**THE USE AND ABUSE OF TRUSTS – Presentation by Martin Lewis at the Private Client Panel at the Saint Petersburg International Legal Forum 2015**

## Introduction

The great majority of off-shore trusts are probably 'sham trusts'. That is to say, domestic and international trust law, official bodies and courts will not recognise them if they examine them closely, as they are often little more than glorified bank accounts, or the paperwork merely disguises a different reality.

To design effective international structures involving trusts, an understanding of how the international law of trusts has emerged and developed can be helpful and which I look at in broad terms this afternoon.

## The sources of international trust law

The briefest history of trusts helps one to anticipate what international trust law very probably provides in most ordinary situations, without going to the text books first and which essentially means an understanding of the roots of English trust law.

Ancient Rome developed the concept of trusts on death, but it was in England in the 12th and 13th century that the concept of trusts created during the lifetime of the person creating the trust (who I shall refer to as 'settlors') emerged and this was in response to the practical problems of leaving land in the hands of perhaps an uncle or brother (in England women had effectively no property rights until the 19th century) when one went away to the Holy Land to fight in a crusade. Nobles returning from the Holy Land at this time were sometimes met by relatives to whom they had entrusted the management of their property, refusing to return property and so returning Nobles petitioned the King and who delegated the determination of these tiresome arguments to his Lord Chancellor and which is the origin of the Chancery Division of the English court system and the law of equity administered by that court.

The powers, rights and duties which developed during this time therefore reflected those one would ideally like one's uncle or brother in England to have, in looking after one's land whilst at war and to be sure that one could have that land back upon returning to England and which powers and duties modern English trust law still reflects after this early extended period of sophisticated and creative legal evolution.

This history therefore explains the key characteristics of a trust and which include primarily that trustees personally become the legal owner of the relevant property and those trustees have duties only to the beneficiaries and not to the creator of the trust, in accordance with the law and their consciences and it is this fundamental feature which is often poorly understood by the creators of trusts and sometimes their advisors as well when selling packaged solutions.

From about the 16th century to just after the Second World War, land law and trust law grew together as trusts were used to control land and dynastic succession within local families and so remained a very domestic English affair.

As a merchant and then imperial power, England took its law informally and then formally to those of its territories that had no existing sophisticated legal system and then on the independence of each part of its empire, England left those territories with legal constitutions and codes which have subsequently developed in parallel and so embedding English trust law throughout the former British Empire, with firstly the exception of India and which had a legal system that the English did not seek to replace. The other exception is America, which since it early escaped England's grasp, has long gone its own way and is so remote from the international law of trusts as to not even be relevant by analogy.

From the 1960's England's smaller former colonies and territories were encouraged to develop trust and financial services industries to provide for their economic security in the absence of resources other than perhaps at best limited tourism.

During this period the concept of 'layering' emerges through the creation of structures using companies and trusts on behalf of ultimate beneficial owners and allowing for new levels of sophistication in tax planning by essentially arbitraging different legal and tax systems.

Trusts involving the off-shore trust concept which emerged from this extended history are normally created in the settlor's lifetime and are mainly used for securities, cash and moveable assets and not property as was historically the case in England.

The 1970's lead to further growth in the use of international trusts in response to aggressive socialist taxation policies in England in particular. We now forget that tax on investment income in England reached 98% in the 1970's!

It is interesting that jurisdictions with an English legal heritage began to and now cite precedents in different jurisdictions other than their own, as if they are local law rather than foreign law and which has helped the development of an international law of trusts. Electronic methods of communication are also encouraging legal convergence.

Non common law systems uninfluenced by the English model, as you know, do not historically include the trust concept as part of their systems and find them alien. However, to compete for settlors and their advisors, some of those systems have introduced their own trust law based on the English model (Brunei, Dubai, Labuan, San Marino). Curacao is the latest that I know of to do this as recently as 2012, the same year that Cyprus with its English heritage updated its trust law reflecting this international competition and to try and position it as the leading international trust law choice within the EU.

First world countries such as France have also introduced their own version of the trust concept and based on contract rather than the English law of 'equity' as developed in the medieval period.

The legislation for these non common law trusts tend to have greater differences than between those with English roots, but since they generally tend to respect the express provisions of a trust instrument, such instruments tend to very closely reflect English drafting.

The way that the international law of trusts has developed has been further strengthened by the 1985 Hague Convention on the law Applicable to Trusts and on their Recognition and which does not introduce or change the domestic law of ratifying countries, but which provides for recognition of the concept constituted under any foreign law and with choice of law and the matters to be determined in accordance with chosen law.

The English trust law model therefore predominates in international trust law and which further reflects the English training of many lawyers active in this area of the law, English local lawyers in most offshore jurisdictions, English judges in many courts of former English colonies and present day dependent territories and the fact that the English Privy Council is the ultimate court of appeal for many such jurisdictions.

However, the competition of various jurisdictions has led some of them to go too far, with for example the excessive reservation of powers by the creator of the trust, protection from creditors, exclusion of foreign law etcetera and it is these jurisdictions that will come under pressure lead by the G8, to moderate their excesses.

It is rising public consciousness of and the public response to industrial scale tax evasion and how 'evasion' is now being conflated with previously legitimate tax 'avoidance', that is now feeding through to public policy in the first world. Because good long term advice in relation to preserving wealth is about where legal requirements are likely to develop, rather than playing short term games with mere words just today, that we should take note of this emerging international trend in the first world in controlling the excesses of the off-shore trust industry in some countries.

Nonetheless, an independent law of International trusts is to many minds the greatest achievement so far in the development of international law outside human rights law.

**Limitations**

It remains the case that these are limitations with respect to the use of off-shore trusts and reflecting that they are more demanding than companies. This is because companies have no conscience, are essentially amoral creatures of statute and cannot be put in prison. Trusts on the other hand are a bundle of personal duties and powers imposed on and exercised by individuals with various degrees of discretion and recalling that it is trustees that own property and not entities called 'trusts'.

Therefore, trusts compared with companies place much heavier obligations on trustees who can be personally liable, when compared to the obligations placed on directors and the trustees range of legitimate discretion means that there is greater room for disagreement and disputes between settlors, trustees and beneficiaries on how trustees exercise their independent powers and therefore perhaps creating a greater potential for such disagreement and litigation.

It is also the case that the Hague Convention does not displace local procedural law and the application of which may lead to different outcomes from what might be anticipated under international and its underlying English trust law. That divergence might also be conscious by the local jurisdiction in distinguishing itself from competing jurisdictions.

**A Russian trust law?**

There has of course been a debate in Russia about introducing its own form of the trust concept since the 1990's and recently the Russian government is consulting again in this regard and presumably as a political solution to the practical issues arising from the natural competing interests following Russia's controlled foreign companies' legislation.

Is a Russian trust law a good idea? I can only say as an outsider that the practical consequences might be that the state in common with the experiences of other states, will be that it will not have the resources to police overseas arrangements and so those arrangements will be abused and there being a difficult period for trusts and their adventurous use when government catches up with them. Domestically, the obligations placed on trustees who are individuals may in practice be so onerous that the concept may be little used and so not provide the broader based answer to the requirements of a larger part of society, rather than a narrow part.