The Offshore Taxation Review

CHANNEL ISLAND TRUSTS: THE 100 YEAR RULE AND THE RULES AGAINST PERPETUITIES AND EXCESSIVE ACCUMULATIONS

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1 Importance of the Rules Against Perpetuities

Anyone drafting a trust governed by English proper law knows that very careful attention needs to be paid to the rules against perpetuities and excessive accumulations, yet surprisingly few draftsmen properly understand the rules. In the case of an English trust, the Perpetuities and Accumulations Act 1964 often comes to the rescue by altering the trusts so as to validate them. Usually, the alterations are of little consequence, especially where the trustees have wide discretionary powers to alter the trusts. Where the trust is governed by a proper law other than that of England there may be no statute to save the day. The Perpetuities Law of as sophisticated a jurisdiction as the Cayman Islands came into effect only on 1st August 1995.

Failure to comply with the rules could be virtually irrelevant in trust terms but vital in tax terms. An unintended resulting trust to the settlor could render all income and gains of the trustees taxable as his and might even bring the gifts with reservation of benefit provisions into play.

2 Channel Island Trusts

In the cases of trusts created nowadays governed by the laws of Jersey of Guernsey, there are no rules of the proper law of the *trust* against perpetuities. Instead, each of these jurisdictions has a statutory provision that a trust cannot last more than 100 years. Common lawyers often think that this is the same as a 100-year perpetuity period. In this article I compare the 100-year rule with the rule

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against remoteness of vesting. I argue that it will often be very wise to ensure that a trust governed by Channel Island proper law will also comply with the common law rule. I also consider the English rules against excessive accumulations of income in the context of Channel Island trusts.

3 The Rules Against Remoteness of Vesting

The main rule against perpetuities, and the only one which is in general relevant in the case of an English trust other than a purpose trust, is the rule against remoteness of vesting. It provides that all gifts must vest indefeasibly in possession at or before the end of the perpetuity period. At common law, the period may be defined by reference to relevant lives in being, plus a further period of twenty-one years. Several jurisdictions now allow a fixed period of years to be chosen instead. Care must be taken to ensure that the terms of the statute are scrupulously observed. In England, for example, one may choose a "duration equal to such number of years not exceeding eighty as is specified in that behalf".[2] It is arguable that a period which is not a whole number of years is not permissible; likewise a period of uncertain duration, even though it cannot exceed eighty years.

It is often erroneously supposed that the rule requires that a trust come to an end on or before the expiration of the perpetuity period. That is not so. All that is required is that the trusts become fixed and immutable at that time. For example, at the end of the perpetuity period, there could be trusts continuing for A for life, remainder to B for life, remainder to C absolutely, A, B and C being persons then in existence and ascertained. The trust could continue for up to a century after the end of the perpetuity period.

4 The One Hundred-Year Rule

In the case of the Channel Island rules, the trust must come to an end when one hundred years has elapsed. The statutes are silent as to what happens if the rule is broken. For example, I transfer my property to trustees upon trust to accumulate the income for a 100-year Trust Period and subject thereto upon trust for such of my descendants as shall be living at the end of the Trust Period and attain twenty-one years and if more than one in equal shares absolutely. Now under the terms of the trust I may have descendants who are alive at the end of the Trust Period but who do not attain twenty-one until some time after that date.

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2 The Perpetuities and Accumulations Act 1964 section 1(1). The rule is subject to certain exceptions. See, for example, section 9(2) (options).

That flouts the rule. What is the consequence? Is the gift of capital void completely, so that there is a resulting trust to the settlor? Does one wait and see whether at the end of the Trust Period there are any descendants who are alive and under twenty-one and is the gift then completely void if there are? Does the capital go to all my descendants then alive who have attained twenty-one? Does one divide the capital into as many shares as there are descendants then in existence, each descendant who has attained twenty-one taking his share but the shares of the others being held on resulting trust?

Consider another example. I settle assets upon trust for my newly-born son for life, remainder to his widow for life, remainder to my sons's children in equal shares absolutely. Under an English trust, this is not void for perpetuity, even at common law. All gifts must vest indefeasibly in possession at the latest on my son's death. He is a life in being, so that the perpetuity period then has a comfortable further twenty-one years to run. Under a Channel Island trust, there could be real problems. My son could live for more than a further one hundred years. Does that mean that his life interest is void from the beginning, or just from the end of the one hundred years, if he is then still alive? Similarly, his widow could very easily be alive long after the expiry of the one hundred years. Is the gift to her void from the beginning or is it simply made determinable on the expiration of the 100 year period? What happens to the capital on the expiration of the 100 year period? If the son or the widow is still alive, do the son's children then in existence scoop the pool? Or the son? Or his widow? Is there a division of the capital on an actuarial basis, assuming for this purpose that the 100-year rule did not exist and that the gifts of income were valid according to their tenor? Or is there a resulting trust? Channel Islands law at present provides no answer to these problems.

The complications become much greater if the trust is originally discretionary and the trustees purport to create interests which offend, or may offend, the rule. Here, there is the additional complication that the appointment may be completely void even though the same trusts would or might have been valid, in whole or in part, if created by the settlor.

Now, in most cases, what happens to the trust property at the end of 100 years may, so far as those currently alive are concerned, seem academic, especially if the trustees have adequate discretionary dispositive powers. The real problems are that (a) the trust could possibly be void altogether from the beginning, or that (b) the default beneficiary (the Jersey Zoo?) could find it had scooped the pool before the ink was dry on the settlement, or that (c) because there was a remote resulting trust the settlor found himself liable to tax on the income and gains of the trust.

5 Change of Proper Law

It may be thought desirable to make provision for the change of the proper law of a trust from that of one of the Channel Island bailiwicks to that of some other jurisdiction which does have a rule against remoteness of vesting. Alternatively, one might wish to empower the trustees to transfer trust funds to the trustees of another settlement governed by a different proper law. In each case, one would need to ensure that the trusts were valid under the other proper law. My preferred option is so to draft the trusts that not only are they valid under the law of the bailiwick in question (as not offending the 100-year rule) but they would also not fall foul of the common law rule against remoteness of vesting. Although the drafting is a little more complicated, the additional flexibility is in my view well worth the effort.

6 Which Proper Law is Relevant?

Suppose that a settlor domiciled, resident and ordinarily resident in the United Kingdom set up a trust ostensibly governed by, say, Guernsey law for the benefit of beneficiaries who are likewise all domiciled resident and ordinarily resident in the United Kingdom. The trust property is situate in England. He stipulates that the trust shall be governed by Guernsey proper law and ensures that its terms comply with the 100-year rule but not the rule against remoteness of vesting as it applies in England. The Guernsey courts will, I apprehend, accept that the trust is governed by Guernsey proper law and will therefore treat it as valid.

The English courts might take a different view. If, on the basis that the trust is governed by English law, there is a resulting trust for the settlor, because, say, the final gift of capital *may* be void, then the UK Revenue will normally seek to tax the settlor on all the income and gains arising under the settlement. The question of the ability of the Revenue to levy such a charge will be determined by the English courts. What will matter is whether they will regard the settlement or any particular gift to it as governed by English proper law. This is a question which it is not possible to answer with certainty in all circumstances.

If the first trustees are resident in Guernsey and the trust is at least initially administered there, the English courts will probably accept that the trust is governed by Guernsey proper law. They may, however, decide that the English rule against remoteness of vesting is still applicable in determining the validity of any gift made by the settlor to the trustees of property situate in England, especially if it is real property.

In case of doubt, it would be wise so to draft the trusts that they complied with the current English rule against remoteness of vesting.

7 The Rules Against Excessive Accumulations

At common law, accumulation of income was permissible throughout the whole of the perpetuity period. It is only by statute that accumulation is now restricted to lesser periods in England. Under Channel Island law, accumulation is permissible throughout the 100-year period. A problem could arise if the English courts decided that the English accumulation rules applied to a gift of property situate in the United Kingdom, even though the proper law of the settlement was otherwise that of one of the Channel Island jurisdictions. What is to be done to safeguard against such a possibility?

There are two possibilities. The first is to choose the most convenient accumulation period available under English law in case English law is applicable. While settlors often choose a twenty-one year period, in a tax context the lifetime of the settlor may be more appropriate. If there is no doubt that income arising during the settlor's life is being validly accumulated, that would normally enormously reduce or even eliminate the potential UK tax problems. Another possibility is to provide express alternative trusts of income to take effect if for any reason the accumulation directed should turn out to be void. That way, the UK Revenue would not be able to argue that there was a resulting trust and thus levy a charge to tax on the settlor.

8 Conclusion

When drafting Channel Island trust instruments, whether settlements, appointments or transfers of assets to other trusts, it is vital to bear the 100-year rule in mind as the consequences of breaching it could be serious, especially in tax terms.

There is much to be said for drafting a Channel Island trust so that it does comply with the common law rule against perpetuities. This will facilitate the change of its proper law or the transfer of its assets to the trustees of a trust governed by a different proper law.

Likewise, in directing or empowering accumulations, it will sometimes be appropriate to consider whether some other proper law may be relevant and to take appropriate steps to mitigate any charge to tax which might otherwise arise.