INTERNATIONAL TRUSTS AND DIVORCE LITIGATION

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INTRODUCTION

The recent increase in high value divorces involving an attack (as part of ancillary relief proceedings) on offshore trusts encouraged the authors to write *International Trusts and Divorce Litigation*.[1]

The consequences of the House of Lords decision in *White v White*[2] are only now becoming apparent. By establishing equality of financial provision between spouses, wealthy husbands have become more obdurate and less inclined to settle with their divorcing spouses. On the other hand, the wives in such cases, in an effort to realise the equality promised by *White and White* are driven to attack the offshore structures which high net worth husbands (especially those not domiciled in the UK) use to shelter their wealth.

The conduct of these cases requires a combination of skills; obviously both family law and trust law but also a working knowledge of the various offshore jurisdictions and the different systems of law which govern offshore trusts.

Reproduced below is *International Trusts and Divorce Litigation's* opening chapter: 'Overview and Context'. The remainder of the book contains an outline of trust law and the basis on which courts exercise their jurisdiction in both divorce and trust matters. There is a chapter covering the English court's attitude to the division of assets on divorce. There are then separate chapters focusing on divorce lines of attack on trusts (variation of nuptial settlements and trusts as a resource) and non-divorce lines of attack (formal invalidity, uncertainty, flawed assets and other grounds for breaking a trust). Lastly, there are chapters on practice and procedure

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[1] Published by Jordan Publishing, November 2007.

[2] [2001] 1 AC 596.

and international enforcement issues relating to trusts. The focus of the book is very much on the interaction between the English Family Division and the offshore jurisdictions.

OVERVIEW AND CONTEXT

In recent years there has been significant growth in both divorce rates and the use of offshore trusts. While these phenomena are generally unrelated, they are the seeds of much high value matrimonial litigation in the Family Division of the English High Court.

Growth in Offshore Trust Services

In Britain, the post-war years saw steadily rising estate duty rates which were nevertheless relatively easily avoided by structures such as discretionary trusts. The unusual and unique English law rule regarding domicile has played a key role in the growth of the use of offshore trusts.

For non-UK citizens, they can retain their non-UK domicile of origin while being resident for the foreseeable future in the UK. With proper advice, and often by setting up an offshore trust, they can live off capital and avoid remitting to the UK foreign income or capital gains, thereby avoiding UK tax. This makes the UK one of the best tax havens in the world, especially for non-US citizens. This in turn partly explains the very high London property prices, boosted by wealthy foreigners wanting to be UK tax resident and to enjoy the benefits of the non-domicile rule.

For high net worth families, the emergence of Jersey and Guernsey as offshore centres offered sophisticated, confidential, financial services coupled with an entirely legitimate means of avoiding estate duty (at least until legislation from the late-1960s onwards began to curtail tax planning opportunities for UK domiciliaries). The attractiveness of these arrangements has been compounded by the fact that all assets held offshore remain beyond the grasp of British death duties provided the relevant parties are domiciled outside the UK. Even English real estate can be held offshore by the simple device of holding the property through an offshore company whose shares are then themselves held in an offshore trust. From the late 1960s, the newly independent Caribbean states such as the Bahamas, joined the offshore club while Cayman, Bermuda and the British Virgin Islands (BVI) chose to remain British overseas territories. Offshore trusts remain attractive to settlors who while resident in England, have been able to retain their non-domiciliary status. Arguably, the possibility of these fiscal advantages being removed by legislation has increased their attractiveness to such taxpayers. These jurisdictions have begun to produce legislation designed to attract the offshore investor. The Cayman Islands, for example, have produced 'Star Trusts' (Special Trust Alternative

Regime Law 1997) while the BVI are vigorously promoting Vista Trusts, principally as vehicles for family companies.

Against this background all the major financial institutions now offer bespoke private banking services for high net worth individuals. Offshore tax and trust services are marketed hand-in-hand with upmarket banking services.

Growth and Globalisation of Wealth

London has become arguably the leading financial centre of the world, recently overtaking New York. Wealth has increased dramatically; now assets of £70 million are required to make it into the *Sunday Times* 'Rich List 2007'. In their first list in 1989, a £70 million fortune meant a position of 92, whereas in 2007 it takes £770 million to reach the same position.

Much of the wealth is new rather than inherited; in 1989 75% of those on the Rich List had inherited their wealth, whereas now 78% have made the money themselves.

A significant proportion is international too; mostly thanks to the non-domicile tax regime. Boston Consulting Group has estimated that there are 1,500 non-domiciliaries living in the UK, worth £28 billion; some would say the number is an under-estimate. Since 1995, the number of work permits for financial services in the City has doubled.[3] In the prime central London property market, foreign buyers account for one-third of all buyers, which rises to 75% for properties worth more than £5 million.[4]

Recent Developments in Divorce

Whatever the reason, there is no doubt that divorce is on the increase. In 1961 there were 27,224 divorces in Great Britain. By 2004 the figure for the UK as a whole had risen to 167,116.[5] There is no reason to suspect that high net worth individuals are as a group under represented in this explosion of matrimonial litigation, indeed anecdotal evidence would suggest quite the contrary.

In terms of financial provision on divorce, the watershed occurred in October 2000 when the House of Lords gave judgment in *White v White*.[6] Prior to that case, the

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[3] (2006) *The Economist*, 21 October.

[4] Knight Frank Survey 2007.

[5] Source: Office for National Statistics.

[6] [2000] 2 FLR 981.

court's approach to financial provision had focused almost exclusively on meeting the recipient spouse's 'reasonable requirements'. In principle, this meant identifying capital needs such as a home (or two or three), a car and so on. The court would then go on to fix an appropriate annual budget and calculate a suitable capital sum to finance that budget using a 'Duxbury' calculation based on expected investment return, life expectancy and taxation. All this inevitably meant a glass ceiling for the claims of wealthy husbands' wives. Such a wife might very well end up with a fairly small percentage of the family wealth.

Lord Nicholls of Birkenhead giving the lead judgment in *White v White* said that there should be no bias in favour of the money creator as against the homemaker and the child carer. The yardstick of equality was to be an important safeguard against discrimination. As a general guide, equality was to be departed from only if, and to the extent that, there was good reason for doing so. The focus therefore has shifted from the needs of the recipient spouse to whether there is any valid reason to depart from a 50/50 split of the couple's assets.

Trends in Matrimonial Litigation

The increase in the divorce rate, growing prosperity serviced by a sophisticated private wealth industry and latterly the aftermath of a seismic shift in the law on ancillary relief have all combined to produce an increase in litigation involving trusts and divorce. This change in the law will apply to any forthcoming dissolution of civil partnerships between same-sex couples, in effect same-sex marriage. Since the law on financial claims on dissolution is virtually the same as on divorce, all references to ancillary relief in this article include financial claims on civil partnership dissolution. Empirical evidence is hard to collate but an examination of the law reports indicates that the courts appear to be spending more time on trust and divorce issues.

Minwalla v Minwalla[7]

The Royal Court in Jersey enforced 'as a matter of comity' an order of the English court effectively requiring the Trustees of a Jersey Trust to transfer significant assets to the wife in satisfaction of an ancillary relief order.

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[7] *Minwalla v Minwalla and DM Investments SA, Midfield Management SA and CI Law Trustees Ltd* [2004] EWHC 2823 (Fam), [2005] 1 FLR 771.

Re B Trust[8]

More recently in this case, the Royal Court, while giving substantive effect to a judgment of the English Family Division, went on to express the view that the English courts could follow a more restrained approach towards Jersey trusts:

> 'It would in our view, avoid sterile argument, and expense to the parties, if the English Courts were, in cases involving a Jersey Trust, having calculated their award on the basis of the totality of the assets available to the parties, to exercise judicial restraint and to refrain from invoking their jurisdiction under the Matrimonial Causes Act to vary the trust. Instead they could request this Court to be auxiliary to them.'

Charman v Charman[9]

The English Court of Appeal upheld a letter of request directed to the Bermudian court seeking information from the trustees of a Bermudian Trust as to assets settled into trust by the husband. The Supreme Court of Bermuda however rejected the request as a 'fishing expedition' and contrary to the established authorities such as *Re Westinghouse.*[10] Coleridge J went on to make an order for £48m in favour of the wife. That order looks through the trust assets and treats them as if all available to the husband. On appeal, the Court of Appeal upheld the judgment at first instance, considering the trustees likely to advance all the capital of the trust to the husband (who was the settlor and a beneficiary) in the event of need, concluding:

> 'It is essential for the Court to bring to it [an enquiry as to the attributability of the assets in a trust] a judicious mixture of worldly realism and of respect for the legal effects of trusts, the legal duties of trustees and, in the case of offshore trusts the jurisdictions of offshore Courts. In the circumstances of the present case it would have been a shameful emasculation of the Court's duty to be fair if the assets which the husband had built up in [the trust] during the marriage had not been attributed to him.'

The flurry of judicial activity in the offshore world resulting from orders of the English Family Division is being matched on the legislative front. Jersey has recently enacted a new Art 9 of the Trust (Jersey) Law 1984 which brings Jersey into line with many of its offshore competitors in terms of providing a defence against attacks by other jurisdictions. It is interesting to speculate whether any of the recently decided cases in Jersey would have been decided differently had that legislation been in

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[8] 2006 JLR 562.

[9] [2005] EWCA Civ 1606, [2006] 1 WLR 1053.

[10] *Re Westinghouse Electric Corporation Uraniam Contract Litigation MDL Docket 235 (No 2)* [1978] AC 547.

force earlier: *Re B Trust* was decided just after the legislation came into force. Guernsey is set to introduce similar legislation this year.

Meanwhile, in Guernsey, the final report of the revision of Trust Law Committee has recommended that foundations be introduced in Guernsey law. These would be corporate entities with a founder and a council but no beneficiaries in the conventionl trust sense. Foundations have already been introduced in the Bahamas and are being considered elsewhere in the trust world, having been available in Liechtenstein for nearly 80 years and more recently in Panama. It will be interesting to see if such structures became popular in the wealth management industry as a potential shield against spouses seeking to enforce ancillary relief orders against such entities.

Difficult issues arise for trustees facing an attack on their trust, mounted by a spouse seeking to enforce an ancillary relief order against the trust. The settlor, frequently the other spouse or partner, will expect the trustee to defend the trust with all the resources of the trust assets. However, trustees who enter into the fray would do well to bear in mind the cautionary note struck by Lightman J in *Alsop Wilkinson (a firm) v Neary*[11] where he held that generally if the validity of a settlement needs to be defended it should be left to beneficiaries under the settlement to do so, protecting their interests under the settlement at their own risk as to costs. If the trustees assume the burden of defending the trust from an onslaught by one of the parties to matrimonial proceedings, then they may well also assume the risk of becoming personally liable as to costs. The role of a trustee has seldom been more difficult.

Charman v Charman (No 4):[12] *the widening gap between the divorce and trust worlds*

The Court of Appeal judgment in *Charman (No 4)*, delivered in May 2007, may be seen as the apogee of the English divorce jurisdiction's robust attitude towards offshore trusts, and as widening the gap which has developed over the past few years between the Family Division on the one hand and the trust industry on the other as to the respect to be accorded to trusts.

With the notable exception of the reasoning of Munby J in *A v A*[13] the Family Division judiciary have viewed trusts, and self-settled offshore discretionary trusts in particular, with a high decree of scepticism. As Coleridge J stated in *J v V (Disclosure: Offshore Corporations)*:[14]

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[11] [1995] 1 All ER 431.

[12] [2007] EWCA Civ 503, [2007] 1 FLR 1246.

[13] [2007] EWHC 99 (Fam), [2007] 2 FLR 467.

[14] [2003] EWHC 3110 (Fam), [2004] 1 FLR 1042.

> 'These sophisticated offshore structures are very familiar nowadays to the judiciary who have to try them. They neither impress, intimidate, nor fool anyone. The Courts have lived with them for years.'

And as Munby J himself referred to in *Re W (Ex Parte Orders)*:[15]

> 'the robustness with which the Family Division ought to deal in appropriate cases with husbands who seek to obfuscate or to hide or mask the reality behind shams, artificial devices and similar contrivances. Nor do I doubt for a moment the propriety and utility of treating as one and the same a husband and some corporate or trust structure which it is apparent is simply the alter ego or creature of the husband.'

This is all well and good in an appropriate case. But where the same attitude is evinced towards a trust where rights and expectations genuinely have been created in favour of third parties, tension will necessarily occur if the Family Division treats the trust as a creature of one of the spouses or (which amounts to much the same thing) that the assets in the trust are a resource of that spouse. The problem in the latter respect is particularly acute, given that the claim that the assets/source of the assets in trust are to be treated as a resource of one of the spouses bypasses the safeguards intended by the rules – the joinder of the trustee and minor children to an application to vary a trust or treat it as a sham.

It also bypasses an important safety valve introduced by most offshore jurisdictions to protect trusts and those interested in them: the non-recognition of foreign orders affecting the validity of a trust or giving directions as to its administration including variation. While the Royal Court of Jersey (which has had to deal with the largest number of English ancillary relief orders affecting trusts to date) has afforded a high degree of comity to such decisions, it has made it clear that it does not expect the Family Division to exercise exorbitant jurisdiction by varying or declaring sham Jersey law trusts.[16] Ironically, the Court of Appeal in *Charman* agreed[17] and acknowledged as important the suggestion made by the Royal Court of Jersey in *Re B Trust*[18] – that the Family Division should decline to vary a Jersey trust but instead invite the offshore court to act as an auxiliary to it in regard to any proposed variation.

But the Court of Appeal went on to decline to do so in *Charman*, expressing the view that Mrs Charman was fortunate in neither having to ask for a variation nor to

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[15] [2000] 2 FLR 927.

[16] *Re Fountain Trust* 2005 JLR 359

[17] Op cit, n 12, at para [58].

[18] 2006 JLR 562

allege sham because she 'had the evidence with which to identify the assets of Dragon [the offshore trust] as part of the husband's resources'.

To a trust lawyer, this assertion is startling. Dragon was a properly constituted discretionary trust established by the husband some 20 years previously which was, by the time of the trial, governed by the law of Bermuda. A highly reputable professional trust company was trustee. There had been no capital distributions out of the trust. The husband's letters of wishes, in conventional precatory terms, described him as wishing to be treated as 'primary beneficiary' while at the same time making it clear that he expected other members of his family to receive benefit from the trust. No evidence was adduced of the trustee's intention as to distributions to the husband. Notwithstanding, the Court of Appeal approved the decision of Coleridge J at first instance[19] taking the whole of the assets of the trust into account as a resource of the husband, on the basis that if asked, the trustee would be likely to advance the entire capital of the trust to him.

This decision is likely to put pressure on any discretionary trust in conventional form created by one of the parties to the marriage. It takes to new lengths the 'robust' attitude of the court towards trusts, effectively treating assets which are acknowledged to be in third party ownership and control as no more than an extension of a spouse's bank account: it does not treat assets in trust in the same way as the Chancery Division would, as Munby J urged in *A v A*.[20]

The Court of Appeal in *Charman*, while noting with some surprise that the court in Bermuda had not agreed with its decision on the Letter of Request in *Charman*,[21] rejected the suggestion that it was sending out a message to the offshore world that in family cases trusts do not matter, while expressing the anticipation that the courts of Bermuda 'will be disposed to help to ensure, within the parameters of its laws, that whatever may ultimately be awarded to the wife in these proceedings will clearly be paid'. The House of Lords has now refused Mr Charman leave to appeal against the Court of Appeal's decision.

The offshore courts will undoubtedly be placed in a difficult position as the result of orders such as this which, while not directly affecting the validity of trusts governed by their laws or purporting to vary them seek to put pressure on trustees to advance substantial sums to one of their beneficiaries to avoid enforcement proceedings and possibly bankruptcy of the beneficiary. Trustees placed in such a position will undoubtedly want to seek the directions of their own court as to whether to comply

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[19] [2006] EWHC 1879 (Fam), [2007] 1 FLR 593.

[20] [2007] EWHC 99 (Fam), [2007] 2 FLR 467.

[21] Op cit, n 9, at para [25].

with a request made by the affected beneficiary in such circumstances because among other concerns, they will be concerned that:

(a) they may be making a payment to a beneficiary for an ulterior purpose – to pay to another who may not be a beneficiary. Accordingly, the question arises as to whether that is a proper application of trust funds (which can only be applied for the benefit of a beneficiary);

(b) whether any request emanating from a beneficiary in such circumstances is a genuine request or whether it is vitiated by duress;

(c) whether the interests of other beneficiaries (who will be represented in those proceedings) would be adversely affected by such a payment and the extent to which any such detriment should be taken into account;

(d) whether the interests of the requesting beneficiary would be better secured by funds remaining in trust for potential future benefit than by assisting with the payment to the beneficiary's spouse.

In an acute case it may be that trustees will surrender their discretion to the court.

To what extent the offshore courts will be prepared to assist, as envisaged by the Court of Appeal, or whether for policy reasons or otherwise they will politely resist the pressure exerted on trusts imposed by such orders, remains to be seen.

Settlors and the trust industry will undoubtedly take note of this trend in the Family Division's decisions and adjust practices and procedures to address concerns that conventional discretionary trusts may be treated without more as an extension of the settlor.

Fixed interest or hybrid trusts may become more fashionable. Trusts may be made purely in favour of children where the reality is that only they are intended to benefit. Appointments may be made where otherwise assets would remain in a general discretionary pot. Undoubtedly, great care will be taken as to the location of trust assets and the wording of letters of wishes.