

SPECIAL SITUATIONS: FOREIGN TAXATION AND TRUSTS AND ESTATE PLANNING

Anthony Dessain and Michael Wilkins¹

1 Introduction

The Jersey insolvency regime may principally arise

- (a) under the Désastre Law;
- (b) under the Companies Law; or
- (c) under a foreign created insolvency procedure.

An insolvency may have an effect on taxation and trust planning. The tax consequences will be addressed first and the impact on trusts second. In both cases it is necessary to establish certain primary rules and then see how they are affected by an insolvency.

1.1 On Tax

The *first tax related rule* concerns enforcement of foreign taxes (see 2.1 – 2.3 below).

The *second tax related rule* concerns confidentiality (see 2.4 – 2.6 below).

The *third tax related rule* concerns how domestic tax claims are treated in an insolvency (see 2.7 below).

¹ This article is adapted from an appendix to Anthony Dessain and Michael Wilkins's book "Jersey Insolvency and Asset Tracking" published by Key Haven Publication PLC.

1.2 On Trusts and Trust Planning

The *first trust related rule* is that an insolvency of a trustee or a beneficiary will not create a claim on trust assets. If trust assets are wrongly seized, the trustees may be able to intervene. This however would depend on whether trusts are recognised in the country where the assets have been seized (see 3.1 below).

The *second trust related rule* is that while a company can be insolvent a trust cannot be (see 3.4 below).

The *third trust related rule* concerns an attempt by a liquidator or the Viscount to set aside transactions or even the trust itself or to obtain information about them. In an insolvency the powers to obtain information and documents are often greater than under the general law (see 3.5 below).

2 Tax

2.1 The First Tax Related Rule

The first tax related rule is that foreign revenue claims are unenforceable.

Claims on behalf of a foreign state to recover taxes due under its laws are unenforceable both in the Courts of England and Jersey (including revenue debts due in Commonwealth states). (See: *Government of India v Taylor* [1955] AC 491 HL.) The English Court of Appeal in *QRS 1 ApS and Others v Frandsen* (1999) 1 WLR 2169 confirmed this principle and held the rule was not overridden by the Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters of 1968.

The rule applies to both direct and indirect enforcement of revenue debts. In the *Government of India* case the House of Lords also held that the liabilities for which a liquidator is required to provide in the liquidation of a company do not include claims unenforceable in the English courts and therefore that a tax claim was not such a liability.

The Royal Court has clearly adopted the *Government of India* principle and, indeed, the underlying reasons for it. See: *In the matter of Tucker* 1987-88 JLR 473. In that case, the Royal Court specifically approved the words of Lord Denning MR in *Attorney General of New Zealand v Ortiz* [1984] AC 1 at p.20 when he said:

“No one has ever doubted that our courts will not entertain a suit brought by a foreign sovereign, directly or indirectly, to enforce the penal or revenue laws of that foreign state. We do not sit to collect taxes for another country or to inflict punishment for it.”

See *Tucker* at p.491.

In *Tucker* there was no claim for payment of tax payable in England. An English trustee in bankruptcy sought an order from the Royal Court to act in aid of an English High Court Order. The trustee in bankruptcy sought to ascertain what assets were undeclared by the bankrupt and which were held in offshore trusts. The High Court Order had been made under Section 122 of the now repealed Bankruptcy Act 1914 (of the UK). It sought a private examination of, and the production of documents by, a Jersey advocate having knowledge of the trusts.

The Royal Court considered whether an examination of witnesses with or without documents amounted to an indirect attempt to enforce a foreign revenue claim (p.492). After some considerable reasoning it concluded there was no valid distinction (p.501). One of the reasons given was that double tax treaties normally provide for the agreed exchange of information and such a treaty existed between Jersey and the UK.

It is interesting to compare that under Article 3 of the Judgments (Reciprocal Enforcement) (Jersey) Law 1960 specified foreign judgments will only be enforced (in Jersey) where a sum of money is payable – but that sum is to be "not for taxes or other charges of a like nature or in respect of a fine or other penalty". *The QRS 1 ApS* case is interesting in this regard (See also: Enforcement in Jersey of Foreign Judgments at 2.8.2 and Appendix 1).

Their Lordships in *Government of India* also approved the "admirable" Irish decision of *Buchanan v McVey* [1955] AC 516. That case involved indirect enforcement and has been followed in many jurisdictions. In that case all the proceeds of litigation would have gone to the Scottish Revenue. It was held that the sole purpose of the action was to collect the Scottish Revenue's debt. This approach was approved in *Ayres v Evans* (1981) 56 Fed LR 235 (Federal Court of Australia).

2.2 Exception to the First Tax Related Rule

An exception to the first tax related rule applies where there is an insolvency and other creditors.²

Why is the position different if there is an insolvency? *Tucker*, of course, involved an application under the then applicable English Bankruptcy Act. Like *Buchanan*, *Tucker* on its facts at the time of the hearing involved only one creditor – a foreign revenue authority. Where, however, there are a number of creditors the position may differ. In *Ayres v Evans* about 53% of the claims were due to the New Zealand Revenue. The other claims were ordinary civil claims. The Australian court held that:

“The rule that the Courts will not act to enforce a revenue claim by another State does not apply where a liquidator or official assignee seeks to get in property which will in due course benefit ordinary creditors as well as the Revenue. It is only if the Revenue is the only claimant that the Government of India rule will apply.”

In giving the decision of the Royal Court in *Tucker*, the Bailiff, Sir Peter Crill with “some reluctance” rejected the request for assistance as there were no non-revenue claims outstanding at the date of the hearing before the Royal Court.

The issue went one stage further *In the matter of Robert Jeremy Bomford, a bankrupt* JU 2002/164; 2002 JLR N34. There the Royal Court granted assistance under Article 48 (after 1st July 2005 Article 49) of the bankruptcy Law where a trustee in bankruptcy applied for such relief and the English Revenue’s claim amounted to 90% of claims but there were three or four other creditors. The Court concluded that it would be unfair to those creditors if the Court did not render assistance merely because the Revenue was a more substantial creditor. The decision was, however, not the subject of argument, nor was any party convened. (See further: Recognition and Universality at 6.2 and its footnote 2.)

Notwithstanding the above, an English judgment in favour of a liquidator of an insolvent English company against a defaulting director can be registered under the Judgments (Reciprocal Enforcement) (Jersey) Law 1960 (See: Enforcement in Jersey of Foreign Judgments at 2.8.2 and Appendix 1) – even where a substantial element of the claim is due in respect of tax in the United Kingdom. This applies even where the

² That is, creditors in addition to a foreign revenue authority.

Revenue had petitioned for the winding up: *Le Marquand and Backhurst v Chiltmead Limited (by its Liquidator, Halls)* 1987-88 JLR 86. In that case the UK Revenue and UK Customs and Excise were owed 97% of all claims. The Royal Court referred to *Ayres v Evans* before concluding that the liquidator was making the claim in the capacity of liquidator and not as a front man or agent for the Inland Revenue. He was not embarking on a revenue-obtaining exercise for the Inland Revenue.

The decision in *Le Marquand and Backhurst v Chiltmead Limited* was also made in the light of Article 3(2)(b) of the 1960 Law which provides that it is not possible to register a judgment for the recovery of “money payable in respect of taxes or other charges of a like nature.”

2.3 Should trustees pay an unenforceable tax claim?

The position generally then, is that foreign taxes are not enforceable in Jersey. Jersey trustees should not generally pay unenforceable debts. To do so is in effect to enter into a gratuitous transaction, one not at first sight in the interests of beneficiaries. Trustees therefore run the risk of being in breach of trust in making any such payment. The position in *Ayres v Evans* was considered and distinguished in *Clapham (as Attorney of Midland Bank Trust Company Limited) Executor of the Will of E L Le Mesurier (née Le Brocq) v F D Le Mesurier* 1991 JLR 5.

In *Clapham v Le Mesurier* the deceased was a Jersey lady domiciled in England with property both in Jersey and England. Her English will named a bank as executor and the executor appointed the plaintiff as its attorney. The defendant was her eldest son and the principal beneficiary. He opposed the grant of Jersey probate to the English bank as the effect would be to remove the Jersey estate to England where it would be used exclusively to pay off revenue debts. However, if the defendant was granted probate in Jersey the Jersey estate would fall to the family. The Royal Court held that the defendant should be granted probate. The plaintiff's claim was in effect an indirect attempt to enforce foreign revenue laws in Jersey and this would not be permitted.

Although not affected by insolvency *per se*, the rule against enforcing a foreign revenue claim in relation to a trust has been considered in a number of cases. Some of these were summarised in *Clapham v Le Mesurier*, above. The general rule is that trustees should not pay unenforceable claims unless

- (1) the trust deed authorises it and it is right to do so; or

- (2) the Royal Court approves the payment.

Trustees of a Jersey or non-Jersey proper law trust may apply to the Royal Court for appropriate directions³ under Article 51 (prior to 1st July 2005 Article 47) of the Trusts Law. The Royal Court has approved payment to a foreign tax authority where:

- (1) there was no clause authorising payment but where it was in the general interest of the beneficiaries and to avoid a possible increased assessment (*In re Marc Bolan Charitable Trust* (1981) JJ 117);
- (2) there was a clause authorising payment and:
- (a) it was in the interests of the beneficiaries whose interests were paramount (*In re X's settlements* 1994 JLR N6); or
- (b) the settlor intended that the beneficiaries should take free of liability to tax in the foreign country – *Abdel Rahman v Chase Bank (CI) Trust Co Limited and Five Others* (1984) JJ 127 CA; or
- (c) if non-payment would breach foreign law and there was a serious prospect of penalties or the danger of liability being enforced against trustees personally in the foreign country (*Re Walmesley* (1983) JJ 35).

2.4 The Second Tax Related Rule

The second tax related rule concerns the duty of confidentiality and the limited ability of foreign revenue authorities to obtain information and documents.

There are no Jersey statutory provisions relating to banking secrecy or other fiduciary relationships.

However, there are positions of office which require a statutory oath of secrecy to be taken by the office holders. See: the Income Tax (Jersey) Law 1961, as amended, and the Social Security (Jersey) Law 1974.

³ See footnote 95 at 5.12 for the approach to be adopted.

In the matter of the Representations of McMahon and Proberts 1993 JLR 35; *McMahon and Proberts v Attorney General* 1993 JLR 108, the Royal Court expressly approved the English case of *Tournier v National Provincial and Union Bank of England* [1924] 1KB 461 which sets out the duty of confidentiality between a bank and its customer and the limits of that duty. That duty also applies as between lawyers or accountants or stockbrokers and clients and generally all professional persons.⁴

In *Citibank (Channel Islands) Limited and Others v Jersey Evening Post Limited and Another* (1990) JU 125, on behalf of the Royal Court, the Bailiff, Sir Peter Crill, spoke of this duty in the insular context as follows:

“It cannot be said too often that the Island’s success in financial circles depends on the strictest confidentiality being observed by all to whom confidences are given.”

2.5 First Group of Exceptions to the Second Tax Related Rule

There are a number of exceptions to confidentiality, some statutory and some arising from the common law. The statutory kind fall into groups – those dealing with an insolvent situation; those dealing with civil claims; those dealing with general criminal proceedings – for example, the Proceeds of Crime (Jersey) Law 1999 – and those of a regulatory kind. All these could involve a tax issue. There is another group of statutes dealing with specific criminal conduct such as drug trafficking, terrorism, and insider dealing.

2.5.1 At Common Law

The common law exceptions to confidentiality concern freezing and disclosure orders made by the Royal Court to enable justice to be done. These latter categories are not so likely to be relevant to tax issues.

⁴ In the case of *Viscount and PricewaterhouseCoopers v Attorney General* 2002 JLR 268, the Royal Court considered (e.g.) whether there is a special public interest in respecting the confidentiality of communications between clients of a trust company *en désastre* and the Viscount. The Court concluded that the public interest in respecting the confidentiality of such communications is no more or less than that which existed in communications between such clients and the directors of the trust company before it was declared *en désastre*. In *Acturus Properties and 47 Others v HM Attorney General* 2001 JLR 43 the Royal Court had earlier decided, *inter alia*, that when the Attorney General issues notices requiring the provision of information under the Investigation of Fraud (Jersey) Law 1991, the decisions giving rise to the notices are subject to judicial review; however a presumption of regularity applies to the exercise of the Attorney General’s powers under the Law.

As said, in *Tucker* the Royal Court held that an examination of witnesses with or without documents amounted to an indirect attempt to enforce a foreign revenue claim. *Tucker* represents the current law in Jersey at this time. However, the subsequent English case of *Re State of Norway's Applications* (Nos 1 & 2) [1989] 1 All ER 745 HL could have a persuasive effect on the *Tucker* decision.

In that case, the House of Lords held that:

- (1) A request by the State of Norway to the English Court to examine two London bankers on whether a deceased Norwegian national's estate should be liable to pay Norwegian taxes was permissible in that such a request was a civil or commercial matter. This was the case as under Norwegian law the request was a civil matter as opposed to a criminal matter. It was not a public but rather a private matter. It was also a civil matter as opposed to a criminal matter under English law.
- (2) The duty to give evidence arose as
 - (a) there was no “fishing expedition” – the questions were now in limited form;
 - (b) the judicial discretion to refuse it on the grounds of supporting the convention outweighed the public interest in allowing bankers to maintain their duty of confidentiality to their customers.
- (3) The *Government of India* principle was still in force but was not infringed as the request related not to a claim in England but to information in England which could lead to a claim in Norway and enforcement of Norwegian Revenue laws in Norway – Lord Goff said:

“I cannot see any extra-territorial exercise of sovereign authority in seeking the assistance of the Courts of this country in obtaining evidence which will be used for the enforcement of the revenue laws of Norway in Norway itself.”

Accordingly, a request for information by a foreign revenue authority could be rejected on the basis of *Tucker* – but *Tucker* could itself be affected by the *State of Norway* case. If it is so affected the request will

nonetheless be refused if it is not a civil or commercial matter in the foreign state and in the responding state, or if it is a “fishing expedition” or if it is not of relevance to the revenue authorities seeking information with regard to enforcement of taxes in the country receiving the request.

2.5.2 By Statute

Those statutes principally affecting confidentiality may be considered to be:

- (a) Service of Process and Taking of Evidence (Jersey) Law 1960, as amended

This Law has been amended by the Service of Process and Taking of Evidence (Amendment) (Jersey) Law 1985. It extends The 1970 Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters so that evidence can be taken in Jersey in respect of foreign civil or commercial matters. The civil proceedings must be pending or be contemplated. The request must come from a court or tribunal (the Royal Court determined the requirements of the requesting body in the case *Re Imacu Limited* 1989 JLR 17). However, the Royal Court will not assist the requesting Court if the *State of Norway* requirements are not met (see: 2.4 above).

- (b) Income Tax (Jersey) Law 1961, as amended

Under this Law, the Jersey Comptroller of Income Tax has certain powers to require information, but these will be subject to his oath of secrecy save in respect of answering specific questions under the double taxation arrangements with the United Kingdom and Guernsey.

- (c) Evidence (Proceedings in Other Jurisdictions) (Jersey) Order 1983

Under this Law, the Royal Court may assist a foreign court in collecting evidence for a civil or a criminal matter. The criminal proceedings must have been instituted and not merely contemplated. The Order of the Royal Court can only extend to the examination of witnesses and production of documents. A witness can claim privilege where he could not be compelled to give that evidence in proceedings in Jersey or in the jurisdiction of the requesting court. In *Re Charlton* 1993 JLR 360 the defendants failed in their argument that as the offences before the English court related to the common law offence of cheating the Public Revenue and constituted a statutory offence under the Value Added Tax Act 1983

they amounted to fiscal charges and Jersey should not assist the English courts in what would amount to an indirect enforcement of UK revenue laws. The Royal Court held that evidence of Jersey bank accounts could be provided to the requesting English court under this statute as the matter was of a criminal not a fiscal or civil nature.

(d) Bankers' Books Evidence (Jersey) Law 1986

Confidentiality can be breached in civil proceedings (including an arbitration) which have been commenced and where the Royal Court is satisfied of the materiality of the inspection and that the application is made in good faith.

Under the Bankers' Books Evidence (Jersey) Law 1986, the Royal Court may order information to be provided by a bank where that information is required for criminal proceedings which have been commenced in the Island.

(e) Banking Business (Jersey) Law 1991, as amended

Under the Banking Business (Jersey) Law 1991, as amended, there is power given to the Jersey Financial Services Commission to obtain from a bank such information as assists the Commission in discharging its regulatory functions. The Commission also has powers to hold investigations in the interests of depositors or potential depositors in deposit-taking institutions ("registered persons"). Disclosure made to the Commission may be made by it to an auditor of a registered person to enable the Commission to discharge its functions to persons exercising other statutory functions in Jersey, to other regulatory authorities outside the Island and in connection with the institution of criminal proceedings.

(f) Investigation of Fraud (Jersey) Law 1991

Under this Law, H.M. Attorney General for Jersey has the power to make an order requiring disclosure where he is satisfied there is a suspected offence of serious or complex fraud. The Attorney General may require any person who he believes has relevant information to answer questions and furnish information relevant to the investigation.⁵

(g) Criminal Justice (International Co-operation) (Jersey) Law 2001

⁵ See (App 3) 2.4 (footnote 3).

This Law was passed in 2001 to extend co-operation with other countries in criminal investigations and proceedings. Of particular importance in the present context is that where a criminal investigation is being carried out or criminal proceedings have been instituted in a foreign country, H.M. Attorney General for Jersey may, in response to a request received from that territory, issue a notice requiring a Jersey-based respondent to give evidence before the Royal Court or the Viscount in support thereof.

2.5.3 There are other statutes giving powers to the regulators and for specific criminal matters. It is not necessary here to deal further⁶ with these statutes which erode confidentiality rules for specific criminal and regulatory purposes. They should generally not impact on tax matters.

2.6 Further Exception to the Second Tax Related Rule

A further exception to the second tax related rule is where there is an insolvency.

As regards insolvency, the *Désastre* Law and the Companies Law (and in particular Part 21 (prior to 1st July 2005 Part XXI) of the latter relating to winding up of companies) include provisions whereby those conducting the bankruptcy have powers that would not otherwise apply. These powers can have far-reaching effects both on confidentiality of structures and transactions. These may impact upon the tax position or upon the status or value of a trust.

The general position is that an overseas appointed official has no status unless he is recognised by the Royal Court. The Royal Court will normally recognise a duly appointed insolvency office holder: *Hamel v Hawkes and Gardner Limited* (1900) 220 Ex 122. Indeed, the Royal Court has indicated that a foreign Trustee in Bankruptcy should use the well-established route and apply for an order-in-aid under the relevant bankruptcy law or practice in order, for example, to seek leave to use documents discovered or disclosed by order in proceedings (*In re Esteem Settlement* 2002 JLR 213 at 221). If a *désastre* is declared all assets including statutory documents and accounts of a company vest in the Viscount or, in an insolvent winding up, in the liquidator. Confidentiality cannot therefore be subsequently assured. The Royal Court may declare a *désastre* as in *Royco Investment Company Limited (en désastre)* (1st June 1989) unreported at the instance of, for example, an English

⁶ The reader with a greater interest in such matters is referred to the authors' *A Guide to the Obtaining of Evidence in Jersey*, most recently published by the present publishers in the *Receivers, Administrators and Liquidators Quarterly*, Volume 4, Issue 2, 2000.

Court appointed provisional liquidator. This enabled the provisional liquidator to persuade a New York Court to uplift assets held in New York for the benefit of creditors generally.

Section 426 of the Insolvency Act 1986 of the UK and Article 49 (prior to 1st July 2005 Article 48) of the *Désastre* Law permit specific prescribed foreign courts to make requests of the Royal Court in certain respects in a similar way to that in which the 1914 Bankruptcy Act permitted orders in aid under Section 122 (now replaced by Section 426 of the Insolvency Act 1986 of the UK).

Under Section 426 an English Court can request assistance from the Royal Court.

The effect of Article 49 (prior to 1st July 2005 Article 48) of the *Désastre* Law is explained fully in Chapter 6 of the book.

2.7 The Third Tax Related Rule

The third tax related rule refers to the treatment of domestic tax claims and the priority of creditors.

The Viscount and a liquidator have a first charge on assets for their costs and expenses and then, after payment of secured creditors, priority creditors will be paid. These include the Comptroller of Jersey Income Tax for arrears of Jersey income tax for the year of the declaration and for the previous year. After all priority creditors have been paid, unsecured creditors will participate. (See further: *Categories of Creditor* at 5.7 of the book).

3 Trusts and Trusts Planning

3.1 The First Trust Related Rule

The first trust related rule is that a bankruptcy does not generally affect the status of trust assets.

The assets of a trustee who becomes bankrupt will, to the extent they are owned by him personally and validly, fall into the insolvency regime but those held by him as trustee will not. Article 8(2) of the *Désastre* Law states that property held by the debtor in trust for any person shall not vest in the Viscount. There is no corresponding provision in the Companies

Law in relation to a liquidator. However, Article 54 (prior to 1st July 2005 Article 50) of the Trusts Law states that trusts assets will not be deemed to form part of the estate of a trustee unless he is also a beneficiary. It also confirms that in an insolvency a creditor cannot claim against the trust property unless the trustee has a claim against the trust or he has a beneficial interest in the trust. (See also: Status of Trust Assets at 5.3.4 of the book).

One attraction of the *désastre* route is the comparative speed and ease with which it can be declared. Although the requirements are now more onerous, it is still sometimes acceptable to apply *ex parte* supported by an affidavit whereupon the Royal Court may declare that all assets of the debtor vest in the Viscount. The availability of a declaration *en désastre* reduces the danger that assets will be spirited away or concealed in advance.

- 3.2 A *désastre* or winding up of a settlor, trustee or beneficiary may create problems. There may be bankruptcy procedures invoked outside Jersey against a settlor, trustee or beneficiary. Any combination of such persons may be resident in Jersey or elsewhere. Each set of facts will give rise to different considerations. The location of the assets will also be material as will whether any external territory so affected recognises the concept of the trust and what are to it foreign bankruptcy regimes.

A Jersey bankruptcy can have an effect on a trust with a non-Jersey settlor, beneficiaries and assets. The Royal Court has a wide jurisdiction over trusts. (See: Trusts Law, Article 5; see also: Status of Trust Assets at 5.3.4 of the book; Trust Assets at 5.4.8; and Invalid Trusts and Invalid Transfers to Trusts at 5.16.4).

The Royal Court also has a wide power to give directions under Article 51 (prior to 1st July 2005 Article 47) of the Trusts Law. Indeed, the Court is frequently requested to give such directions by trustees and beneficiaries and insolvency office-holders.

A Jersey company can be subject to an insolvent or creditors' winding up. Only the shareholders, by a two-thirds majority, can require this. A creditor of the company cannot wind up a company. (See further: *Désastre* or Winding up – Some considerations at 5.5.4.2 of the book).

- 3.3 However, if a settlor is declared *en désastre* there may be an attempt to challenge his capacity, the transfer of assets to the trust and/or the trust itself. In practice, most settlors are not ordinarily resident in Jersey nor

have a business in the Island but a Jersey company may be utilised. A beneficiary may be declared *en désastre* and make a claim against the trustee seeking to extract funds in order to facilitate the payments of the debts in the *désastre*. However, the likelihood in practice is that a beneficiary in an international context is unlikely to be capable of being declared *en désastre*.

There may, however, be a *désastre* of the trustee, perhaps a Jersey company, or of a director, shareholder or beneficial owner of a Jersey trustee company. Although the *désastre* will not extend to the assets forming part of a trust fund, in practice problems are likely to occur. Such is particularly the case if there has been fraud, poor accounting, mixing of funds and general uncertainty. In such a case, funds although subject to trust, are unlikely to be released until: the claimant – a beneficiary, for example, or co-trustee – proves he has an interest in the trust (i.e. has status); the nature and extent of the trust assets are clear; and it is established that the bankrupt had proper title as a trustee and it is proper, therefore, to transfer the trust to a new trustee. This may require a court order. Either the Viscount or an interested person would apply to the Royal Court for directions to seek protection – *In the Representations of the Viscount in the matter of PKT Consultants (Jersey) Limited* (1st August 1991) JU 110c; 1991 JLR N5. A *désastre* may apply to one trustee in Jersey in which case the foreign trustee would need to act swiftly to preserve the position.

The Viscount's authority in a *désastre* has also developed to ensure the continued protection of the public interest in the context of the Island as a finance centre. His rôle is more investigative and the Royal Court has indicated that the authorities will look at the cause of the failure and help the recovery of assets for those entitled. The Viscount's authority to oversee these trust assets probably derives from his extended jurisdiction illustrated in *Jobas Limited v Anglo Coins Limited* 1987-88 JLR 359. There the Royal Court said the Viscount had a duty to investigate the debtor's affairs (See further: Background at 5.1 of the book). Under the Financial Services (Jersey) Law 1998, as amended, all company and trust service providers will be regulated by the Jersey Financial Services Commission which has wide regulatory powers.

3.4 The Second Trust Related Rule

The second trust related rule is that while a company can be insolvent a trust cannot. It would simply cease to exist if it had no assets. One of the essential requirements of a trust is that trustees must hold assets. Clearly,

a trust is not a legal entity and cannot therefore be a debtor. Where a claim is made it is made against a trustee personally and he has a right of indemnity against the trust fund. Where, however, as a matter of Jersey law, a trustee of a Jersey law trust enters a transaction where the other party knows the trustee is acting as such, the trustee will be liable only to the extent of the trust assets (unless he is in breach of trust) – Article 32 (prior to 1st July 2005 Article 28) of the Trusts Law.

It follows by virtue of Article 28 that a creditor who has knowledge of a trust will have recourse only to the extent of the trust assets and no more. If the creditor is suing outside Jersey the question arises whether the foreign Court in question could recognise and give effect to the Article. As Article 28 is a Jersey statutory provision and there is no equivalent to the Article, for example, under English law, the answer to the question would depend on whether the Court in question is likely to apply the domestic law of its own jurisdiction or, additionally, the conflict of law rules (inclusive of issues of Jersey law). A ‘non-trust’ jurisdiction may have additional difficulties as, of course, it simply may not recognise the concept of a trust at all.

3.5 The Third Trust Related Rule – Attacking a Trust or Trust Assets

The third trust related rule is an aspect arising from an insolvency. Here the Viscount, in a *désastre*, or a liquidator, in an insolvent winding up of a Jersey company, is able to affect the value or status of assets held indirectly by a trust.⁷ He may do so by:

- (a) setting aside a voidable transaction such as a preference;
- (b) setting aside a transaction at an undervalue;
- (c) seeking to obtain compensation from directors for fraudulent or wrongful trading;
- (d) alleging there is unperfected security;
- (e) alleging that the establishment of a trust was invalid;
- (f) alleging there was an invalid transfer to a trust;
- (g) asserting lack of capacity; or

⁷ For comment on the efficacy of spendthrift and protective trusts, see Tracing at 2.7.7 of the book.

(h) alleging forced heirship.

For example, there may be a claim against a settlor or his estate. If the trust arrangement was a sham or otherwise invalid the assets purportedly held in trust would revert back to the settlor or the settlor's estate in which case those "trust" assets could become available for creditors. The leading case relates to the *Esteem Settlement*: See in particular 2.7.3. – 2.7.7 of the book.

For unsuccessful attempts to challenge a trust, see the interim judgment in *Johnson Matthey Bankers Limited v Shamji and Others* (1st May 1986) unreported and 1985-86 JLR N26 and *MacKinnon v The Regent Trust Company Limited* 2004 JLR 477 and 2005 JCA 066 where the Court of Appeal referred to vitiating factors such as mistake, duress, undue influence, fraud, sham or perhaps *donner et retenir ne vaut*.

Alternatively, a beneficiary may become bankrupt anywhere in the world and there may be attempts by creditors to attack the trust or the trust assets or there may be attempts to compel the beneficiary to use his legal rights or influence over the trustees to obtain the release of those assets.

The court may simply order the beneficiary to transfer assets on the basis that the Jersey trust assets are the latter's property (or assess if it is in his interests for property to be paid out on his behalf). The trustees on the other hand may have a duty not to help the beneficiary if by doing so trust assets will pass to a non-beneficiary, for example, a divorcing husband (or if such would not be in the best interests of other beneficiaries).

See further: *In Re Esteem Settlement* 2001 JLR 8; and conclusively *In re Esteem Settlement* 2003 JLR 188. See also: Piercing the Veil at Chapter 4 of the book.

3.6 No Asset Protection Trust Legislation

Jersey has no statutory Asset Protection Trust ("APT") legislation designed to protect debtors and to encourage bankrupts or potential bankrupts to defeat creditors. Of course, the effect of a trust may be to preserve assets and make them harder or impossible for creditors to realise them. Although there is no specific APT legislation, the general law established by *Gerald Stewart Golder v Société des Magasins Concorde Limited* (1967) JJ 721 established the principle that the Royal Court would interfere with the transfer of assets when the transferor had the intention of defeating the claims of existing or imminent creditors. Whilst this case did

not involve a trust, there is no reason why that principle should not be applied where a settlor transfers assets to trustees. The *Golder* case does not, however, apply to protect creditors when no claims have been made nor are imminent at the time of the transfer of the assets. Jersey is not and never has been a British colony. Accordingly, the Fraudulent Conveyances Act of 1571 passed in England and known as the Statute of Elizabeth, does not apply in Jersey. The effect of that Act is to allow transfers to be set aside where there was an intention to defraud, not only existing, but also future creditors. Under the Trusts Law, a trust would be invalid if it is contrary to public policy. It is thought that where a trust is set up deliberately to defeat existing creditors its validity could be questioned and it is further thought by many that where a settlor remains solvent, immediately after transferring assets to a trust and provided there is no existing claim or imminent likelihood of such a claim, there would be no reason to invalidate the transfer or invalidate the trust. Prudence, therefore, dictates that settlors should not put all their assets into trust, should clearly record their solvency state at the time of the transfer and record that the reason for establishing a trust was other than to defeat creditors.

In any event, even where there is Asset Protection Trust legislation it is clearly important to consider the location of a debtor and other beneficiaries, the location of the trustee and the situation of the assets. The jurisdiction in which an insolvency occurs may well not recognise Asset Protection Trust legislation.

3.7 Universality v Territoriality

Movement of people, assets, rights and goods across national boundaries will complicate the position and, create new problems. The law will react dynamically to new situations. At present, the insolvency regimes of countries are divergent in terms of substantive and procedural law, culture, aims and methods but increasing co-operation and means of working together are being found. The principal question is, how will trusts and trustees be affected by a bankruptcy? It may be a Jersey domestic bankruptcy or a foreign bankruptcy in which case to what extent will a foreign bankruptcy be recognised and will it receive assistance in Jersey?

A matrix of different applications will apply:

Will the bankruptcy affect:-

- (a) the trustee;

- (b) the trust fund, or the trustees' personal funds;
- (c) the settlor;
- (d) the beneficiaries; or
- (e) the assets subject to the trust?

Their location and the relevant laws will need to be considered.

The insolvency procedures may throw up problems of the validity of claims, set off, priorities, security, recognition of status, interest, title to assets, transactions at an undervalue, preference, employees rights etc.

Countries either adopt the universality principle which holds that a bankruptcy proceeding in one state covers the world-wide assets of the debtor or the territoriality principle which limits the consequences of bankruptcy to the country where the bankruptcy occurred.

3.8 Other Exceptional Circumstances

Of course a *désastre* may apply to an underlying company of a trust. Such may be a trading company. The trustee will be under a duty to assist the Viscount under the *Désastre* Law. In the case of a company the directors may be examined on oath (Article 20 of the *Désastre* Law). Questions of undervalue and preference may be raised and give rise to personal liability on the part of the directors (Articles 17, 17A and 17B of the *Désastre* Law and Articles 176 and 176A of the Companies Law). Questions of wrongful or fraudulent trading may also arise (Article 44 of the *Désastre* Law; Articles 177 and 178 of the Companies Law).

Where an application under Article 49 (prior to 1st July 2005 Article 48) (of the *Désastre* Law) is successfully made, this could have consequences in relation to a trust. Accordingly, in an appropriate case, an order could be made following an English liquidation to trace assets passing into any trust or company whether created or incorporated in Jersey and an order for disclosure of documents and/or an examination of those involved could be made. The examination could be ordered by applying Article 20 of the *Désastre* Law or under the equivalent section 236 of the Insolvency Act 1986. However, such a hearing might be held in private to protect confidentiality and third parties and possibly to reduce the risk of dissipation of assets. (*In the matter of the Atlantic Income Fund (in*

liquidation) (23rd May 1996) JU 95 and *In Re Esteem Settlement* 1995 JLR 266.)

An officer of a company or a trustee could resist such an order if it were to be oppressive in effect. There are various degrees of oppression from when the insolvency practitioner has decided not to sue the examinee (no oppression) through to when he might, or has decided to do so or has already done so (substantial oppression) – *Re Bank of Credit and Commerce International SA* [1997] Ch 526.

The applicant would have made out a proper case and the Royal Court would exercise a discretion to balance, on the one hand, the reasonable requirements of the office-holder to carry out his task, and on the other the need to avoid making an order which is wholly unreasonable, unnecessary or oppressive to the person concerned. *Re British & Commonwealth Plc* (N.S. 1&2) [1993] AC 426 at 439 HL.

Moreover, if the office holder can show that the evidence needed to support such an order is so sensitive and confidential that only the Royal Court should see it, a "private and confidential affidavit" can be placed before the Court and exceptionally withheld from the other party. (*Re British & Commonwealth Holdings Plc* [1992] Ch 342 at 355; *In re Bishopsgate Investment Management Limited* (No 2) [1994] BCC 732 at 740; *In re C Ltd* 1997 JLR N8). Any documents disclosed⁸ will, of course, be subject to an implied undertaking that they can only be used for the particular proceedings involved unless leave of the Royal Court is obtained (See: *Enhörning v Nordic Link Limited and Others* (24th January 1997) JU 14; See further: Restricted Use of Discovered and Disclosed documents at 2.7.10 of the book).

A foreign Trustee in Bankruptcy may not be able to obtain direct leave to vary the implied undertaking as he should use the procedure of registering his appointment and applying for an order in aid under the insolvency law and practice: See: *In re Esteem Settlement* 2002 JLR 213 at 221.

Trusts do not generally make good trading vehicles. They are usually asset rich and indeed if they cease to hold assets they will, as said above, cease to exist.

⁸ See also: *In the matter of the Rabaiotti 1989 Settlement and other Settlements* 2000 JLR 173.

3.9 Protection for the Trustee

There is some protection against claims and insolvency procedures provided by Article 32 (prior to 1st July 2005 Article 28) of the Trusts Law.

As stated at 3.4 above, apart from where there is a breach of trust, in any transaction or matter affecting a trust, where a trustee informs another party that he is acting as a trustee a claim by that party will be limited to the value of the trust property. There is a second limb to this rule, namely, where that other person is not informed of the trusteeship and he is otherwise unaware of it, the trustee is personally liable to that person but can have recourse to the trust property by way of indemnity for that personal liability.

Under English law only the second limb of the rule applies. If the trust fund is insufficient the trustee loses out. Quite apart from the Jersey law position, if a trustee was sued by a party outside Jersey e.g. in the US or England and he had been told that the trustee was acting in such a way, would such a court recognise the first limb? The answer is probably “no”. Therefore, trustees should always contract to limit their liability with third parties in any event. This of course may not be possible in tort and insolvency could follow.

Other instructive cases affecting directors and trustees include: *Agip (Africa) Limited v Jackson and Others* [1992] 4 All ER 451 and *Royal Brunei Airlines SDN BHD v Tan* [1995] 3WLR 64.

4 Conclusion

Accordingly, insolvency may affect both the recoverability of tax and the information and documents that can be obtained for the purposes of foreign tax recovery. Similarly, in relation to enforcement of judgments and in relation to trusts, an insolvent scenario may result in payment of a foreign tax, the obtaining of information and documents and possibly the setting aside of a trust or transactions themselves. It may also impose liability on directors, including those of trust companies where it would not otherwise attach.

(Note further now, that the Financial Services (Extension) (Jersey) Law 2000⁹ provides for the registration and detailed supervision of, and maintenance of best

⁹ By amendment of the Investment Business (Jersey) Law 1998 now re-named the Financial Services (Jersey) Law 1998, as amended.

practice among, persons carrying on, *inter alia*, trust company business. cf Regulatory Laws at 3.3.7.3 of the book).