Challenging trusts – two litigators’ perspectives on shams, reserved powers and resulting trusts

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Shams: what is a sham in the context of trusts?

♦ A sham is an attempt to deceive; it is a pretence that a trust has been created when, in truth, there is no trust (at least as set out in the relevant purported declaration).

♦ *Snook v London and West Riding Investments Ltd* [1967] 2 QB 786 per Diplock LJ at 802:

“... acts done or documents executed by the parties to the ‘sham’ which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intended to create ... 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 or obligations which they give the appearance of creating.”
Shams: what is a sham in the context of trusts?

- A pretence to the world that a particular trust was intended and created but *the reality is that this was not what the settlor intended* (and therefore not what he or she has created).

- The settlor necessarily also pretends that he or she has parted with the equitable/beneficial ownership of the property the subject of the alleged trust but *the reality is that he or she has not divested himself of the relevant equitable interest*.

- The intention and the substance of what has happened is that *there has been no transfer of equitable title to the relevant property*: there is no trust as purportedly declared and there are no beneficiaries as held out in the relevant (purported) declaration of trust.
Shams: what is a sham in the context of trusts?

- *Midland Bank v Wyatt* [1995] 1 FLR 696:

  - A declaration of trust was purportedly made by the owner of a family home of his interest in the property for the benefit of his wife and daughters. The declaration was “*put in the safe for a rainy day*” and only produced and sought to be relied upon when a charging order was obtained against the property.

  - The purported settlor was held not to have intended that his declaration of trust have any effect when made; put simply, it was not his intention to divest himself of his beneficial interest in the relevant property for the benefit of those held out as beneficiaries.
Shams: what is a sham in the context of trusts?

- *Minwalla v Minwalla* [2004] EWHC 2823 (Fam)

- The Family Division of the English High Court (applying English law to the question) held that a purported Jersey law trust was a sham.

- The Court found that the settlor was “the true and sole owner” of the relevant property because he “never had the slightest intention of respecting even the formalities of the trust deed ... His purpose was only to set up a screen to shield his resources ... [His] intention was that the resources were his and would continue to be his ... and the trustees went along with his intentions.”
Shams: what is not a sham?

- The parties’ motives are not relevant. What signifies is whether the parties intended the transaction to be given effect in the form in which it is set out, not why they so intended.

- Thus, a transaction will not, however, be a sham simply because it was entered with an improper motive: see *Chase Manhattan Equities Ltd v Goodman* [1991] BCLC 897 per Knox J at 921:

  "... impropriety of motive alone will not provide grounds for treating a transaction as a sham."

- Additionally, there is no cause of action for “piercing the veil” of a trust: *In re Esteem* [2003] JLR 188. Surrender of control of trust by trustee to settlor is a breach of trust, not a retrospective reversal of transfer of legal and beneficial title.
Shams: the elements that must be proved to make out an allegation of sham

♦ *First*, the settlor (and probably the trustee) must intend not to create a trust (at least, as purportedly declared).

♦ *Second*, the settlor (and probably the trustee) must intend to deceive or give a false impression (or simply to mislead?). As to the requisite element of deceit or fraud (if not illegality) see:
  - *MacKinnon v Regent Trust Co Ltd* (CA) [2005] JLR 198
  - *Hitch v Stone* [2001] EWCA CIV 63
  - *Carmen v Yates* [2004] EWHC 3448
  - *Equuscorp P/L v Glengallan Investments P/L* [2004] HCA 55
  - *Hill v Spread Trustee Co Ltd* [2005] EWHC 336 (Ch)
Shams: the elements that must be proved to make out an allegation of sham

- However, must there be an intent to deceive in addition to the plain intent not to give effect to the trust as declared? Is there a distinction without a difference between a sham and an ineffective transaction? What does the requirement that there be an intention to deceive add? Are the first two elements, in truth, co-extensive?

- Third, the intention to deceive must be joint or common between the “settlor” and the “trustee” (although obviously motives might differ).

- However, a sham in the context of trusts necessarily involves an intention in the false settlor not to create a trust: the basic requirement for the creation of a trust of certainty of intention is necessarily absent in every case where a sham is found. It follows, then, that whatever else the settlor has done, without the intent to create a trust, he has not created a trust as purportedly declared.
Shams: the elements that must be proved to make out an allegation of sham

♦ Put another way, if a sham is to be found, the requisite intention to create a trust must not exist.

♦ That being so, why is there a requirement for a joint or common intention to deceive between “settlor” and “trustee”?

♦ Snook: All parties must have the same common intention: “for act 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 or obligations which they give the appearance of creating.”
Shams: the elements that must be proved to make out an allegation of sham

♦ *Midland Bank v Wyatt [1995] 1 FLR 696*

  - The settlor’s wife also signed the purported declaration but was found not to have any intention to deceive:

    “... a sham transaction will still remain a sham transaction even if one of the parties to it went along with the “shammer” not either knowing or caring about what he or she was signing. Such a person will still be a party to the sham ... .”

♦ But, in *In re Esteem [2003] JLR 188* and *Abacus (C I) Ltd and Grupo Torras SA v Al Sabah [2004] 6 ITELR 368*, the Royal Court of Jersey held that both trustee and settlor must intend that the true arrangement is otherwise than as it is presented to the world.
Shams: the elements that must be proved to make out an allegation of sham

- This requirement was strongly repeated in *MacKinnon v Regent Trust Co Ltd* [2005] JLR 198 where the Royal Court held:
  - Essential feature of sham is common intention of settlor and trustee to mislead or deceive third parties by giving false impression that rights and obligations actually create in accordance with the declaration;
  - Both settlor and trustee must intend that the true beneficial position is otherwise than as stated in the trust declaration;
  - Common intention requires dishonesty but includes recklessness.
Shams: the elements that must be proved to make out an allegation of sham

- To like effect, see also *Shalson v Russo* [2005] 2 WLR 1213 at 1273-4; *Hitch v Stone* [2001] STC 214 and *Hill v Spread Trustee Co Ltd* [2005] EWHC 336 (Ch).

- Additionally, reckless indifference by the purported trustee will be taken to constitute the necessary common intention by the trustee with the settlor: *A v A* [2007] EWHC 99 (Fam).

- What does the invariable presence of a professional trustee signify for the requirement of joint or common intention?

- What does all of this mean for a claim of sham against an apparently effective trust?
Shams: the elements that must be proved to make out an allegation of sham

♦ Note, the learned editors of *Lewin on Trusts* (18th ed’n at para 4-22) opine that the apparent requirement of joint or common intention can effectively be attenuated such that the only real enquiry is as to the purported settlor’s intention:

“... the requirement that the trustees must share the intent [to deceive] follows, not only, or perhaps not so much, from any separate legal principle, as from the need to establish the settlor’s shamming intent. For unless the settlor has reason to believe that the trustees will go along with ignoring the trusts, and will be willing to treat the settlor as still the owner of the trust property, the settlor can hardly expect that this will happen, and so can hardly be found to have intended that it should.”
Shams: impeaching transactions rather than the trust

♦ A provision in a lease may be invalid as a sham where the lease itself remains valid (see *A G Securities v Vaughan* [1990] 1 AC 417).

♦ The doctrine of sham has been found generally to be capable of application to particular provisions within documents without invalidating the whole document (*National Westminster Bank v Jones* [2001] 1 BCLC 98).

♦ Individual transactions under trust may be shams even if trust itself is valid: *In re Esteem Settlement* [2003] JLR 188.

♦ Given the difficulties of establishing common intention, it may well be easier to attack successfully a particular transaction rather than the trust as a whole.
Shams: what is the consequence of a finding a purported trust to be, in truth a sham?

- Where a sham is proved, there is, of course, no trust as purportedly declared.

- The settlor retains beneficial title to the relevant property; the property is held for his benefit alone.

- That being so, third parties can treat the relevant property as still belonging to the settlor or the settlor’s estate.

- Trustees have no power (as declared) and must account for the property solely back to the settlor or his creditors.
Shams: what is the consequence of a finding a purported trust to be, in truth a sham?

- Beneficiaries who have received distributions as volunteers may well have to account for same.

- However, sham cannot be asserted against innocent third parties by the shamming settlor (that is, in an attempt to take advantage of his or her own deceit at the expense of an innocent third party): *Carmen v Yates* [2004] EWHC 3448 (Ch); see also *Commissioner of Stamp Duties (Queensland) v Joliffe* (1920) 28 CLR 178 per Isaacs J at 182-184 as now approved in *Byrnes v Kendle* [2011] HCA 26.
**Shams: what does a claimant have to show to establish a sham? What will be evidence of a sham?**

- Sham is an extreme finding by any Court and will always be so regarded.

- The necessary exercise for a claimant is proving intention: this is a question of fact and it is always difficult to prove the necessary intent to deceive simply by reason that evidence of an intent to deceive will, of its nature, generally have to be circumstantial; it is not something most people would, for example, record in writing.

- Subsequent conduct, facts and circumstances (for example, subsequent actions of the parties disregarding the trust declared as in *Minwalla*) may be taken into account (*A G Securities v Vaughan* [1990] 1 AC 417) insofar as they are relevant to determining what was the true intention behind the relevant act or document.
Shams: what does a claimant have to show to establish a sham? What will be evidence of a sham?

- Distinction is to be drawn between a trustee acting inconsistently with the terms of the trust compared with simply being influenced by the settlor.

- Disregarding terms of trust without dishonesty a breach of trust but not sham.

- The Royal Court of Jersey has stated that it would be generally reluctant to enforce a foreign judgment declaring a trust governed by Jersey law to be a sham particularly if Jersey law was not applied by the foreign court: In re Fountain Trust [2005] JLR 359.

- A court will not readily disregard a written document.
Shams: what does a claimant have to show to establish a sham? What will be evidence of a sham?

♦ In Jersey, the Royal Court has also said that it would not readily conclude that a trust said by the settlor to have been established for benefit of her close family did not reflect her true intentions and was a sham: *MacKinnon v Regent Trust Co Ltd* (CA) [2005] JLR 198.

♦ So, what kind of evidence will a claimant need, if he or she is to impeach a purported trust as a sham?
Shams: conclusions and protecting your position as trustee

♦ Objective of claim: recovery against settlor or settlor’s estate

♦ Intent to deceive and joint or common intent

♦ Difficulties of evidence and proof and difficulties in pleading claim in particular including allegation/s of dishonesty (problem particularly stark before disclosure with the consequent risk of a claim being struck out)

♦ Times change? Argument that non-effectiveness the key, not fraud or deceit and the idea of the illusory trust

♦ What, then, should you do as trustee to avoid being found to be a party to a sham (with all the costs and reputational consequences such a finding will bring)?
The first aspect of settlors’ reserved trusts powers: contribution to a finding of sham

- There are two aspects of settlor reserved powers that fall to be considered:
  - *First*, will the existence of such powers contribute to a finding of sham
  - *Second*, do such powers fall within the settlor’s personal property?
Settlors’ reserved trusts powers (1): contribution to a finding of sham

♦ Reserved powers in trusts are not uncommon, and are in no way necessarily inconsistent with a valid trust (including powers to revoke a trust, remove and appoint trustees and direct investments).

♦ The point is expressed neatly in *Lewin* at para 4-25:

“*So long as the trusts are intended to take effect according to their terms, the retention of large powers or weighty influence by a settlor does not itself make the trusts void as a sham. ... A trust is either a sham ... or it is valid and enforceable. There is no third state of affairs between a valid trust on the one hand and a sham on the other.*” (emphasis ours)
Settlors’ reserved trusts powers (1): contribution to a finding of sham

♦ The question therefore comes back to the settlor’s intention: did he intend to create a trust or not?

♦ Part of the evidence answering this question can be whether or not the settlor has retained so many powers and such control over the trust assets that he cannot be said to have divested himself of beneficial ownership; but the mere existence of reserved powers – no matter how extensive - cannot, of itself, impeach a trust’s existence.
Settlors’ reserved trusts powers (1): contribution to a finding of sham

- *Rahman v Chase Bank (CI) Trust Co Ltd* [1991] JLR 103 shows how reserved powers can contribute to a finding of sham.
  - Settlor retained a power (exercisable with the trustee’s consent) to appoint the capital of the trust to any person including himself; and a power (exercisable without the trustee’s consent) to appoint $1/3$ of the trust capital in any 12 month period.
  - Trustee had a power to transfer the capital to the settlor, but in exercising that power, had to have regard “*exclusively to the interests of the settlor*”.

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Settlors’ reserved trusts powers (1): contribution to a finding of sham

- The main administrative powers enjoyed by the trustee could only be exercised with the settlor’s written prior consent.

- The Royal Court of Jersey concluded that the settlor “retained dominion and control over the trust fund throughout his lifetime” and that the settlement was made “to appear to be what it was not”.

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Settlors’ reserved trusts powers (1): contribution to a finding of sham

- The recent Bermudian case *Re the AQ Revocable Trust* [2010] 13 ITELR 260 provides an example of trusts being found “illusory” on the basis substantially of settlor reserved powers.

  - Settlor declared trusts of which he was the sole trustee the terms of which included that the trusts were revocable by the settlor during his lifetime, that he had the right to the entire net income during his life and to such of the capital as he as trustee determined.

  - Subsequently, the settlor married again and made a new will revoking previous wills; certain of the beneficiaries under the new will challenged the trusts on the basis that they were invalid or testamentary in nature and so revoked by the later will.
Settlors’ reserved trusts powers (1): contribution to a finding of sham

- Ground CJ, at 272, held that:

  “... the concatenation of rights and powers in the settlor, when coupled with the fact that he was the sole trustee at the time of the constitution of the trusts, rendered this trust illusory during his lifetime. ... the cumulative effect of the trust documents, when taken with the de facto situation, means that the settlor as trustee could not effectively be called to account during his lifetime.” (emphasis ours)
Reserved powers: the current statutory provisions as to reserved powers and shams

- In response to cases such as these, various jurisdictions have introduced legislation providing that reservation of extensive powers under a trust shall not impeach or render void a trust: see, for example, art 9A Trusts (Jersey) Law 1984, section 41X in the new Part IVD of the Trustee Ordinance in Hong Kong (cf's 90(5) Trustee Act (Singapore) which is limited to expressly countenancing reservation of powers of investment or asset management functions).

- What all such provisions have in common is that they are all state that a reservation or grant of a power or beneficial interest in trust property shall not affect the validity of/invalidate a trust.
Reserved powers: the current statutory provisions as to reserved powers and shams

- But, how useful are these provisions, given the question of whether a trust is a sham is answered primarily by the settlor’s intent, not the presence of reserved powers in a settlement?

- Extensive reserved powers may lead to difficulty in determining whether the settlor, or trustee, is in control of the trust estate.

- As we have seen, while determining the settlor’s intent is paramount in determining whether there is a sham, the parties’ behaviour subsequent to the purported declaration of trust may be very relevant evidence in determining that intent.
Reserved powers: the current statutory provisions as to reserved powers and shams

- Likewise, where there are immovable or frozen trust assets in a jurisdiction outside that of the purported trust’s governing law, it is by no means a given that the former jurisdiction will apply the law of the latter jurisdiction in determining what is considered to be the true ownership of the relevant assets.

- This may be so notwithstanding any statutory assertion in the purported governing law that any question of a trust’s validity is governed only by that purported governing law e.g. art 9(1) and (2) Trusts (Jersey) Law 1984 which provides that such questions are to be determined only by reference to Jersey law; cf s 41Y Trustee Ordinance (Hong Kong) and ss 90(1) and (2) Trustees Act (Singapore).
Reserved trusts powers (2): the risks of a settlor’s
reserved trust powers as settlor’s personal property

✦ The second aspect of reserved trust powers of particular interest to trust litigators is
the possibility of such a power or powers being found to be part of a settlor’s
personal estate.

✦ In particular, while s 43(3) Bankruptcy Ordinance (Hong Kong) excludes property
“held by the bankrupt on trust for any person”, s 43(4) provides that:

“References in this Ordinance to property, in relation to a bankrupt,
include references to any power exercisable by him over or in
respect of property except in so far as the power is exercisable over or in
Reserved trusts powers (2): the risks of a settlor’s reserved trust powers as settlor’s personal property

respect of property not for the time being comprised in the bankrupt’s estate and cannot be so exercised for the benefit of the bankrupt” (emphasis ours).

♦ See, in exact same terms, ss 283(3) and (4) Insolvency Act (England & Wales)

♦ Consider also s 78 Bankruptcy Act (Singapore) which provides that the property of the bankrupt divisible among his creditors includes the capacity to exercise and to take proceedings for exercising all such powers in or over or in respect of property as might have been exercised by the bankrupt for
Reserved trusts powers (2): the risks of a settlor’s reserved trust powers as settlor’s personal property

his own benefit at the commencement of his bankruptcy or before his discharge”; the definition of “property” includes things in action/obligations “whether present or future or vested or contingent, arising out of or incidental to, property”.

❖ The test: whether a power cannot be exercised for the sole benefit of the settlor. That is, is the relevant power a personal or beneficial power enjoyed by the settlor for his benefit alone?

❖ For example, a power of revocation vested in settlor the exercise of which returns the relevant trust property to the settlor must be intended to be exercisable for the settlor’s benefit and thus is a beneficial power.
Reserved trusts powers (2): the risks of a settlor’s reserved trust powers as settlor’s personal property

- The key case is *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Co (Cayman) Ltd* (2011) 14 ITELR 102 where the question was whether receivers could and should be appointed over a judgment debtor’s power of revocation of certain trusts.
  - In 1999 D settled $US24 million into trusts governed by Caymans law.
  - In November 2001, a Turkish judgment for $US30M was given against D personally

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Reserved trusts powers (2): the risks of a settlor’s reserved trust powers as settlor’s personal property

- TMSF acquired the right to enforce the judgment against D and then obtained a personal judgment for $30M against him in the Caymans (by suit there on the earlier judgment). D was subsequently declared bankrupt in Turkey.

- The trusts contained a power reserved to D as follows:

  “This Trust may be revoked, amended, varied or altered in any manner whatsoever from time to time and at any time by the Settlor by deed and delivered to the Trustees ... .”

- TMSF sought the appointment of receivers (under statute) by way of equitable execution over this power and orders that D assign the powers to the receivers, with authorisation to exercise the power to revoke the trusts and vest the relevant assets in the receivers.
Reserved trusts powers (2): the risks of a settlor’s reserved trust powers as settlor’s personal property

- Privy Council judgment delivered by Lord Collins:

“The powers of revocation [here] are such that in equity, in the circumstances of a case such as this, [D] can be regarded as having rights tantamount to ownership. The interests of justice require that an order be made in order to make effective the judgment of the Cayman court recognizing and enforcing the Turkish judgment.

There is no invariable rule that a power is distinct from ownership. Nor ... is there an invariable rule that any departure from the distinction between power and property is effected solely by legislation” (at 119-120).
Reserved trusts powers (2): the risks of a settlor’s reserved trust powers as settlor’s personal property

- “[i]n the present case the power of revocation cannot be regarded in any sense as a fiduciary power ... . The only discretion which [D] has is whether to exercise the power in his own favour. He owes no fiduciary duties. As has been explained, the powers of revocation are tantamount to ownership” (ibid).

- It was “unnecessary to decide the question ... whether the court has jurisdiction, instead of ordering the delegation of the powers of revocation to the receivers, to order [D] to revoke the trusts, with the result that he would have substantial assets of which the receivers could take possession” (ibid) but it is clear that the answer would have been “yes” (see at 121).
Reserved trusts powers (2): the risks of a settlor’s reserved trust powers as settlor’s personal property

- *TMSF* plainly shows how the reservation of beneficial powers to a settlor may make a trust’s assets vulnerable to claim by a settlor’s creditors.

- In essence, D’s powers to revoke the trust were seen by the Court as “*tantamount to ownership*”. A settlor’s general power to appoint trust assets is obviously no different in nature (indeed the Cayman Court of Appeal thought that “[a] power of revocation is merely a narrow power of appointment”: (2009) 13 ITELR 1 per Vos JA at 17).

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Reserved trusts powers (2): the risks of a settlor’s reserved trust powers as settlor’s personal property

- Addressing the problem:
  - Releasing powers in existing trusts? Have a protector hold the powers?
  - Settlor’s acceptance of not having the powers or otherwise settlor’s acceptance (in writing!) of risks of having the powers.
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