trusts, or a jurisdiction with a fancy reputation for being secretive or 'on your side'. The above makes clear that if your adversary has conducted any research, the battle will be staged 'onshore' where perception and the courts are often mistrusting of anything 'offshore' unless you can prove otherwise.

3. Avoid any charade or sham

You'll see elsewhere on www.bayernlegal.com an article on the role of protectors and sham trusts (Snook v London And West Riding Investments (2005), England and Wales). The message again here is to ensure that you are depending on the substance of the trust, not its supposed form, to be the backbone of how it works. So, always use quality trustees who understand and can document your intentions (see *Nedbank v Mendelow* (2013) from South Africa) – here the trust was set aside as there was no real intention of transfer). Do not hold onto the trust's assets through levers such that you could probably manage and reclaim the trust whenever you feel like it.

4. Seek proper advice

So much depends on how the trust is framed, managed and set up. In a world of ever-increasing complexity and cross-border issues, real attention to detail is required in all jurisdictions which may be relevant (think children living in the US; marrying beneficiaries and the need for pre-nuptial agreements; think tax; think forced heirship; think domicile and English and US idiosyncrasies).

Begin with the end in mind, as Stephen Covey would recommend in his '7 Habits of Highly Effective People' and identify potential ways of ensuring the trust remains valid, confidential and the assets are truly 'safe'.

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