The Offshore Tax Planning Review

A SHORT SURVEY OF RECENT DEVELOPMENTS IN TRUST LAW IN OFFSHORE JURISDICTIONS

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This article attempts to set out a framework for analysing the trust laws of different jurisdictions, and to discuss some of the recent developments in offshore jurisdictions. It is neither possible nor desirable in a relatively short article to attempt to discuss every trust jurisdiction around the world. Instead, this article aims to establish a matrix from which one might determine which jurisdiction offers particular features in its trust law.

The focus of this article is on trust legislation in each jurisdiction. It is, of course, neither feasible nor desirable to attempt to compare the competence of individual trustees, trust corporations or legal services in different jurisdictions, although these are all vital factors in the selection of suitable jurisdictions. Nor does this article examine the tax rules or exchange control rules in each territory: the focus is exclusively on trust legislation.

Looking from the point of view of trust legislation, it is possible initially to divide the world into four parts. These four parts are: civil law states without a trust law, civil law states with a trust law, common law states with unreformed trust laws, and common law states with a reformed/revised/codified trust law. In this article I shall say something about each group.

1 Civil Law Jurisdictions Without a Trust Law

It is trite to say that one cannot govern a trust by the laws of these jurisdictions. However, increasingly often, settlors or beneficiaries are residents or nationals of these jurisdictions or trust assets are located in these jurisdictions.

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The principal comment to be made with respect to these jurisdictions is to note the impact of the Hague Convention on the Law applicable to Trusts and on Their Recognition[2]. This Convention does not introduce the trust as such into civil law jurisdictions. It has much more limited aims, and rather limited consequences. Firstly, it provides a framework of common rules for determining the governing law of a trust[3]. Secondly, it specifies the minimum consequences of the recognition of a trust. These are: that the trust property constitutes a fund separate from the property of the trustee; and that the trustee may sue or be sued and take official acts as trustee[4]. This addresses one of the major perceived problems of trusts in civil law countries; that these countries have no property law concept of a trust and that the assets contained in the trust fund are regarded as available to satisfy the claims of the trustee's creditors.

The Hague Convention will enter into force in January 1992. Article 30 of the Convention provides that it will enter into force three months after the deposit of instruments of ratification by three states. The United Kingdom ratified in 1989, and Italy in 1990; then, on 17 October 1991, Australia signed and ratified it, thus bringing the Convention into operation.

The United Kingdom has enacted the terms of the Convention into domestic law through the Recognition of Trusts Act 1987. In addition, the Recognition of Trusts Act 1987 (Overseas Territories) Order 1989[5] extends the Convention and the Act to the jurisdictions listed in Schedule 2 of the Order: these are Bermuda and the British Virgin Islands, the Falkland Islands and South Georgia, Saint Helena, the British Antarctic Territory, and the Sovereign Base Areas of Akrotiri and Dhekelia. The United Kingdom Act may also be extended to any colony, the Channel Islands, and the Isle of Man[6]. Interestingly, the Isle of Man has enacted its own Recognition of Trusts Act in 1988, rather than proceed by an extension of the UK Act.

The Convention is of somewhat limited effect, and it may well be that its major indirect effect will be to provide an occasion for offshore jurisdictions to re-examine their trust laws and introduce some of the reforms which are mentioned below.

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2 For a rather good description of the Convention and its effect see D. Hayton; "Trusts in an International Context" in Tolley's Tax Havens (1990).

3 Articles 6 - 10 of the Convention.

4 Articles 11 and 12 of the Convention.

5 S.I. 1989 No. 673.

6 Recognition of Trusts Act, 1987, s. 2(2).

2 Civil Law Jurisdictions with a Trust Law

A small number of civil law states have seen the light and recognised the joy of trust law. One of the earliest was Japan which adopted a trust law - the *Shintaku Ho* - in 1922. The Japanese trust law was largely forgotten, however, until 10 or 15 years ago and has only recently come into use. Rather better known is Liechtenstein, which adopted a trust law in 1926. Other civil law countries which have followed suit include Costa Rica and, more recently, Panama. Monaco enacted legislation in 1936 which recognises the validity of a trust if the trust is valid under the law of the settlor's nationality. Most recently, France is considering the addition of several articles to the *Code Civil* providing for "*la fiducie*". The proposal has been delayed due to problems concerning the taxation provisions, but is likely to be finalised next year.

Though the laws of these civil law countries are sometimes used in practice for the formation of a trust, there are some difficulties with this approach. Most of those who are familiar with English trust law would probably agree that one has to have studied the history and the rules of equity before you can really understand trusts. There must be a worry that a judge, trained in a civil law system, might have some difficulty in grappling with the concept of a trust if the dispute were to come to court[7].

But with this caveat about the judiciary, those civil law countries which have a trust law do have some attractive features. Liechtenstein, for example, has never been troubled by the rule against perpetuities, nor the rule against excessive accumulations, nor the rule that non-charitable purpose trusts are void. Article 931 of the Liechtenstein law[8] also allows the creation of trusts in Liechtenstein governed by a foreign law, and this facility is known to be used in practice.

3 Common Law States with Unreformed Trust Laws

Under this category one can place those jurisdictions whose trust laws are fundamentally similar to, though not necessarily identical with, the laws of England and Wales. Examples of such jurisdictions are Hong Kong and the Isle of Man. They have a Trustee Act or Ordinance based generally on the English Trustee Act of 1893 or 1925. Most also have a Variation of Trusts Act, and a Perpetuities and Accumulations Act which allows the use of a perpetuity period of a number of years not exceeding 80 and provides for "wait and see".

There are two particular comments one may make on this group of jurisdictions. Firstly, the United Kingdom has clearly been the source of inspiration for most developments in trust law in the past. However, the United Kingdom can no longer really be classed as a leader in trust law developments. For example, in 1983 the Law Reform Committee in their 23rd Report on the "Powers and Duties of Trustees" listed

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7 For an interesting discussion of how trusts have been viewed by the Swiss courts, see M. Roy Saunders; International Tax Systems and Planning Techniques (looseleaf), para. B6.12.6 discussing the Swiss Federal tribunal case of *Harrisson C. Credit Suisse* (R.O. 96 11 79).

8 The *Personen und Gesellschaftsrecht.*

several defects in existing English trust law and recommended amending legislation. At present, there is no sign of such legislation on the horizon. Instead, the source of inspiration for innovations in trust law has now moved to the offshore jurisdictions[9]. In particular, it is the private sector in these offshore jurisdictions, arm in arm with government, which has been proposing most recent developments in trust law.

The second comment one may make about those common law countries with unreformed trust laws is to warn that their trust law may have acquired certain inherited defects from English trust law. A few such defects may be mentioned here.

Many readers will be aware of the difficulty which arises where UK-resident trustees resign in favour of a trust corporation resident in an offshore jurisdiction. The United Kingdom trustees will only be discharged if the trust corporation falls within the narrow definition of "trust corporation" in the Trustee Act 1925[10]. This legislation is, however, also adopted in the Isle of Man[11] and Hong Kong[12].
Secondly, there is a serious problem in England as to whether trustees can delegate to an investment manager the power to decide on the purchase and sale of investments (as opposed to merely advising the trustees on suitable investments)[13]. Under section 23 of the Trustee Act, subject to the terms of the trust, trustees may not delegate the discretion to buy or sell investments to an agent. Such a delegation would be void and give rise to a potential liability for breach of trust. However, section 25 of the Trustee Ordinance of Hong Kong repeats section 23 of the English Act, as does section 21 of the Isle of Man Act. Most of these difficulties can be cured by a well drafted trust deed, but they need to be recognised and avoided by the draftsman.

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9 For a general discussion of the defects of the English trust law, see D. Hayton; "Developing the Law of Trusts for the Twenty-First Century" (1990) 106 L.Q.R. 87.

10 By virtue of sections 37(1)(c) and 68(18) Trustee Act 1925, and see P. Matthews; Emigrating Trusts: exporting a UK Resident Trust (Key Haven, 1990), section 9.

11 Ss. 36(1)(c) and 65(21) Trustee Act, 1961.

12 Ss. 38(1)(c) and 2 Trustee Ordinance (Cap. 29).

13 Cf. D. Hayton; "Developing the Law of Trusts..." p. 88 et seq.

4 Common Law Jurisdictions with Reformed/Revised/Codified Trust Laws

In the matrix of jurisdictions, this part of the world can be divided into three sub-divisions:

(a) Those jurisdictions whose trust law is basically the received law, but with amendments;

(b) Those jurisdictions which have codified their trust law;

(c) Those jurisdictions which have adopted separate legislation for international trusts.

Each of these categories can be illustrated by a jurisdiction; the jurisdiction chosen is not necessarily the best of the class, but simply an illustration.

(a) Jurisdictions which have amended their received trust law

A good example here is Bermuda. The basic legislation is the 1975 Trustee Act, which is based on the English Act of 1925. To this they have added in recent years the Trusts (Special Provisions) Act of 1989 and the Perpetuities and Accumulations Act, also of 1989.

The Special Provisions Act has four separate purposes. Firstly, it introduces a definition of trusts, and rules concerning the governing law of trusts, which owe a great deal to the Hague Convention. As I have mentioned, the Convention has been extended to Bermuda.

Secondly, the Special Provisions Act introduces very limited asset protection provisions. Section 11 of the Act provides that a Bermudan Court shall not set aside a trust -

> "pursuant to the law of another jurisdiction in respect of:
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> (a) the personal and proprietary effects of marriage;
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> (b) succession rights, testate and intestate, especially the indefeasible shares of spouses and relatives; or
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> (c) the protection of creditors in matters of insolvency,
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> unless the law of Bermuda has corresponding laws or public policy rules".

It appears to be recognised in Bermuda that this provision is both relatively conservative so far as asset protection legislation goes, and is rather vague - deliberately so. Other jurisdictions, both in this category and others, have adopted bolder asset protection rules[14]. It is doubtful, however, whether any jurisdiction has completely cracked the asset protection problem yet. We will not know this for certain however, until the question is resolved through the courts.

The third change in the Special Provisions Act is the introduction of a facility for creating valid, non-charitable purpose trusts[15]. Purpose trusts are, of course, generally void under the English common law unless established for a charitable purpose[16]. The reason for the invalidity is that they lack beneficiaries who can approach the courts to enforce the trust. Bermuda has followed Nauru, Ontario, and some of the states of the United States in providing for the creation of non-charitable purpose trusts, limited to a maximum term of 100 years. The condition for establishing such a trust is that there must be a "designated person" - a barrister, attorney, chartered accountant or a trust corporation - appointed to enforce the trust.

The final feature of the Special Provisions Act was to introduce a schedule of standard powers of trustees which could be incorporated into a trust by reference, rather in the manner of Table A of the Companies Act 1948. This is a useful facility which could simplify the drafting of trust deeds (though I doubt if it will).
The other amendment to the received trust law in Bermuda is the Perpetuities and Accumulations Act which is similar to the English Act of 1964, but with a 100 year maximum perpetuity period in place of 80 years. Whether the extension of the perpetuity period from 80 years to 100 years makes a great deal of difference to settlors is a question one might debate. What is helpful, however, is the ability in many jurisdictions to accumulate income throughout the perpetuity period.

This is perhaps an appropriate point to mention that there are a small number of jurisdictions which have abolished the rule against perpetuities entirely, examples are Manitoba, Nauru, and the Turks and Caicos Islands (with respect to trusts governed by Turks and Caicos law). The bald abolition of the rule against perpetuities raises one worry. The origins of the rule were, inter alia, to prevent land from becoming subject to restrictions on its sale over generations and therefore becoming effectively inalienable[17]. This objection can, it seems to me, be raised today with respect to all assets, including shares and personal property. It seems therefore that there is a danger that perpetual trusts would not be recognised in other jurisdictions on public policy grounds. It should be noted that Article 18 of the Hague Convention allows the courts of a jurisdiction to refuse recognition of a trust which is manifestly contrary to public policy. At the turn of the century, the Privy Council in the case of

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14 For a general discussion of asset protection trusts, see Milton Grundy and John Briggs; Asset Protection Trusts (Key Haven, 1990).

15 Ss. 12 - 16 of the Act.

16 See, for example, *Re Astor's S. T.* [1952] Ch. 534.

17 See Hanbury & Maudsley; Modern Equity (13ed., 1989), p.327.

Abul Fata v Russomoy Dhur Chowdhury[18] held an Islamic Law *Wakf* void on the grounds that it offended the rule against perpetuities and hence the rules of public policy. Where a perpetual trust owns property situated in a jurisdiction which retains the rule against perpetuities, there is always the danger that the trust might be held void.

Aside from Bermuda, other jurisdictions in this category are the Bahamas[19], the Cayman Islands[20], Gibraltar[21] and, the most recent recruit, the British Virgin Islands[22].

(b) Jurisdictions which have codified trust laws:

This development started with the Trusts (Jersey) Law of 1984, which was amended in 1989[23]. The 1984 Jersey Law was copied with amendments in Guernsey, and has most recently been used as the basis for the Turks and Caicos Trusts Ordinance.

What is interesting is that the motivation for codifying the trust law was different for these territories. For Jersey and Guernsey, the motive was to end the uncertain theoretical basis for the law of trusts in those jurisdictions. The motivation in the Turks and Caicos Islands appears to have been quite different - simply to attract foreign settlors to use the facilities of the Islands. This pattern of codifying trust laws may well be the fashion of the future in offshore jurisdictions.

The three codified trusts laws have this in common. The trust laws distinguish between trusts governed by the law of that jurisdiction and foreign trusts. Foreign trusts are dealt with relatively briefly: they are to be recognised, enforced and are amenable to the jurisdiction of the local court. The bulk of each code deals with trusts the proper law of which is the law of that jurisdiction. Here, the code sets out the law in relatively standard and familiar terms. There are certain special features though. Jersey and Guernsey both have 100 year perpetuity periods and allow accumulation of income throughout this perpetuity period. The Turks and Caicos

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18 (1894) L.R. 22 I.A. 76.

19 The relevant legislation is the Trustee Act of 1893, amended by the Trusts (Choice of Governing Law) Act, 1989 and the Fraudulent Dispositions Act, 1991.

20 The relevant legislation is the Trusts Law, 1967 together with the Trusts (Foreign Elements) Law, 1987 and the Fraudulent Dispositions Law, 1989.

21 With the Trustee Ordinance, and the Perpetuities and Accumulations Ordinance, 1986, and the Bankruptcy Amendment Ordinance, 1990.

22 With the Trustee Act (Cap. 260) and the Trustee (Amendment) Act, 1991.

23 The 1989 amendment abolishing the rule *donner et retenir ne vaut rien.*

Islands have abrogated the perpetuity rule for Turks and Caicos trusts. The Turks and Caicos Ordinance also has an asset protection provision tagged on as the last section of the Ordinance; it appears to have been added as an afterthought, and there may be doubts whether it is effective.

One note of warning might be sounded on all three codified jurisdictions. The codes all contain a similar provision rendering the directors of a trust corporation personally liable as guarantors for any breach of trust if the trust corporation is resident in or carries on business in that jurisdiction *or is the trustee of a trust governed by the law of that jurisdiction*[24]. Thus if a Gibraltar trust corporation accepts a trust governed by the law of Jersey, the directors of the trust corporation are personally liable - as least in the courts of Jersey.

(c) Jurisdictions which have enacted separate legislation for offshore or international trusts

It might be said of these jurisdictions that they have recognised that trust law is a branch of the offshore finance industry. An example here is Malta, whose Offshore Trusts Act of 1988 applies to trusts provided the settlor and all the beneficiaries are non-resident and the trust fund does not include any immoveable property situated in Malta[25]. The trust must be registered with the International Business Authority, and is not effective in Malta until registered[26]: this requirement of registration may be a significant competitive disadvantage. The Maltese Act does have an advantage, however, in that the tax and exchange control exemptions for the trust are set out in the legislation and guaranteed[27].

One minor note on the Maltese legislation is to point out that, subject to the terms of the trust, it appears to be a criminal offence for the trustees to disclose any details of the trust administration to the settlor[28]; this may or may not be an advantage for trusts!

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24 S. 57 of the Turks and Caicos Ordinance.

25 S. 6(2) of the Act.

26 S. 43(1).

27 Ss. 44, 45 and 50.

28 S. 29(3).

The trust legislation of other jurisdictions which fall into this category also displays some interesting features. The Cook Islands legislation[29], for example, contains the only statutory definition of protectors, as far as I am aware[30]. It also contains a reversal of the narrow rule in *Saunders v Vautier*[31], that is, the rule that beneficiaries of full age can terminate a direction to accumulate income[32]. The Cook Islands legislation contains a provision declaring a trust valid even though it would be invalid according to the law of the settlor's domicile, residence or place of current incorporation[33]. It also contains extensive asset protection provisions[34].

The Nauru legislation is short and revolutionary. Despite the title of the Act - The Foreign Trusts, Estates and Wills Act, 1987 - it does not say that it is limited to foreign trusts, but it does not apply to trusts of land in Nauru. The rule against perpetuities is abolished[35]. Purpose trusts in Nauru can be perpetual[36] and there is no restriction on the period of accumulation of income[37].

Cyprus has been considering an International Trust Law for several years. A draft is now finalised, and is likely to be enacted within a year. The new law builds upon existing Cyprus legislation, but applies to trusts where the beneficiaries are non-resident and the assets are situated outside Cyprus. The legislation will provide for a 100 year perpetuity period, and accumulation throughout that period. There are also to be asset protection provisions, and wide investment powers. The new legislation will provide for the variation of trusts - which is not presently provided for under Cyprus law. The law does require that there be at least one Cyprus-resident trustee, and requires a registration fee for each trust - which may prove a disincentive.

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29 International Trusts Act, 1984.

30 S. 3(2) of the International Trusts (Amendment) Act, 1989.

31 (1841) 4 Beav. 115.

32 S. 10.

33 S. 5(2).

34 International Trusts (Amendment) Act, 1989, s. 6, inserting several new sections into the principal Act.

35 S. 3.

36 S. 6.

37 S. 4.

Conclusion: the "ideal" trust jurisdiction

A survey, albeit brief, of offshore trust jurisdictions might have been expected to end with a recommendation of the *ideal* trust jurisdiction. However, in my view, there is no ideal trust jurisdiction. I suggest this for two reasons. Firstly, different trusts create different problems, and different jurisdictions offer different solutions to these problems. It is a matter of matching the jurisdiction to the settlor's needs and, hopefully, the matrix set out in this article may help in this task.

A second reason for suggesting that there is no such thing as an ideal trust law is that it is not yet clear that any jurisdiction's trust law offers all the features that one might like to look for. An ideal trust law would have long perpetuity and accumulation periods, provisions for purpose trusts, a schedule of powers and duties of trustees, effective asset protection provisions, and several other features clarifying the existing law of trusts.

In the final analysis, the terms of a jurisdiction's trust legislation is not necessarily paramount when selecting a trust jurisdiction. Frequently, the most important factor in choosing a jurisdiction is the local trustees: are they efficient, amenable, accessible, reasonable, removable, and not exorbitant. So far as trust legislation is concerned, it is primarily important that the trust law be clear, accessible, settled, and not contain any hidden traps for the unwary.