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Asset protection trusts in tax havens

Robert Gordon *and* ***Etienne Waring*** *POINTON PARTNERS*

Broadly speaking, an asset protection trust is any form of trust that provides for funds to be held on a discretionary basis (the best known form, of course, being the common family trust) to be dealt with for the benefit of its beneficiaries. While such trusts have obvious potential benefits (for example, flexibility of taxation planning and bypassing family breakdowns or the bankruptcy of the beneficiaries), establishing them creates a personal legal obligation on the legal owner of the property (ie, the trustee) to comply with a myriad of general duties.

In some tax havens, there has been a movement away from some of these traditional duties, which, for example, has extended to the lessening of trustee liability. This has resulted in some commentators discussing whether the "irreducible core" concepts of a trust, as entrenched in English law, are being left behind in favour of measures to drive new business.[1] Indeed, if the legislature went too far, there is a risk that these special trusts may be considered by onshore courts to be bare trusts, such that the client is regarded as the beneficial owner.

In addition, some tax havens have introduced laws specifically drafted to make actions (chiefly from overseas) against offshore asset protection trusts particularly difficult, which, combined with the potential taxation advantages,[2] makes their use in these jurisdictions significantly more attractive than in the past.

As a result of the increased attacks on onshore discretionary trusts,[3] we are likely to see an increase in the use of trusts in offshore jurisdictions by well-informed business people, especially in offshore jurisdictions where there is no reciprocal enforcement of judgments legislation in force.[4] In the Australasian time zone, there are a number of jurisdictional options.

The nature of trustee duties

The duties of an onshore trustee are onerous but, in particular, these duties include to:

- exercise the care, diligence and skill of a prudent person (a higher standard applies to trustees whose profession, business or employment involves them acting as trustees);[5]
- keep suitable, accurate and up-to-date records, which beneficiaries can request to inspect;[6] and
- invest funds[7] in accordance with the terms of the trust.[8]

Professional trustees have generally sought to overcome some of the above duties by having the trust acquire shares in a company though which the client can carry out the intended activities, rather than though the trust itself,[9] and ensuring that the trust deed contains an "anti-*Bartlett* clause", to absolve the trustee from any duty to interfere with the management of the company. In *Bartlett v Barclays Bank Trust Co Ltd*,[10] a trustee was found to be under a duty to act in relation to investee company shares that had dramatically dropped in value.

Offshore trust law developments (outside the Australasian time zone)

Reduction of duty to invest in the British Virgin Islands

Perhaps the best known of all offshore tax havens[11] is the British Virgin Islands (BVI). In 2004, the Virgin Island Special Trusts Act 2003 (BVI) (VISTA) came into force. VISTA was, principally, established to enable a trust of shares in a company to be established under which:

- the shares may be retained indefinitely; and
- the management of the company may be carried out by its directors without any power of intervention being exercised by the trustee.[12]

In other words, a VISTA trust allows protection of the trustee over and above what may have been available by virtue of a potentially unenforceable anti-*Bartlett* clause.

Purpose trusts in the Cayman Islands

At common law, except in relation to trusts with charitable purposes, to be a valid trust there must be beneficiaries. However, non-charitable purpose trusts have been developed in a number of offshore jurisdictions. The Cayman Islands, which is another well-known tax haven,[13] introduced the Special Trusts (Alternative Regime) Law 1997 (Cayman Islands) (STAR) to allow for the establishment of STAR trusts. The main features of STAR trusts are:

- the rule against perpetuities does not apply (ie, the trust may exist indefinitely);
- the beneficiaries and/or objects may be persons, purposes or both;
- the beneficiaries have no right to enforce the terms of the trust (this power is reserved to special persons appointed as "enforcers" and to courts);
- the beneficiaries have no right to information about the trust; and
- the trusts are not rendered void because of an uncertainty as to their objects.

Reserved powers of settlor

Both BVI and the Cayman Islands have allowed settlors some reserved powers.[14]

Recently in Cyprus,[15] s 4A of the 2012 amended Cyprus International Tax Law grants settlors broad reserve powers. These include:

- a power to retain a beneficial interest in the trust;
- a power to act as the "protector" or "enforcer" of the trust;
- a stipulation that the trustees' powers are exercisable only with the consent of the settlor; and
- powers to amend the terms of the trust, apply income or capital, give binding directions to the trustee, and appoint and remove the trustee.

While reserved powers are reasonably common,[16] at least one author has referred to uncertainty as to whether the protection afforded under Art 2 of the Hague Trusts Convention[17] — "the reservation by the settlor of certain rights and powers is not necessarily inconsistent with the existence of a trust" — was intended to or can extend to the above extent.[18]

Jersey

The most litigated of the special trust provisions are probably those in Jersey[19] in relation to English divorce proceedings,[20] as Jersey has reciprocal enforcement of judgments with the United Kingdom. The Trusts (Jersey) Law 1984 was amended in 2006 so as to give precedence to the Jersey law over the personal law of the settlor or beneficiary in relation to the validity or interpretation of a Jersey trust, dispositions to the trust, capacity of a settlor, and powers and liabilities of the trustee, including claims of heirship rights (other than for a Jersey settlor) or other claims based on a personal relationship with the settlor, with foreign judgments not to be enforceable inconsistent with such provisions.[21]

Offshore trust law developments (Australasian time zone)

Generally speaking, jurisdictions that follow English common law are, naturally, where it would be expected that asset protection trusts might be most useful. Within the Australian business day, Hong Kong, Malaysia, Singapore, New Zealand and Vanuatu come to mind. However, only some incorporate any of the developments discussed above.

Hong Kong and Singapore

Trust law in Hong Kong is mainly based on English common law, supplemented by the Trustee Ordinance and Perpetuities and Accumulations Ordinance.[22] The Hong Kong government has introduced the Trust Law (Amendment Bill) 2013, which seeks to:

- introduce a statutory duty of care on trustees;
- allow professional trustees to receive remuneration;
- impose statutory control on exemption clauses that seek to relieve professional trustees from liabilities;
- allow settlors to reserve some powers (including of investment and asset management); and
- abolish the rule against perpetuities.

The Hong Kong Reform Bill, therefore, is relatively modest compared to legislation in BVI, Cayman, Jersey and Cyprus.

Earlier than Hong Kong,[23] Singaporean trust law, which is governed by common law and the Trustees Act 1967, was revisited in 2004 to make that jurisdiction more competitive from a trust perspective, given its standing as one of the world's leading financial centres.[24] In the summary, the revisions to the law included:

- a general power of investment and statutory duty of care replacing the old very restrictive authorised investments regime (note that the statutory duty of care can be "contracted out" in the terms of the trust);
- a codified ability for settlors to reserve certain powers without the validity of the trust being questioned; and
- the introduction of a 100-year perpetuity period replacing the common law limit of a 21-year life in being for non-charitable trusts.

Malaysia

As with Hong Kong and Singapore, the Malaysian legal system is based on English common law and rules of equity (along with the Trustee Act 1949). Ordinary Malaysian trusts with a suitably drafted deed are useful in international planning, as long as the source of the trust's income is not Malaysia under the Income Tax Act (Malaysia).[25] Unlike Hong Kong and Singapore, Australia does not have reciprocal enforcement of judgments with Malaysia.

Labuan, Malaysia

The island of Labuan is a federal territory of Malaysia and has been set up since 1990 as a tax haven. As well as being part of the common law system, special federal statues deal with tax,[26] company and trust law for Labuan entities.[27] The Labuan Trusts Act[28] (LTA) provides for the regulation of Labuan trusts and confers statutory benefits on Labuan trusts,[29] which are the ultimate in the development of asset protection trusts. Since 2010, these benefits include settlors' reserved powers, choice of no perpetuity period,[30] and, like the VISTA trusts in BVI, a Labuan special trust absolves the trustee from responsibility in relation to the affairs of a Labuan company in which it owns shares (s 46F).

Sections 10 and 11 of the LTA contain some of the most important benefits provided to Labuan trusts, by putting up barriers to enforcement of foreign claims:

- Section 10(1) specifies that no foreign law or judgment in relation to marriage, succession rights or insolvency (except as allowed under s 11) will be enforceable against the Labuan trust.
- Section 11(1) places the onus of proof, beyond reasonable doubt, on any claimant against a Labuan trust, to prove that the settlor created, registered or disposed of property to a Labuan trust with an intent to defraud that creditor, and that transaction rendered the settlor insolvent, or without property to meet that claimant's debt.
- Section 11(4) specifies that the creation, registration or disposition shall not be fraudulent if that happens before the creditor's cause of action against the settlor accrued. Section 11(3)(a) does likewise where the creation, registration or disposition occurs more than two years after the creditor's cause of action accrues. Where the creditor's cause of action accrues within two years of the creation, registration or disposition, it shall not be fraudulent if the creditor fails to commence action in Labuan within one year of the creation, registration or disposition (see s 11(3)(b)). This is a very strict and severe limitation period, which would defeat most potential litigants.
- Section 11(5) specifies that a settlor will not have imputed to him or her an intent to defraud a creditor because the settlor has created or registered an offshore trust, or disposed of property to it, within two years from the date of the creditor's cause of action accruing, or because the settlor is a beneficiary of the trust.
- Section 11(1)(b) specifies that a successful claim may only be met out of the property of the trust the subject of that fraudulent transaction, but otherwise leaves the Labuan Trust intact.

Thus, aside from being required to discharge a criminal burden of proof, the creditor's claim will not put the other assets of the Labuan trust at risk and no such claim could void the creation or resettlement of the Labuan trust. This stands in stark contrast to the usual range of equitable remedies in such cases, which would, save for s 11(1), include a declaration that the trust is void, orders against the trustee to account and equitable damages.

It should also be emphasised that the Malaysian Reciprocal Enforcement of Judgments Act 1958 does not name Australia as a jurisdiction from which judgments will be able to be registered under that Act. Accordingly, a party, for instance, to a family law dispute will need to claim enforcement of the Australian judgment under common law principles in Malaysia. One ground for refusal will be Malaysian public policy,[31] and the provisions of LTA will prevail.[32]

The above protections, combined with the way Labuan trusts are taxed, make Labuan an attractive option for business people in the Australasian time zone.[33]

New Zealand and Vanuatu

New Zealand has a very active onshore and offshore trust industry.[34] However, its trust law has not been amended to provide the particular asset protection features of some of the other jurisdictions discussed in this article. Of great note is that New Zealand has reciprocal enforcements of judgment with Australia.

While Vanuatu has an active offshore trust industry,[35] it has not amended its law to provide the particular asset protection features discussed in this article.[36]

Conclusion

Given the options available in the Australasian time zone, we are likely to see an increase in the use of trusts in such offshore jurisdictions, especially where there is no reciprocal enforcement of judgments legislation in force, such as with Malaysia.

Robert Gordon
Consultant
Pointon Partners
rmg@pointonpartners.com.au
www.robertgordontax.com
www.pointonpartners.com.au

Robert Gordon joined Pointon Partners in 2012 after 20 years at the Sydney and Melbourne Bars. He practises in all areas of tax, with a special interest in international tax. Before going to the Bar, he was a tax partner at Corrs Chambers Westgarth. Robert has a Master of Laws from Monash University, is a Chartered

Tax Adviser and a Trust and Estate Practitioner, and has an Advanced Diploma of International Tax from the Chartered Institute of Taxation (London).

Etienne Waring
Lawyer
Pointon Partners
ew@pointonpartners.com.au
www.pointonpartners.com.au

Etienne Waring practises in commercial, property, taxation, litigation and personal law. He graduated with a Bachelor of Laws with First Class Honours from Victoria University in 2010 and with a Bachelor of Arts from La Trobe University in 2006.

Footnotes

1. Commentators referred to by the Hon Anthony Smellie QC in his speech "Balancing the requirements of the trust with fairness and probity — a perspective from the Cayman Islands", *International Trusts & Private Client Conference*, Ritz-Carlton Hotel, Cayman Islands, 5 October 2012. See also B Steiner, "A rock, a hard stone and the unknown — trustees duties and liability for operating companies" (2011) 10(4) *Trust Quarterly Review* 29, p 30.
2. The taxation advantage of most offshore trust jurisdictions is simply that they generally do not levy any significant tax. However, for clients in high-tax countries such as Australia, the income and gains of such trusts will usually be "attributed" to the client under the "transferor trust" (TT) regime. Penalties apply even for failure to disclose the existence of such a trust. Generally, such attribution ceases on the death of the client, or the client ceasing to be a resident, so that thereafter income can be accumulated offshore for family members with no onshore tax until the beneficiary accesses the funds. If the client's purpose is principally asset protection, paying tax on the offshore trust's income may not be an issue, as that would have happened had the trust been an onshore trust. Interestingly, since the abolition of the "foreign investment fund" (FIF) regime on 1 July 2010, TTs can obtain Australian tax deferral on what would have been FIF interests, and even if the proposed "foreign accumulation fund" (FAF) regime comes into force, as it only deals with "debt interests", the TT can get tax deferral on non-distributor managed equity funds in tax havens.
3. *Re Australian Securities and Investments Commission (ASIC); Richstar Enterprises Pty Ltd v Carey (No 6)* (2006) 153 FCR 509; 233 ALR 475; [2006] FCA 814; BC200604846; *Kennon v Spry; Spry v Kennon* (2008) 238 CLR 366; 251 ALR 257; [2008] HCA 56; BC200810608; *Rafferty v Time 2000 West Pty Ltd (No 9)* [2011] FCA 1483; BC201109856.
4. The Foreign Judgments Act 1991 (Cth) deals with "money judgments". The Cross Border Insolvency Act 2008 (Cth) may be relevant to bankruptcy or insolvency, and the winding up of companies, but note that, to date, of the countries discussed in this article, only New Zealand and the British Virgin Islands have adopted the UNCITRAL Model Law upon which it is based. Australia has not adopted any international treaty that deals expressly with property disputes in the family law context, and so the Foreign Judgments Act is the only relevant legislation. Traditionally, foreign revenue judgments were not enforceable at common law: *Government of India v Taylor* [1955] AC 491; [1955] 2 WLR 303. This position does not apply between EU members (Council Directive 2001/44/EC). Australia has limited Double Taxation Agreements that require it to enforce tax on behalf of treaty partners such as New Zealand, Finland, Norway, France and South Africa. However, Australia has recently ratified the Organisation for Economic Co-operation and Development's Mutual Administrative Assistance in Tax Matters Convention, as have some 80 other countries — notably not including Malaysia.
5. Trustee Act 1958 (Vic), s 6(1). Note that codified duties of trustees are covered by equivalent legislation in other jurisdictions, such as the Trustee Act 1925 (NSW), s 14A(2)(a).
6. *Schmidt v Rosewood Trust Ltd* [2005] All ER (D) 333 (Jun); [2005] UKPC 26; [2005] 1 WLR 3335; *Breakspear v Ackland* [2008] All ER (D) 260 (Feb); [2009] Ch 32; [2008] 3 WLR 698; [2008] EWHC 220 (Ch).
7. *Byrnes v Kendle* (2011) 243 CLR 253; 279 ALR 212; [2011] HCA 26; BC201105711 at [22]–[23], [72]–[73], [119].
8. Trustee Act 1958 (Vic), s 6(2).
9. From an Australian tax perspective, where the funds placed offshore are to be invested in an active business, they would normally be subscribed into a controlled foreign company (CFC) to carry on the business and, generally, such income will not be attributed from such a CFC and the CFC does not pay a dividend to the trust. Often, there will be two classes of shares in the CFC with discretionary dividends payable on a class of share held onshore by an Australian resident company, so that the dividend can be received tax free under the participation exemption (Income Tax Assessment Act 1936 (Cth), s 23AJ).
10. *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515; [1980] 1 All ER 139; [1980] 2 All ER 92; [1980] 2 WLR 430.
11. There is no income tax in the British Virgin Islands. However, there is reciprocal enforcement of judgments legislation with Australia (in Australia, see the Foreign Judgments Regulations 1992 (Cth)).
12. Virgin Island Special Trusts Act 2003 (BVI), s 3.
13. There is no income tax in the Cayman Islands. However, there is reciprocal enforcement of judgments legislation with Australia.
14. Section 86 of the British Virgin Islands Trustee Act 1961 and, in the Cayman Islands, the Trusts (Amendment) (Imminent Effect of Reserved Powers) Law 1998.

15. Cyprus is a tax haven of sorts — that is, there are special low-tax rules for non-resident controlled entities. For example, there is no income tax on foreign-source income of an "international trust". Note that there is no reciprocal enforcement of judgments legislation with Australia. However, as the recent banking crisis in Cyprus shows, careful consideration is needed regarding where bank accounts should be kept and not keeping "all the eggs in the one basket".
16. For example, s 9A of the Trusts (Jersey) Law of 1984 (inserted in 2006).
17. Hague Convention on the Law Applicable to Trusts and on Their Recognition.
18. E Yiolitis, "The powers that be" (2013) 20(10) *STEP Journal* 53.
19. Jersey is a tax haven of sorts, as it does not have capital gains tax and does not tax foreign source income or interest on Jersey bank deposits.
20. See J Gleeson, "Alteration or variation? Mubarak v Mubarak in the Royal Court of Jersey" (2008) 6(4) *Trust Quarterly Review*; Z Howard, "*Aaliya Mubarak v Iqbal Mubarik* [2008] JCA 196" (2009) 7(1) *Trust Quarterly Review*; A Laws, "Mubarak, a Guernsey viewpoint" (2009) 7(1) *Trust Quarterly Review*. The Trusts (Amendment No 5) (Jersey) Law 2012 (entered into force 2 November 2012) has made refinements in the light of *Mubarak*.
21. Jersey does not have reciprocal enforcement of judgments with Australia.
22. Cap 257 (Hong Kong).
23. Hong Kong is a tax haven of sorts — that is, there is no capital gains tax and foreign source income is not subject to tax.
24. Singapore is a tax haven of sorts — that is, there is no capital gains tax and foreign source income not remitted into Singapore is not subject to tax. In summary, there are further specific exemptions for a Singapore Foreign Trust.
25. Malaysian source income would be taxable in Malaysia at the current rate of 26%. Dividends from Labuan companies are expressly exempt under that Act.
26. A Labuan trust is not taxed on investment income, and on trading income is taxed at 3% of audited profit, or a flat tax of RM20,000 (about US$6600), by election — in which case, no audit is needed. A Labuan company is subject to the same tax regime.
27. Under the Hague Trusts Convention, the specification in the trust deed that the law of the trust will be that of Labuan, Malaysia, must be recognised by signatories to that convention (ie, including Australia).
28. Labuan Trusts Act 1996 (Labuan, Malaysia) — the legislation is available at www.ectrustco.com.
29. For commentary, see M Lea, "Twenty first century trusts" (2010) 18(2) *STEP Journal* 65.
30. Sections 8B and 16(2) respectively.
31. See A V Dicey, J H C Morris and L A Collins, *The Conflict of Laws* (14th edn), Sweet & Maxwell, London, Rule 44, and the reference at ¶ 14-143 to *Mayo-Perrot v Mayo-Perrot* [1958] IR 336.
32. See, generally, *Jupiters Ltd (t/as Conrad International Treasury Casino) v Gan Kok Beng* [2007] 7 MLJ 228. See also, generally, K Pham, "Enforcement of non-monetary foreign judgments in Australia" (2008) 30 *Sydney Law Review* 663 and Dicey, Morris and Collins, above, n 31, ch 14.
33. For more on Labuan and avoiding cross-border estate disputes, see P K Searle, "Cross border estate disputes — minimise the risk", 15 October 2012, available at www.ectrustco.com.
34. While New Zealand is generally a high-tax country (although it has no capital gains tax), provided the settlor and beneficiaries are not resident in New Zealand, a NZ trustee is not liable to tax in New Zealand on foreign source income, nor is the settlor or beneficiaries.
35. There is no income tax in Vanuatu.
36. Note that there is no reciprocal enforcement of judgments with Australia.