



# Trusts: Weapons of Mass Injustice?

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February 13<sup>th</sup>, 2017

## Foreword

The title may provoke some trust practitioners and users, but many features that make trusts useful to their users can also be deployed for socially abusive and harmful purposes - just as defensive weapons can be used for offensive purposes.

This paper seeks to start a debate on the harms that trusts can inflict on societies, and what can be done about this. I take a global perspective (so not everything will always apply to each country), and propose global and local solutions. I do not address the *purely internal* relationships between parties to a trust (such as settlors, trustees and beneficiaries), but focus on trusts' impact on wider society.

With the support of



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<sup>1</sup> Special thanks for the extremely valuable feedback received from Adam Hofri-Winogradow, Adam Riff, Elise Bean, Graham Moffat, Heather Lowe, Jack Blum, Robert Palmer, Sol Picciotto and Stewart Sterk.

# Executive Summary

Trusts are usually described as a legal arrangements involving private family matters (such as caring for sick or vulnerable people, or arranging family affairs for tax and estate purposes.) A simple trust arrangement typically involves three parties: a settlor (such as a parent) transfers assets to a trustee (such as a trusted lawyer) who must hold and manage those assets according to the settlor's instructions, and for the benefit of beneficiaries (such as the parent's sick child).

This paper deals with the other side of trusts: the abuses and risks that they create and facilitate.

First, **secrecy**. While trusts may hold assets and engage in business just like companies, they hardly ever need to register, allowing the true owners, beneficiaries or controllers of trust assets to keep hidden, especially from public scrutiny. This secrecy enables all manner of financial crimes and abuses. Even when trusts *do* have to register, their complex control structures often confuse authorities about who really controls or benefits from the assets. We summarise our recent work explaining [who should be registered as a "beneficial owner" of a trust, which trusts should be registered, and how to enforce this](#), and the relevant information.

Second, trusts go beyond secrecy by shielding assets from the rest of society. They do this by placing assets into 'ownerless limbo', where the assets have legally been 'given away' but not yet received by a real, warm-blooded person – thus unreachable even by legitimate personal creditors of the parties to the trust, or tax authorities or crime-fighting agencies. Trusts' asset protection can be stronger than the usual limited liability available to shareholders of incorporated companies, and this is available not just for vulnerable persons, but for anyone, especially wealthy people accumulating wealth through generations, worsening inequality.

On top of all this, tax havens are engaged in a race to the bottom to offer ever more devious and illegitimate forms of trust law allowing multiple subterfuges to defeat the laws of other jurisdictions.

I suggest, as a basis for debate:

- requiring trusts to be publicly registered as a precondition for them to be legally valid and binding on third persons
- Mechanisms for piercing their asset protection that affects third parties outside the trust.
- Disallowing assets in "ownerless limbo", ever. In short, until they have been received by someone, then they should be considered as not having been given away.

Some problems require international cooperation: otherwise, people can move themselves or their money abroad, to escape new rules. Yet our proposals could be undertaken by a single country: not to solve the global issue, but to prevent trusts' from causing harm in their own territories.

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# 1. Introduction

## Two related global problems: Inequality and Secrecy

When inequalities of wealth and power get out of hand this can distort whole economies and societies. [Oxfam](https://www.oxfam.org/en/pressroom/pressreleases/2017-01-16/just-8-men-own-same-wealth-half-world)<sup>2</sup> reported in 2017 that the wealth owned by 8 individuals equals the wealth of the poorest half of the world population, and given that inequality has been a central factor in recent political earthquakes such as Brexit and the election of Donald Trump, it is surely fair to categorise this as an international emergency. And once wealthy elites become politically powerful enough they can influence laws in their interest, to stay in power or “legalize” schemes that help them and increase inequality further.

Trusts are one of the primary vehicles used to create and perpetuate wealth concentration, enabling wealthy elites escape tax, regulation and creditors - and they must lie at the centre of debates about inequality. Not only that, but the particularly deep secrecy that trusts can create is abused to keep illegal matters private, including tax evasion, money laundering, market rigging and corruption.

## The baby and the bathwater

Trusts - like companies, banks, or countries - are human creations. They exist, supposedly, to help society achieve its goals. This paper seeks to challenge the widely accepted notion that the benefits enjoyed by these legal arrangements, which first emerged around seven centuries ago, remain fit for the modern age.

This paper asks fundamental questions about trusts<sup>3</sup>. It explores how they can be useful but also harmful — and attempts to point the way toward a better system which preserves the socially positive uses while curbing or eliminating harmful elements: throwing out the unhealthy bathwater without also jettisoning the healthy baby. This paper sets out a bold, four-part proposal to update trust law for the modern age.

### 1.1 Should society trust trusts?

Trusts are widely used for proper legitimate business purposes and to protect vulnerable individuals. But trusts also pose two main dangers for society.

First, they can create impenetrable *secrecy*. This arises in part because, currently, trusts do not always need to disclose to authorities (let alone the

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<sup>2</sup> <https://www.oxfam.org/en/pressroom/pressreleases/2017-01-16/just-8-men-own-same-wealth-half-world>; 1.26.2017.

<sup>3</sup> This paper focuses on “express trusts,” which are expressly created, usually in writing - and not on trusts inferred by the law from the conduct or dealings of the parties.

public) all the individuals who own, control or benefit from them, or to disclose their underlying assets.

Second, they *manipulate ownership rights* so that individuals can control and enjoy trust assets while legally distancing themselves far enough from them, so that the assets cannot be reached or even known about by creditors, tax authorities, law enforcement, or public scrutiny. For example, [someone can have full use of a yacht or a house held in a trust](#)<sup>4</sup>, while not being the legal owner. These legal barriers can become impenetrable secrecy barriers shielding those people who enjoy and control the assets from scrutiny. But even if trusts and all the people and assets associated with them *were* to be fully registered and disclosed, this 'asset-shielding' function of trusts would still pose grave dangers.

By legally disconnecting assets from the people who control and enjoy them, trusts can convert wealth into "ownerless"<sup>5</sup> (but still "enjoyable") assets.

Matters are getting worse: rules that are supposed to limit abusive trust activities are steadily being eroded, in a race to the bottom, as new regulations designed to enable abusive trusts continue to pop up all over the place, particularly in offshore secrecy jurisdictions.

The increasing result is, so often, one set of rules for the rich and powerful, and another set of rules for the rest of us. The time has come for our societies to start pushing back against this system, which worsens inequality, facilitates endless crimes and market abuses, and undermines democracy.

## **Creatures of history**

In England during the Middle Ages, if a landowning knight, for instance, had to go off to war, he needed someone to manage his lands and property under a set of instructions for the benefit of his dependents while he was away (and in the event of his death) – without that manager being able to run off with the property for his own benefit. Trusts appeared to solve these and other problems.<sup>6</sup> Originally, the arrangements would be set up

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<sup>4</sup> For example, the New York Times reported on a story where trust assets were used by the settlor (a man accused of defrauding customers and his former spouse): "Oesterlund admitted that he had signed a rental agreement to live in the Toronto penthouse now owned by the trust. In that case, Fisher asked, was Oesterlund paying rent? Oesterlund looked up at the ceiling. "It's being accrued," he replied; no money was actually changing hands. Under orders from Rosen, one of his lawyers, Oesterlund refused to say who was paying the utilities and maintenance at the penthouse. But he admitted that the trust was paying to fuel, maintain and crew the *Déjà Vu* — a boat that he was the only person permitted to use, according to a copy of the boat's insurance contract." ([http://www.nytimes.com/2016/11/30/magazine/how-to-hide-400-million.html?emc=edit\\_ne\\_20161201&nl=evening-briefing&nid=65492409&te=1&\\_r=4](http://www.nytimes.com/2016/11/30/magazine/how-to-hide-400-million.html?emc=edit_ne_20161201&nl=evening-briefing&nid=65492409&te=1&_r=4); 26.1.2017).

<sup>5</sup> "Ownerless" because they do not belong to anyone's personal wealth.

<sup>6</sup> While an institute called *Uses* was meant to solve such issues, it failed to properly address problems when the person in charge of managing the lands (called the *feoffee to use*) decided to keep them to himself. In such a case, the family of the original owner had few means to get the land back. Trusts also helped avoid feudal restrictions on inheritance (for instance, rules aimed at concentrating landholdings for military and other reasons), which meant that land passed by descent according to primogeniture, rather than by an arranged will (Langbein 1995).

verbally, backed by community opinion and sometimes in the presence of sacred objects which gave the agreements divine authority. Over the centuries a body of law grew up to underpin trust arrangements (Harrington 2016: 40).

## What is a trust? Who owns assets in a trust?

A classic trust is a three-way arrangement. The original owner (the “**settlor**” or “**grantor**”) transfers assets into a trust, to be held and managed by the “**trustee**” or trustees, for the benefit of the “**beneficiaries**”. (To aid clarity, in this report we’ll denote the settlor as a ‘he’ and the trustee as a ‘she.’)

The trust assets could be any property: an original Picasso painting, a Nassau-registered yacht, farmland in Bolivia, a racehorse, an apartment in Manhattan or Mayfair, a diamond-encrusted sceptre, a Swiss bank account, a portfolio of Belgian shares, or a shell company which in turn owns all of the above. Anything, really.

Consider a common trust arrangement: A wealthy man—the settlor—transfers certain property to his attorney or a close family member—the trustee—and she in turn holds the property for the benefit of the wealthy man’s wife and children—the beneficiaries.

From a legal perspective, the settlor (the wealthy man in the example above) who has transferred assets into a trust, no longer owns those assets – although he may have some residual control over them via his instructions to the trustee (the lawyer or trusted family member in the example above).

The **beneficiaries**<sup>7</sup> (the wealthy man’s wife and children), don’t own the assets either, nor have direct access to them. They merely have *contingent interests* in them, depending on the terms of the trust deed and sometimes the discretion of the trustee. They may receive something later, or some of them may receive nothing. (More on this in Section 2.2.1 below.) But the beneficiaries don’t own the assets.

### Box 1: trusts and class warfare

“Not only are trusts themselves a holdover from the medieval period, but the practices and norms that define the work of contemporary trustees remain closely tied to chivalric custom: an aristocratic code based on service, loyalty and honour, with the purpose of defending large concentrations of wealth and power from attack by outsiders. In the past, those large fortunes consisted primarily of land, and were defended by force of arms. Today, the fortunes are financial, and the ‘income defence providers’ use legal and organizational strategies as their weapons of choice. But the objectives and results of this activity have remained remarkably consistent: the maintenance of a highly-stratified social structure through the preservation of large private accumulations of wealth.”

Brooke Harrington, 2012. “From trustees to wealth managers”. Pp 190-191.

<sup>7</sup> Beneficiaries are said to have ‘equitable ownership’ over trust assets, but in practice this type of ownership may be rather limited, for example with discretionary trusts.

So if the settlor does not own the assets, and the beneficiaries don't own them, then who does? The trustee or trustees?

Not really. The trustees are usually said to have legal ownership over the assets - but this is a narrow form of ownership because the trustees have fiduciary duties and are bound by trust law to manage those assets under precise instructions from the settlor (for example, via a "**trust deed**") and traditionally must act to benefit the beneficiaries.<sup>8</sup> Trustees cannot appropriate or benefit from those assets for themselves, beyond agreed management fees.

#### **Box 2: Letter of Wishes**

In most cases involving offshore trusts, trustees are given precise instructions in the form of a Letter of Intent (known in the U.S. as a Letter of Wishes) which sets out clear instructions from the settlor on how to proceed. These instructions may well include provisions requiring the trustee to consult the settlor on how assets are managed, and how and when distributions may be made. These Letters of Intent are key to understanding whether or not a trust is a sham (see Box 4) and should also be subject to registration requirements.

To summarise: trusts slice and dice up the concept of 'ownership' into different rights and duties. The settlor has rights to give instructions on the management and future ownership of assets, the trustee has rights to hold and manage those assets under the trust instructions, and beneficiaries have rights to obtain distributions from the trust or otherwise enjoy trust assets, but only under trust instructions or the discretion of the trustee.

Between the settlor giving away the assets, and the beneficiary properly receiving them, a legal fortress has been created, in which powerful legal shields have been inserted between the assets and the real people who stand behind and can benefit from them. So neither the settlor, the beneficiaries nor the trustees clearly own the assets, in the way you might fully 'own' that banknote in your pocket or that money in your personal bank account to do what you want with it. These assets sit in a kind of 'ownerless' limbo because they belong to no one's personal wealth.

And that presents great problems for someone external to the trust arrangement, (such as a creditor or tax<sup>9</sup> or judicial authority) that needs to get access to the assets.

This stronghold can, among other harmful things, create secrecy that goes far beyond the mere lack of registration of trusts and their relevant people and assets.

Those twin concerns – the secrecy and the legal shields – constitute our two principal concerns about trusts.

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<sup>8</sup> While, in principle, trustees have "fiduciary duties" to hold and manage the assets to benefit the beneficiaries, sham trusts may in practice be created where the purpose is to benefit the settlor, regardless of what the trust deed says or appears to say.

<sup>9</sup> Even if trusts are taxable in a country, authorities may never find out about its existence or may not be able to tax the settlor or beneficiary keeping assets in the trust.



## 1.2 What is the true purpose of modern trusts?

Trusts are used in many countries for a multitude of purposes, legitimate and illegitimate, and with a large grey area in between. They are widely used for managing individual and family wealth, and also for many commercial purposes. Other legal structures, like foundations and *anstalts*, are not trusts but can be used to achieve similar ends: they are not the focus of this paper.

Many roles played by trusts are socially useful.

For example, a trust can ensure that a reckless, spendthrift daughter can enjoy a steady stream of income from a trust for many years after the death of her wealthy parents: they know that if she merely received a lump-sum inheritance she might take it to Las Vegas and lose it in a week. Similarly, a trustee can financially care for a sick or disabled child or elderly relative. Genuine charitable foundations can accumulate and manage assets and ensure the income is distributed wisely by trusted managers.

In the commercial arena, they are used to manage investment portfolios, to invest in real estate (real estate investment trusts or REITs<sup>10</sup>); to create special purpose vehicles that secure financing for specific projects; to undertake business ventures rather like companies.

Some functions may benefit individuals but harm wider society.

Trusts are widely used for holding family assets across generations, escaping inheritance and other taxes, shielding wealth from legitimate creditors, and overturning legally established rights of heirs and former spouses (affecting women especially.)

Some trusts facilitate crimes or other wrongdoing such as tax evasion, hiding the proceeds of corruption, and money laundering.

Making matters worse, tax havens and secrecy jurisdictions cater to an industry of 'enablers' who specialise in

### Box 3: Trusts and the global financial crisis

Trusts are routinely used by banks to escape financial regulations. For example, they have been used to legally separate themselves from assets (like mortgage backed securities) thus taking those assets off their balance sheets while continuing to profit from them, and freeing up their balance sheets so that they can continue to engage in new, transactional, speculative and risky activities, with greater embedded leverage. For instance, PwC states, in [a how-to guide](#) on Special Purpose Vehicles:

*The SPV legal entity is usually set up as an 'orphan company' with shares settled on charitable trust and with professional directors provided by an administration company in order to maintain independence between the underlying assets and the originator and to ensure that the assets of the SPV do not appear on the balance sheet of the originator."*

Many of the big financial crashes of the recent crisis involved this basic function, which ultimately turned out to be abusive of society.

<sup>10</sup> Dan Neidle, a partner at Clifford Chance, raised a criticism here that REITs are companies and not trusts. This is itself erroneous: the relevant US code (Title 26; Subtitle A; Chapter 1; Subchapter M;

creating trust laws that help the parties to a trust pursue abusive or criminal ends.

Take, for example Sam and Charles Wyly in the United States, who set up a number of offshore trusts and used them to commit securities and [tax fraud by shielding more than \\$1 billion in family wealth](#) – or the billionaire international art Dealer Guy Wildenstein whose trust-based financial schemes were described as “the longest and the most sophisticated tax fraud in contemporary France”<sup>11</sup>. The new Duke of Westminster in the UK managed to inherit an estate of £9 billion held in trust, escaping [around £3 billion in tax](#)<sup>12</sup>.

The [former Ukrainian president, Viktor Yanukovich](#)<sup>13</sup> allegedly acquired the state-owned Presidential Palace without a competitive tendering process and held it through an array of shell companies whose ownership chain ended in an impenetrable Liechtenstein trust – which also held the hunting lodge, and presidential planes and helicopters. Examples abound (see Annex II for more real-life abuses with trusts).

### 1.3 Did society choose trusts?

Trusts have endured for centuries, so one *could* argue that society “chose” to keep trusts and their like because, overall, they are useful and add value. But did “society” *really* make that choice?

Laws are often heavily influenced by lobby groups representing a wealthy minority rather than the public interest; legislators may not fully understand what they are being asked to do, particularly with complex issues like trust law; and some laws produce unintended consequences. And of course, trust laws originally designed with public benefits in mind can be subverted for more malign purposes. This dual-use characteristic, and the presence of an army of ‘enablers’ to exploit the malign possibilities, makes it difficult to design laws to ensure that the positives outweigh the negatives.

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Part II; § 856: "Definition of real estate investment trust") begins: "(a) In general: For purposes of this title, the term "real estate investment trust" means a corporation, trust, or association— (1) which is managed by one or more trustees or directors..." Full text is available at: <https://www.law.cornell.edu/uscode/text/26/856>. However, Mr Neidle is correct that REITs are not necessarily trusts, and so this section should be read with that caveat. We are grateful for the suggestion.

<sup>11</sup> A Court in 2014 concluded “The Wyls engaged in a thirteen year fraud, creating seventeen trusts and forty subsidiary companies, employing numerous IOM trustees, a veritable ‘army of lawyers,’ hiring an offshore accountant to hold records outside the United States, and delegating several domestic employees to handle the administration of the trusts. . .the Wyls were able to accumulate tremendous tax-free wealth.” (federaltaxcrimes.blogspot.com.ar/2014/09/wyls-ordered-to-disgorge-hundreds-of.html; 26.1.2017). Wildenstein and his brother Alec “[schemed to hide art and assets under the ownership of complex trusts and abruptly moved millions of dollars in artworks to Switzerland from New York days after their father died.](#)” As a consequence, “French tax authorities are seeking back taxes of more than 550 million euros” ([https://www.nytimes.com/2016/10/21/arts/design/wildenstein-tax-trial-ends-with-art-dealers-fate-in-tribunals-hands.html?\\_r=2](https://www.nytimes.com/2016/10/21/arts/design/wildenstein-tax-trial-ends-with-art-dealers-fate-in-tribunals-hands.html?_r=2); 26.1.2017).

<sup>12</sup> <http://www.dailymail.co.uk/news/article-3735458/How-new-Duke-avoid-3billion-tax-bill-Family-trust-save-Westminsters-fortune-death-duties.html>; 26.1.2017.

<sup>13</sup> <http://www.economist.com/blogs/easternapproaches/2014/03/ukraine-s-stolen-assets>; 26.1.2.17.

## Abusive regimes: overview

Some trusts are, from the outset, set up as “shams” in which the settlors or their beneficiaries never actually relinquish their ownership and control rights, while pretending that they have. Some jurisdictions specialise in facilitating these shams.

Some critics have described a process of the “stripping of the trust”, particularly since the mid 1990s, as tax havens and other jurisdictions engage in a race to the bottom, jettisoning safeguards to protect society, in order to attract international trust business from shady or corrupt wealthy people (Hofri-Wingradow 2015).

According to one estimate from 1999, 50-80 percent of all trusts are sham trusts; though some have suggested the true figure is higher.<sup>14</sup> Even rough precision is impossible: there are trusts that some would consider shams, while others with a different perspective would not (though these would generally be considered abusive by most reasonable people.) Section 4 provides an overview of the many abusive regimes.

Given that trusts started out with the goal of protecting powerful elites in the Middle Ages, and are now widely used to defraud creditors, hide crimes, evade taxes, and escape accountability, one has to wonder: is society even aware of how trusts are being used?

### 1.4 Our main arguments

This paper is now divided into four key sections.

In Section 2 we explore how trusts can create secrecy, and why that is a problem.

Section 3 goes beyond transparency and examines problems at the very core of the trust concept. Do the basic principles underlying trusts make sense in the modern age? If a trust shields people from accountability to creditors, spouses, or tax authorities, or if it helps politicians hide conflicts

#### Box 4: Examples of sham trusts

A revocable trust can be revoked and the money returned to the settlor. This is abusive because the settlor’s ‘giving away’ of the assets is supposed to be the essence of the trust, and it is that ‘giving away’ that creates the barrier between the settlor and the assets. If the settlor can get the assets back later, then that ‘giving away’ was a fiction. Alternatively, shams might involve a settlor still controlling and directing the trustee in managing the trust’s funds, enabling a world of mischief where the settlor continues to enjoy the assets, after supposedly ‘giving them away’. The trustee might give the settlor “loans” from trust funds which are never repaid, or invest in the settlor’s company which then mysteriously goes bust – and so on.

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<sup>14</sup> “In the Trusts & Estates 1999 Legalease Special Report, at p.26, Catriona Syed, wrote, ‘It is impossible to estimate how many sham trusts are currently in existence. Estimates vary from 50% to 80% of all trusts.’ Personal experience suggests that the figure is even higher than that. However, that depends on the trusts one is looking at and taking a broad view of what is a sham trust....” (Laidlaw 2000).

of interest or assets, without technically lying about their 'ownership' of the assets in question: do trusts provide an overall benefit to society?

Section 4 explores some of the more abusive trust regimes around the world.

Section 5 discusses possible solutions to the fundamental problems raised by this paper.

An Annex provides additional details.

## 2 Secrecy and transparency

### Trusts: two levels of secrecy

There are many "flavours" of financial secrecy.

For example there is famous Swiss banking secrecy where bankers promise to take your secrets to the grave. Another flavour is where, for example, a tax haven simply refuses to share information with other countries. More sophisticated strategies may consist of individuals indirectly holding assets under the name of anonymous companies or nominees, with each component in a different jurisdiction, in each of which it is hard to obtain information. This can create several tiers of secrecy.

Trusts compound all these problems. For one thing, they are often considered 'legal arrangements' (like any contract) rather than 'legal entities' (like companies) – so they are rarely registered.

Yet trust secrecy goes to a **deeper level** still because of the complex ways in which they manipulate the very concept of ownership. Unlike a company *owned* by one or multiple shareholders, trusts have no owners but involve different types of parties (settlers, enforcers, protectors, trustees, beneficiaries), muddying who actually controls and benefits from trust assets. The relevant parties of a trust may thus escape registration.

#### Box 5: Slippery trusts and corruption

"Investigators interviewed . . . argued that the grand corruption investigations in our database failed to capture the true extent to which trusts are used. Trusts, they said, prove such a hurdle to investigation, prosecution (or civil judgment), and asset recovery that they are seldom prioritized in corruption investigations [...] Investigators and prosecutors tend not to bring charges against trusts, because of the difficulty in proving their role in the crime. . . . they may not actually be mentioned in formal charges and court documents, and consequently their misuse goes underreported." (World Bank "Puppet Masters" report on legal vehicles and corruption, pages 45-46).

Box 4 highlights just how slippery trust secrecy can be. We now discuss the two levels of secrecy in more detail.

## 2.1 Level 1: what to register?

### 2.1.1 Lack of effective registration

Companies are 'legal persons,' almost as if they were real people, with rights and responsibilities.<sup>15</sup> Companies generally need to be registered somewhere in order to have a legal existence, and the act of registration confers these rights (such as limited liability or the possibility to engage in business), in exchange for which responsibilities (such as disclosure) are required.<sup>16</sup>

International bodies are now moving to increase the transparency of companies. Leaders of the G-8 countries recently called for the creation of corporate registries that include the names of the true owners (called "beneficial owners" or "ultimate beneficial owners") of the companies formed under their laws. The European Union has gone even further, requiring its member countries to establish registries for their legal persons, with the beneficial ownership information to be made available to law enforcement and others with a "legitimate interests"<sup>17</sup>.

#### Box 6: Can a trust *itself* own assets?

If the trustee is 'legal owner' of an asset, and a trust is not an entity but merely a 'legal arrangement' or contract, then can a trust *own* anything?

There is much confusion here. In practice, trustees are recorded as the legal owners ("owners in trust") of an asset such as a house. However, sometimes trusts *themselves* are recorded as owning the assets. Some classification systems deem them to be 'entities' and even give them tax identification numbers, or TINs. So trusts frequently behave and are treated a lot like companies and other entities, which is another good reason to demand registration of trusts, just like with companies.

Some countries do not recognise the concept of trusts. A trustee may not be able to invoke a trust to show that they don't fully own the assets, and that makes it risky for settlors and beneficiaries: they could, for instance, completely lose the assets to an unscrupulous trustee, or creditors of the trustee might be able to access the assets.

In 1985, a group of countries concluded the **Hague Convention** on recognising trusts, to try and formalise rules on trusts, to cover these and other matters. However, as of 2010 there were only 12 contracting states to the convention.

Trusts, by contrast, are usually treated merely as legal agreements or arrangements (like contracts) rather than legal persons. (In general it is not the trust itself, but the trustees, who are recorded as the legal owners - "owners in trust" - of the trust assets.)

Trusts are rarely registered with a government agency as a precondition for their existence (let alone publicly disclosed). In fact, it can be exceedingly difficult to find out about a trust's assets, settlors, beneficiaries, trustees, and other related

<sup>15</sup> The inter-governmental Financial Action Task Force (FATF) that publishes the Anti-Money Laundering Recommendations explains: "Legal persons refers to any entities other than natural persons that can establish a permanent customer relationship with a financial institution or otherwise own property" while "References to legal arrangements such as trusts [...] refers to situations where a natural or legal person that is the trustee establishes the business relationship or carries out the transaction on the behalf of the beneficiaries or according to the terms of the trust" (FATF 2012: 58; emphasis added).

<sup>16</sup> In the case of an unregistered entity, its members or shareholders would be personally liable with their personal assets to the entity's creditors.

<sup>17</sup> For instance, the European Union's Fourth Anti-Money Laundering Directive approved on May 20<sup>th</sup>, 2015, requires registration of legal persons under Article 30, but has more limited requirements for legal arrangements, such as trusts, one article below.

parties – or about its very existence. When trusts *are* registered, this is often only with tax authorities, and in ways that are often merely symbolic and hard to enforce (see Box 6). Even then, it is usually only the trustees who are identified and not the real warm-blooded people who truly control or benefit from the trust.

Yet (as Section 3.3.2.1 describes) there is no obvious reason why trusts should be allowed to enjoy similar rights and privileges as companies do in terms of separation of assets (indeed, their users typically enjoy even greater rights than the users of companies) without them also having to share at least as much responsibility and transparency, in return for these privileges.

We propose two ways forward.

First, in an ideal scenario, *all* types of [entities](#)<sup>18</sup> and [arrangements](#)<sup>19</sup> (including trusts) and all their related parties should be registered with government authorities.

Second, as already happens with respect to most legal persons, all types of entities and [trusts should be registered](#)<sup>20</sup> as a precondition for their having legal existence. This is the only way to ensure compliance: basically by saying that unless the trust is registered, it doesn't legally exist or cannot operate, such as opening a bank account, owning an asset.

Third, we advocate that these registers be made public.

For those who complain about invasions of privacy, it is important to remember that nobody is forcing them to set up a trust. Trusts confer privileges provided by society (asset protection, changing title to assets, possibility to engage in business) – and to gain access to those privileges, society is entitled to ask for responsibilities in return. In addition, most if not all legitimate uses of trusts can be achieved via other vehicles, like companies, partnerships or wills<sup>21</sup> (for inheritance purposes). Since trusts may affect third persons, especially creditors, [trusts cannot be said to involve only private matters](#)<sup>22</sup>.

What is more, we propose specific exemptions to preserve necessary privacy.

We now discuss these proposals in more detail.

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<sup>18</sup> See Knobel/Meinzer (2016a) for more details.

<sup>19</sup> See Knobel/Meinzer (2016b) for more details

<sup>20</sup> See Knobel (2016) for more details

<sup>21</sup> It could be argued that trusts are better because neither legal interest nor the equitable interest need to be subject to probate – that is, the 'proving' of a will in court. Likewise, a corporation (or its shareholdings) would be inherited. In addition, a trust could serve to administer multiple, successive, shifting and contingent property interests. However, whether this shifting of contingent interests is legitimate will be discussed below, since it can be used to defraud creditors (preventing defaulted beneficiaries from receiving a distribution) or avoid inheritance tax (if a person may use an estate without ever inheriting it).

<sup>22</sup> <http://www.taxjustice.net/2016/12/07/beneficial-ownership-disclosure-trusts-challenging-privacy-arguments/>; 26.1.2017.

### 2.1.2 Which trusts to register: domestic law and foreign law trusts

Since trusts currently don't need to be incorporated, a person in, say, France could choose to create a French trust (called *fiducie*) using local laws, or they could set up foreign law trust, say, a UK trust, meaning a trust formed and in principle regulated under the laws of the UK (without needing to be in the UK). Different combinations are possible, with different parties to the trust located in different jurisdictions, each with different implications (see Section 4.5).

#### Box 7: Registration of trusts in practice

Some countries require registration of domestic-law trusts while others require registration of foreign-law trusts which have a locally resident trustee or are managed locally. However, more than 50 jurisdictions (half of all covered by the [Financial Secrecy Index](#) (FSI)) require no registration of trusts, or they require registration but with loopholes or restrictions, as the Section below explains.

A few countries require some types of trusts to be registered with their tax authorities under certain circumstances (see Annex I). For instance, registration is required if the trust has income attributable to the jurisdiction (Malta), if the trust carries on a business (Cyprus), or when the trust may be chargeable for tax (UK, among others).

This limited approach is problematic for several reasons. Money laundering and other financial crimes may take place whether or not taxes are owed (or even paid). Even where trusts are reported to tax authorities, that information is usually kept confidential so creditors and foreign authorities can rarely find out about the trust's existence. In addition, a fine is typically the worst sanction for failing to register, so criminals risk little when dodging registration requirements.

### Who should be considered a beneficial owner of a trust and thus be registered?

To understand which related parties to the trust should be registered, it is necessary to understand more about trusts' complex ownership and control structures. The next section explores this.

## 2.2 Level 2: who to register?

Ownership of companies is usually divided into shares. Control over the company, such as the right to vote or appoint the Board of Directors, and economic benefits (e.g. obtaining dividends) in principle, is based on shareholdings. That is why in principle, when it comes to companies, shareholders have to be registered as owners. Also, depending on the threshold of ownership (usually above 25%), these "large" shareholders will have to be registered as "beneficial owners".

With trusts, however, ownership and control can be much more complex.

To recap: trusts are generally defined as legal arrangements where a person (the **settlor** or grantor), gives assets into a trust to be managed or held by a **trustee**, in favour of **beneficiaries**. The document that creates and regulates the trust is called the **trust deed** (though other types of confidential contracts that create trusts exist, too: see below.) Once a trust is created, the trust assets are not wholly owned by the settlor, trustee, or beneficiaries, making simple transparency a difficult issue.

### 2.2.1 Determining trusts' real owners or controllers

Unlike companies where shareholdings serve as a proxy for ownership and control, trusts have no such clearly defined powers of control. So, who should be identified?

The first and obvious choice would be the **trustee**, who is often described as the "legal owner" of the trust assets. But the trustee cannot use or manage trust assets for their own benefit, like someone "owning" a 50 euro note. She is restricted by the trust deed's instructions and assets are only held for the benefit of beneficiaries. So identifying the **trustee** as the only owner (let alone the only "beneficial owner") of the trust assets would be rather like identifying the CEO of a company as the owner of corporate assets simply because she runs things on a day to day basis.

How about the **settlor**? A settlor may have significant control over a trust's assets, depending on the terms of the trust deed and other side documents, and the regulations of the jurisdiction under whose laws the trust is set up. The settlor may, for instance, retain a right to veto the trustee's decisions; to remove or appoint the trustees; or to appoint a "protector" or "enforcer" with power to do these things.

Many settlors write a "letter of wishes" which accompanies the trust deed and makes clear to the trustee exactly how the settlor expects the latter to operate the trust. Some tax havens allow the creation of evocable trusts (which, if revoked, may return the trust assets to the settlor as if the trust had never existed.) And so on: in a world of tax havens, the possibilities seem endless.

Since trust documents explaining the control structure may be secret or too complex to determine who is effectively in control, it is essential to identify and register the settlor, who was the original owner of trust assets. While on paper it may seem that the settlor has given up control, general practice - and common sense - make it clear that not all settlors comply with the legal description: after all, how many people are willing to transfer all their wealth and lose control over it?

Trusts are not easily accepted in many societies, particularly where social trust is low. As one wealth manager put it, "When you propose to elderly Chinese gentlemen, 'Look, I'll tell you what, how about you give me control of your assets and I'll hold on to them for you and our kids until you need them, at which point I may or may not give them to you? And by the way, you'll be paying me a hefty fee all the while,' the elderly Chinese gentlemen laugh very hard for a long time." Many prefer structures like foundations where settlor control is stronger, though some jurisdictions specialise in creating strong settlor control in a (supposedly) trust structure, like the BVI's VISTA trust, described below. (Harrington 2016, p107, p114-115).

So how about **beneficiaries** as owners?



Things are even trickier here. Beneficiaries may be pre-determined (for example, someone's living children), or *determinable* (future grandchildren, the victims of a specific accident), or just potential (for example, those chosen from a range of possible beneficiaries by the trustee's own discretion in a discretionary trust: see Section 4.3.3 or Box 7). They may even be non-existent (for example, in a purpose trust: see Section 4.3.2). Some argue that beneficiaries should only be identified once they have received a distribution from the trust. However, potential beneficiaries may never receive a distribution, or they may be able to control the trustee even before a distribution takes place.

#### Box 8: Discretionary trusts

A country could take the view that if a beneficiary is entitled to future distributions out of a trust, even if she doesn't own them yet, then they could deem her to be the assets' owner.

One way to get around this is to create a Discretionary Trust. Here, there is a range of beneficiaries, and the trustee has 'discretion' over which of those *potential* beneficiaries might get what, and when – if anything. So these are only 'potential' beneficiaries – any one of them might get nothing. If a potential beneficiary has creditors, for instance, the trustee might give her nothing, simply to keep the assets out of her creditors' hands (while still allowing her to *enjoy* the assets.) These potential beneficiaries cannot be said to be 'owners' until there is a distribution. This is such an effective strategy that most asset protection trusts are discretionary trusts. Section 3.3.3 shows ways to tackle this.

Like settlors, depending upon how a trust instrument is written, beneficiaries may be able to write letters of wishes, appoint trust protectors or enforcers, make recommendations on how trust assets should be handled, or otherwise exercise some degree of control over the trust assets.

In light of this complexity, what should be done? Identify no one and benefit with secrecy those who create complex structures? This is no answer.

The only answer is to identify all beneficiaries, potential beneficiaries, or classes of beneficiaries mentioned in the trust deed (e.g. "all the grandchildren of X," or "refugees from Syria") explicitly. This information should be updated when things change: for example, when one of X's grandchildren is born, its name should be registered (like any company that registers the holders of new issued shares). Beneficiaries receiving a distribution should be registered, and distributions should only be **considered legally valid** if the beneficiaries had already been appropriately registered.

The same registration requirement should be made for **protectors** or **enforcers** who are appointed or controlled, usually by the settlor, to ensure that the trustee will do as the settlor wished (or wishes).

Given the infinite ways of adding control and complexity to trusts, unless every related party to the trust (all settlors, trustees, beneficiaries, classes of beneficiaries, potential beneficiaries, protectors, enforcers or any other person mentioned in the trust document) is registered, the real person with control over the trust may be missed<sup>23</sup>.

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<sup>23</sup> The registered person should be the real natural person owning, controlling or benefitting from such role, and not a nominee, proxy or company that is inscribed in any of those roles. For example, if a company is named as trustee, the beneficial owners (the natural persons who are the real owners or controllers of that company) should be registered as well.

In contrast to this wide approach, some people prefer the UK approach (applied whenever a trust is the main owner or controller of a UK company), where only the trustee or any person with effective control over the trust has to be registered. While this sounds simpler because only the relevant people would be registered, it is much harder to implement in practice. In essence, it would require the Trust Registrar staff to read and understand complex trust documents (many of which may remain secret) to try and determine who is really in control. Registering all related parties is a much simpler and more practical solution, and would only affect those creating complex trust structures. For the typical “simple” trust arrangement created to take care of a minor or vulnerable person, the “wide approach” of identifying “all beneficiaries” (only that minor or vulnerable person) should pose no problem.

#### **Box 9: Why disclosure is justified**

From the early ages, information contained in commercial registries was supposed to be publicly accessible to ensure that the general public, including traders, could see who they were doing business with.

If society allows (but does not oblige) people to create artificial entities like companies for business purposes, and lets them enjoy limited liability, then it is justified in exacting a price in exchange for these privileges – notably disclosing their owners and accounts.

Similarly, if someone introduces a risk into society, like a car that may run someone over, the owner should be accountable for the risk – again, she has no obligation to drive the car. The same should happen with trusts. No one has to create one if they want to keep their affairs private, but people benefit from them, often at the expense of creditors and wider society. So the least we should require is full disclosure.

While this “wide approach” may sound excessive, this is already required for financial institutions in more than 100 jurisdictions committed to implement the OECD’s Common Reporting Standard for automatic exchange of bank account information, and the FATF Recommendations on anti-money laundering. When collecting information on trusts’ beneficial owners, financial institutions need to identify all of a trust’s settlor(s), trustee(s), protector(s), beneficiaries and any other natural person with effective control over the trust.

### **2.2.2. Public disclosure**

Many people argue that trust information should not be publicly disclosed because they involve private family matters. They argue that most trusts are legitimate, that beneficiaries may not even (need to) know about the existence of the trust, and that it would be too complex to register trusts anyway<sup>24</sup>.

We do not accept this argument. The very features that make trusts useful are also often used to enable crimes such as tax evasion or money laundering: this means they stop being exclusively private matters.

One could argue that access by tax authorities and law enforcement would be enough to address this. Yet this is clearly not enough: numerous scandals such as HSBC’s leaked accounts and the Panama Papers show that society cannot blindly

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<sup>24</sup> See in [Knobel \(2016\)](#) a response to those general allegations against trust registration.

rely on authorities to do the job, especially when politicians themselves are involved in illegal and unreported offshore affairs.

But the abuse of trusts is not only related to criminal offences.

A carefully drafted trust may block access to trust assets by legitimate creditors (e.g. a lender) of the settlor or beneficiary. In other words, whenever a trust changes title to assets (its apparent owner or holder) or allows individuals to engage in business not in their own name but through a trust, it stops being a private matter and potentially impacts outside parties and wider society.

Our core proposal here is that **in order for a trust to have legal validity and be [binding on third parties](#)<sup>25</sup>, trusts should publicly disclose their beneficial owners.** *Anything that cannot affect third parties* (e.g. reasons why a beneficiary was appointed, fees payable to the trustee, etc.) need not be registered, and may remain private.

There could also be other specific carve-outs from disclosure: for example, if a judge or public authority confirms a need for such an exception. However, this needs to be carefully handled, and we see no difference between trusts and companies here (for example, we are aware of no law indicating that a shareholder need not be registered simply for being a minor or vulnerable). Beneficial ownership information should generally be accessible to society, as a *quid pro quo* for society letting them enjoy the privileges and benefits that a trust makes possible.

As mentioned, nobody is obliged to set up a trust, and most legitimate trust functions can be achieved through other mechanisms anyway.

### **3 Beyond secrecy: other uses of trusts**

Separating or limiting ownership or rights to trust assets among settlors, trustees and beneficiaries made sense in the Middle Ages – and may still be a convenient way to achieve protection for minors and vulnerable people. Yet there are many harmful uses too.

Are trusts' provisions proportional to their ends, and could the same results be achieved in other ways, with less collateral damage?

#### **3.1 Legitimate, socially useful functions**

Trusts can be put to many good uses.

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<sup>25</sup> The next section will propose limits to shields against legitimate creditors in some cases.

### 3.1.1 Protecting vulnerable persons

For example, a parent may know that his reckless, spendthrift daughter would likely blow her inheritance in Las Vegas in a week. The parent can instead put her inheritance into a trust, which will give her a steady stream of income for years after her parents' death. No matter how hard she tries, she will not be able to get hold of the trust assets (principal) beyond that income doled out by the trustee. One could make a similar trust arrangement on behalf of a sick child or elderly parent, or someone who is mentally incapacitated. Genuine charitable foundations can hand over large assets to be looked after and distributed wisely by trusted managers.

Several other arguments are sometimes put forward in defence of trusts which are superficially attractive but which on examination are less convincing.

Many justifications are similar to those put forward in defence of tax havens: most commonly that trusts and tax havens protect people's assets against rogue operators, bad legal systems, or economic instability. For instance, some argue that trusts are necessary to protect doctors (or rich people) from bogus lawsuits in the U.S., or to protect deserving heirs from bad inheritance laws.

The general response to this is that if there is an unjust law or injustice in society – and there are many – the answer is not to provide an escape route only for the wealthier sections (who are the commonest users of trusts and tax havens.) There's no group more politically powerful than the rich and powerful: providing them with an escape route from an unjust law is to remove from the equation the one constituency with the power to push for society-wide reform. What is more, these superficially legitimate justifications are routinely used to cover up abuses: for instance a trust tool that could be used to fend off illegitimate lawsuits, will inevitably be used to fend off legitimate ones – such as genuine medical malpractice suits against rogue doctors.<sup>26</sup> Foundations ostensibly set up for charitable purposes (see Section 4.3.1) are routinely turned into vehicles to help settlors escape paying tax.

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<sup>26</sup> To explore the generic arguments, see Tax Justice Network's *On the non-perils of information exchange* (<http://www.taxjustice.net/2014/05/29/non-perils-information-exchange/>; 26.1.2017). In addition, the New Zealand Law Commission in a review of trusts (Section 4.4.7 below) considered whether there should be a public register of trusts. It said trusts were in most cases "an inherently private arrangement", they do not transact with the public as commonly as companies so there is less need for a public database. [...] Compliance costs for a register of trusts would be excessive, as trust documents are changed much more frequently than company documents. [...] Consistent with the recommendation of the Law Commission, the Inquiry does not recommend a public register of foreign trusts..." (NZ 2016). New Zealand law and practice starts with the presumption that a person's financial affairs are that person's own business. However, the use of trusts to evade and avoid taxes or launder money makes the handling of trusts a public matter. In addition, given the use of asset protection trusts to defraud creditors, the 'lack of transaction with the public' is in fact an outcome of the widely abused 'asset protection' function of trusts. Lastly, while NZ authorities hardly audit trust information because they lack any tax-related interest in them, public scrutiny could prove more effective.

### 3.1.2 Commercial uses

Trusts are widely used for commercial purposes, serving many functions which most people would usually associate with companies<sup>27</sup>. For their users, trusts offer advantages over companies. For example:

- Trusts are generally much more libertarian, flexible vehicles than companies. Unlike many types of companies, they do not necessarily need registration, and they are not generally required to submit to certain governance requirements such as regular shareholder meetings, authorisations before issuing new shares, and so on.
- Whereas shareholders in principle control company managers, the beneficiaries of a trust (who are or may be entitled to receive trust assets in future, like corporate shareholders) may have no such control to influence investment decisions.
- Trusts can favour the development of major capital-intensive projects by shielding the project assets from the risk of the project owners or sponsors going bankrupt. For example, in a real estate endeavour in Argentina, the bankruptcy of the construction company could stop the whole project in its tracks, leaving future home owners (who may have already paid large deposits) empty handed. A trust might shield the building project from that construction company's creditors.<sup>28</sup>
- Trusts can help banks separate assets from their balance sheets, while allowing them to continue to profit from them. Box 2 above gives an example. These activities contribute to financial-risk-taking by banks, at society's expense, so their legitimacy is highly questionable (however, this would be a matter of financial regulation rather than trust law.)<sup>29</sup>

The main benefits of a trust, beyond secrecy and the flexibility to regulate the trust as the settlor wishes, generally involve its '**asset protection**' function – those shields between the assets and the beneficiaries, settlors and other people relevant to the trust, as explained in Section 1.2 above. Those shields ensure that the spendthrift daughter can't suddenly grab all

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<sup>27</sup> For example, the Delaware business trust statute allows a trust to be organized with all the attributes of a standard business corporation (Mattei 1998). In addition, the reason why corporations (instead of trusts) are used for some types of business could simply be related to inertia (ibid.), although this was not the case in "the late nineteenth century, when business trusts were used as the holding companies through which industrial oligopolies and monopolies were assembled--hence giving us the Sherman "Antitrust" Act of 1890" (ibid.).

<sup>28</sup> This feature also allows for "guarantee" trusts, where assets are put in a trust as collateral. If the debtor pays the creditor or delivers on a contract, he gets the trust assets back. Otherwise, the creditor gets the collateral.

<sup>29</sup> Harrington (2016) says (p19) "Many of the financial and legal tools [wealth managers] refined to protect clients' assets also formed the organisational structure of the subprime mortgage crisis. This is particularly clear in the case of 'special purpose vehicles' . . . put a corporate subsidiary into a special-purpose vehicle, and it is protected from bankruptcy, creditors and litigants."

the assets, for example, or stop nefarious interests getting their hands on that charitable foundation's lump sum.

But the 'asset protection' function can lead to many socially unwanted uses too.

All of this once again raises the question: can we get rid of the socially harmful aspects while preserving the benefits?

## 3.2 The cons: 'ownerless' assets and less legitimate uses

### 3.2.1 The asset protection function

While a trust's asset protection may help protect vulnerable persons or be involved in legitimate commercial activities, the same type of trust may equally allow abuses. A trust's settlor or beneficiaries may be living in the trust's Manhattan penthouse, partying on the trust's yacht, or hanging one of the trust's Picasso on their penthouse wall, yet avoid having to declare ownership or pay taxes on them. So the tax authorities or creditors of the related parties may be unable to penetrate the trust's shield,<sup>30</sup> even with a court order.

The trustee isn't a route to accessing the assets either: she is more like the CEO of a company, who manages the assets but she or her creditors cannot access them for themselves. (Annex II outlines real-life cases where creditors and tax authorities were unable to access trust assets from persons convicted of murder or sexual abuse against a minor, even though most reasonable people might conclude that this state of affairs is unacceptable).

#### Box 10: Rule against perpetuities

A common trust regulation is the "rule against perpetuities." The basic idea is to legally limit the duration of a trust so that people cannot put assets in 'ownerless' limbo forever, or under a settlor's "dead hand" control for generations after their death. This clearly has great social value, among other things curbing inequality and boosting social mobility and opportunity.

Yet many jurisdictions are engaging in a race to the bottom to relax this prohibition, as they seek to drum up trust business. Under some legal systems now, trusts can last for centuries, enabling dynasty trusts where the aim is to concentrate assets (or rather, value) in a family or bloodline or other group for generations.

### 3.2.2 Three ways to pierce an asset protection trust

Despite the legal fortress created by trust law, courts have, in general, specified three ways to gain access to assets inside an abusive asset protection trust, providing limited opportunities to pierce the trust.

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<sup>30</sup> The trust *itself* could perhaps have creditors, but for a trust merely holding assets and not conducting any risky activity, it is unlikely to have many or any creditors.

**First**, access to trust assets may be achieved through choice of law provisions or doctrines. In other words, a creditor may argue that the applicable law is not the law of the jurisdiction where the trust was set up, but that of another jurisdiction, such as where the trustee or the settlor is resident. That alternative law may permit access to the trust assets. **Second**, a party can try to prove 'fraudulent conveyance' (see Box 10) – that the assets were transferred into the trust for the purpose of defrauding creditors or other legitimate parties, and thus wasn't a legitimate transfer. **Third**, a party can try to show that the trust is a 'sham' because the settlor retains enough control that they can't really be said to have given the assets away -- it remains an 'alter-ego' of the settlor.

#### **Box 11: Fraudulent conveyance**

Assets in a trust aren't always legally shielded against outsiders. Asset protection can often be overturned if, for instance, fraudulent conveyance can be shown. That is, assets (serving as collateral) were transferred into the trust *after* or right before a debt became enforceable so that the debtor has no assets to repay the debt. It could then be argued in court that the transfer into the trust was a fraudulent conveyance.

Each of these alternatives is usually possible only in specific circumstances, and are generally expensive, tough and complex to achieve. For example, the "choice of law" solution may be unavailable if no trust related parties or assets are resident or located in jurisdictions that do not recognize asset protection trusts. Fraudulent conveyance may be unavailable if the trust was created long ago, planning ahead of time before there were any creditors, and constrained by statutes of limitations for fraudulent conveyance. Regarding sham trusts, if the trust deed is created diligently it may be difficult or impossible to prove that the settlor is in control, especially if he is not a beneficiary<sup>31</sup> and the trustee is somehow independent<sup>32</sup>. Establishing any of the three alternatives may also require a lengthy court battle.

In short, current ways to pierce asset protection trusts are not effective or affordable, in time or resources, by most law enforcement officers, courts, or creditors to prevent abuses.

Further measures are necessary.

### **3.3 Striking the balance between legitimate uses (commercial, protection of vulnerable persons) and abusive ones**

If trusts may offer both convenient ways to protect vulnerable people or engage in business endeavors, but also abusive conducts, how can trust law keep the good elements and discard the potential risks?

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<sup>31</sup> A settlor may not be included as a beneficiary, but just as with "flee clauses" (see Section 4.1 below), a settlor could retain a right (through a protector) to appoint himself as a beneficiary once the contingency or creditor disappears.

<sup>32</sup> Independence may be reduced by appointing a reliable protector or enforcer, letter of wishes or veto or removal rights, or even a position of blackmail over the trustee.

### **3.3.1 Defence of Trusts 1: “only sham trusts are bad, don’t target legitimate ones”**

Some may argue that the best solution is to target only sham trusts (Box 3).

This is not sufficient, however, because the problem goes far beyond shams.

Let’s say the trust is not a sham because it has a fully independent trustee over whom the settlor has no control whatsoever, and from which the settlor receives no benefit.<sup>33</sup> The trust is entirely for the benefit of his children and grandchildren. Should all the current benefits of trust law (no registration, asset protection against personal creditors of settlors and beneficiaries, separation of ownership) apply? Is this scheme so socially beneficial that society should grant such a trust deeper protection than that of “private property”, and allow it to endlessly accumulate wealth and withstand tax demands and claims by legitimate personal creditors?

Capitalism already offers private property and corporate limited liability to incentivise wealth creation. Yet neither of these privileges mean that a legitimate (personal) creditor cannot, at least indirectly, reach your property if you owe them money. Nor does it mean that someone shouldn’t pay their taxes either.

What is the social benefit derived from these astonishing privileges, which go beyond “private property” and “corporate limited liability”, and worsen inequality?

Fully independent trustees may well be upstanding and thoughtful managers who help families invest or use or distribute assets wisely. But if society wants to promote these activities, then the same logic should apply to family therapy practitioners. Yet no one is suggesting that assets of families undergoing therapy should be shielded from creditors. So why the special status for trusts holding family wealth?

Another argument in defence of trusts might involve focusing on the fact that beneficiaries are sick or vulnerable people, or minors who need protection.

Yet this superficially appealing argument does not stand up to scrutiny either.

For one thing, nothing in trust law requires beneficiaries to be spendthrift daughters or the sick or disabled. Anyone, no matter how rich, middle-aged or healthy may be a beneficiary of a trust.

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<sup>33</sup> Even in this case, it is impossible to ensure the trustee’s independence. The settlor may appoint a protector, write a letter of wishes, or give power of attorney to veto or remove the trustee to someone else that he/she trusts. Besides, who really believes that under “discretionary” trusts, the trustee really has free discretion? Who would be crazy enough to transfer all of his/her wealth to have a complete stranger decide on who should get what?



Society certainly *should* protect vulnerable people – but why not achieve those goals instead through public policy measures (e.g. ensuring basic rights to free health and care, pensions or legal protections by law for anyone proven vulnerable)? As Box 11 shows, there is no good reason why vulnerabilities such as physical disabilities should confer special *tax* privileges or afford them *protection from creditors*. (Not only that, but why afford the protections only to those lucky enough to have settlor-parents who can afford trust lawyers?)

To reiterate: why should a disabled person's assets be rendered unreachable by the rest of society: tax authorities, criminal authorities and legitimate creditors? No one pretends that needing and having a nurse take care of a person renders their assets unreachable by creditors. So why does having a trustee to manage that sick person's assets produce results so very different?

To be clear, trusts for vulnerable people may be a great solution for parents to ensure that their sick family child will be taken care of, especially after they die. That should be promoted and encouraged, if the State provides no better solution. But currently, trust-based asset protection is not limited to basic needs required by vulnerable people, like housing, health and education while the need exists. Trust benefits are indiscriminate, wide-ranging, and often indefinite.

To put it bluntly: if a deaf person permanently paralyses a pedestrian in a drink-drive accident, why should the victim not be able to access the deaf person's assets in compensation?

Is it acceptable that a child victim of sexual abuse cannot obtain compensation from their wealthy but handicapped abuser who is the beneficiary of a trust? Such things have happened: see, for example, *Scheffel v. Krueger* 2001 (though in that case the abuser was not even handicapped, he simply benefitted from a spendthrift provision in the trust that allowed him not to pay damages to the abused child. See Annex II).

### **3.3.2 Defence of Trusts 2: "don't blame trusts - companies also offer asset protection"**

One could argue that trusts aren't the only type of entities that could be abused. Some types of companies, after all, also offer limited liability to cap the potential loss of their shareholders, protecting their personal assets.

#### **Box 12: Princess Christina's eyes**

In February 2009 the Dutch newspaper *Volkskrant* revealed that Princess Christina of the Netherlands, living in London, paid no tax in the UK (or Netherlands) by using the Daffodil trust, administered in Guernsey, believed to be holding many tens of millions of Euros' worth of assets. She is nearly blind, and *Volkskrant* summarised the Dutch government's argument on her behalf: "The Princess needs careful asset management because of her visual handicap." Her eye condition is sad, but does it in any way justify a tax-escape mechanism – potentially costing large taxes that might otherwise benefit multiple victims of eye diseases? Clearly not.

Note: Princess Christina reportedly closed down Daffodil in 2016.

Notwithstanding valid criticism against corporate limited liability, which is outside the scope of this paper, the trust's asset protection function is different (and greater) than corporate limited liability.

### **3.3.2.1 Corporate limited liability versus the trust's asset protection function**

Comparing companies to trusts is a bit like comparing apples to oranges<sup>34</sup>. But, as usual, some observations can be made, since an individual could choose to either incorporate a company or set up a trust to protect personal assets (see Annex III to compare asset protection under a company or under a trust).

Corporate limited liability is a two-way protection.

First, it protects shareholders: company creditors can potentially reach the *company's* assets, but cannot access the *shareholders'* personal assets<sup>35</sup>. Second, it protects the corporation: the shareholders' personal creditors cannot directly reach company assets (which could destroy the business): creditors can only access their shareholdings. These privileges are a price society willingly pays in order to promote reasonable risk-taking by company shareholders and broader economic development.

In other words, society exempts shareholders from "unlimited" liability in exchange for broader economic development.

In the case of the trust, how does society benefit?

One could argue that it is socially beneficial that vulnerable people are protected, but as explained above, there are better and less indiscriminate ways to do this.

More broadly, trusts also allow savings and wealth concentration, which are *potentially* socially desirable. However, given the current levels of inequality, one could easily argue that these mechanisms for wealth concentration harm society. Should society pay a high price (potentially "immunity" from liability) in exchange for this harm? Clearly not.

Regardless of the conceptual arguments supporting corporate and trust limited liability, the protection awarded to trusts is greater than that of corporate limited liability. Here is the **striking difference between a trust's and a company's limitation of liability**.

Whereas the personal creditor of a corporate shareholder cannot make a direct claim against the company's *assets*, they may at least be able to

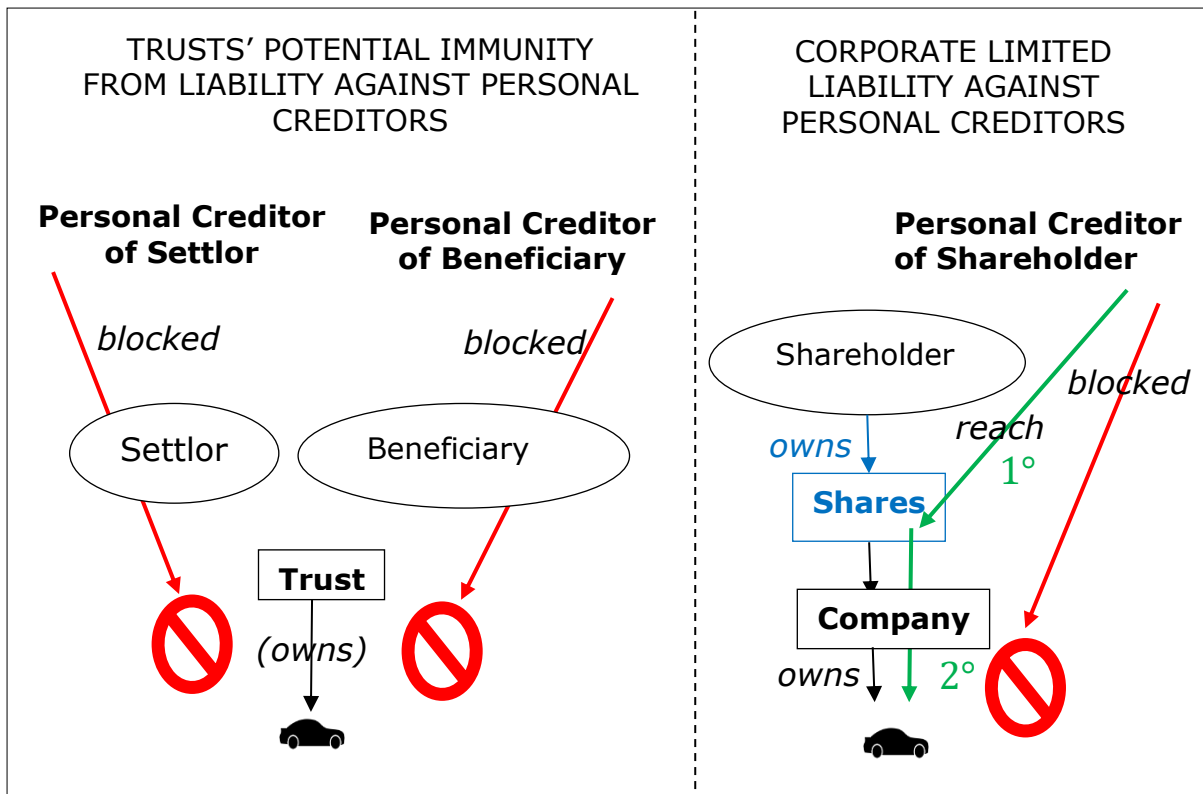
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<sup>34</sup> One could argue that companies have different legal provisions from trusts, and that tradable shareholdings and rights to dividends or voting rights are different from interests in a trust.

<sup>35</sup> Similar to corporate limited liability, direct creditors of a trust can reach trust assets, though not the personal assets of the settlor, trustee or beneficiary (since the trust does not belong to any of them). In some countries, trust creditors may reach the trustee's personal assets but then the latter may indemnify themselves out of the trust funds for any sums trust creditors have collected.

eventually access the debtor's *shareholdings* (and if the creditor ends up controlling the company she may be able to sell the assets too.)

A trust, by contrast, has no shareholders, so even if the indebted settlor or beneficiary has no other assets to repay a debt, there are no "shareholdings"<sup>36</sup> in the trust to repay creditors<sup>37</sup>. If the trust is carefully drafted, personal<sup>38</sup> creditors cannot access those trust assets.



So the protection enjoyed by trust settlors and beneficiaries is far stronger and deeper than what corporate limited liability offers. It is indiscriminate and in many cases indefinite, resulting often in a *de facto* immunity and loss of accountability against legitimate creditors.

Should society tolerate this?

This question can be broken down into two parts. First, is it right that the asset protection function of a trust should be greater than corporate protections of limited liability? Second, when, if ever, should the asset protection function exist at all?

<sup>36</sup> Beneficiaries may have "interests" in the trust, such as a right to receive \$X in the future. However, if crafted diligently, the trust deed may prevent those interests from ending in the hands of a specific beneficiary, for instance by incorporating spendthrift provisions or creating a discretionary trust (see Section 4.3.3.)

<sup>37</sup> Creditors may be voluntary (e.g. a lender lending money) or involuntary (e.g. a victim of an accident). While a lender could have taken some precautions before lending money, if aware of the existence of the trust, a victim of an accident couldn't have. No one really chooses to be the victim of an accident, let alone the asset protection schemes of the person liable for the accident.

<sup>38</sup> A personal creditor is an individual or tax authority that has a claim (a credit) against a settlor or a beneficiary (or a shareholder in the case of a company). It is different from a trust (or corporate) creditor (e.g. individual or tax authority) that has a claim or credit against the trust or the company.

It seems reasonable to argue that trusts which serve legitimate and socially useful purposes, such as guaranteeing or engaging in legitimate business transactions, should be protected. A judge could determine if that is the case. But even then, trusts should enjoy only the same degree of protection as corporations enjoy via limited liability. Sometimes this is the case (as with unit trusts<sup>39</sup>, see Box 12, or when beneficiaries' interests in the trust are already vested). In such a case, personal creditors of beneficiaries cannot access trust assets directly, but should still be able to access the beneficiaries' "units" or "interests" in the trust (similar to the personal creditor of a shareholder accessing the shareholdings, but not corporate assets directly). However, in other cases, trusts engaging in legitimate businesses could enjoy greater limitation of liability, for example if a business endeavor is organized as a discretionary trust<sup>40</sup>. This should not be allowed.

### **Box 13: Unit Trusts (a type of commercial trust)**

Many investment entities or collective investment funds use the form of "Unit Trusts", which turn the concept of trusts upside down. In this case, beneficiaries or unit-holders (investors) are the ones who provide the funds (unlike a typical trust where the settlor does it). In exchange for their contribution, investors get "units" in the trust, similar to interests in a mutual fund, or shares in a company. A bank or investment entity may function as settlor and trustee, managing and investing the trust funds. Investors (beneficiaries or unit-holders) may sell their "units" or redeem them to get their money back.

These types of trusts are less problematic than an ordinary family trust because creditors may eventually access the beneficiaries' units (as if they were accessing shareholdings). In this sense, unit trusts' asset protection is similar to corporate limited liability but does not go beyond it (unlike the greater asset protection of an ordinary trust, where beneficiaries have no units or shares that could be reached by creditors).

Family trusts involved in wealth concentration seem to offer no *social* benefits (plenty of private benefits: but the flip side of these is that they directly worsen equality, fair taxation, and so on.) They should obtain no asset protection whatsoever, other than that of normal private property. Although they do contain useful functions managing and (legally) allocating assets within families, these can be achieved through other mechanisms, such as clear, well-drafted wills or appointing a financial or asset manager (in the same way as going to family therapy). Once the asset protection function is added (where a person may invoke a trust to "prove" lack of ownership and control over assets), the real harms become apparent: cheating on taxes (whether legally or not), hiding assets, defrauding creditors, and other abuses.

### **3.3.3 Proposal: Striking the balance in practice**

Our proposal is, in essence, this.

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<sup>39</sup> Personal creditors of a unit trust's beneficiary (also called unit-holder), could eventually reach the units, in the same way that a shareholder's personal creditor could eventually reach the shareholdings.

<sup>40</sup> Since beneficiaries have no units or enforceable interests in the discretionary trust, but rather contingent ones, their personal shareholders may have no way to access trust assets.

Where third parties may be affected, trust assets should not be allowed to be in an ownerless limbo, enjoyable by (or accumulating for) the settlor or beneficiaries, but unreachable by legitimate creditors. Putting it crudely, the settlor should not be deemed to have given away the assets until the beneficiaries have received or become entitled to a distribution. Before this distribution, legitimate creditors of the settlor<sup>41</sup> (such as tax authorities) can reach the assets in the hands of the settlor, and after the distribution the beneficiaries' creditors can reach the assets now in the hands of beneficiaries.

For example, if beneficiaries have units or vested interests (e.g. the right to receive 25% of trust assets because they are older than 18 years old), those assets should be considered to belong to the beneficiaries (and reachable by the beneficiaries' creditors). The remaining 75% of trust assets should be regarded as belonging to the settlor (reachable by its creditor).

If this approach were taken, no trust asset would exist in limbo.

What about vulnerable individuals who need protection?

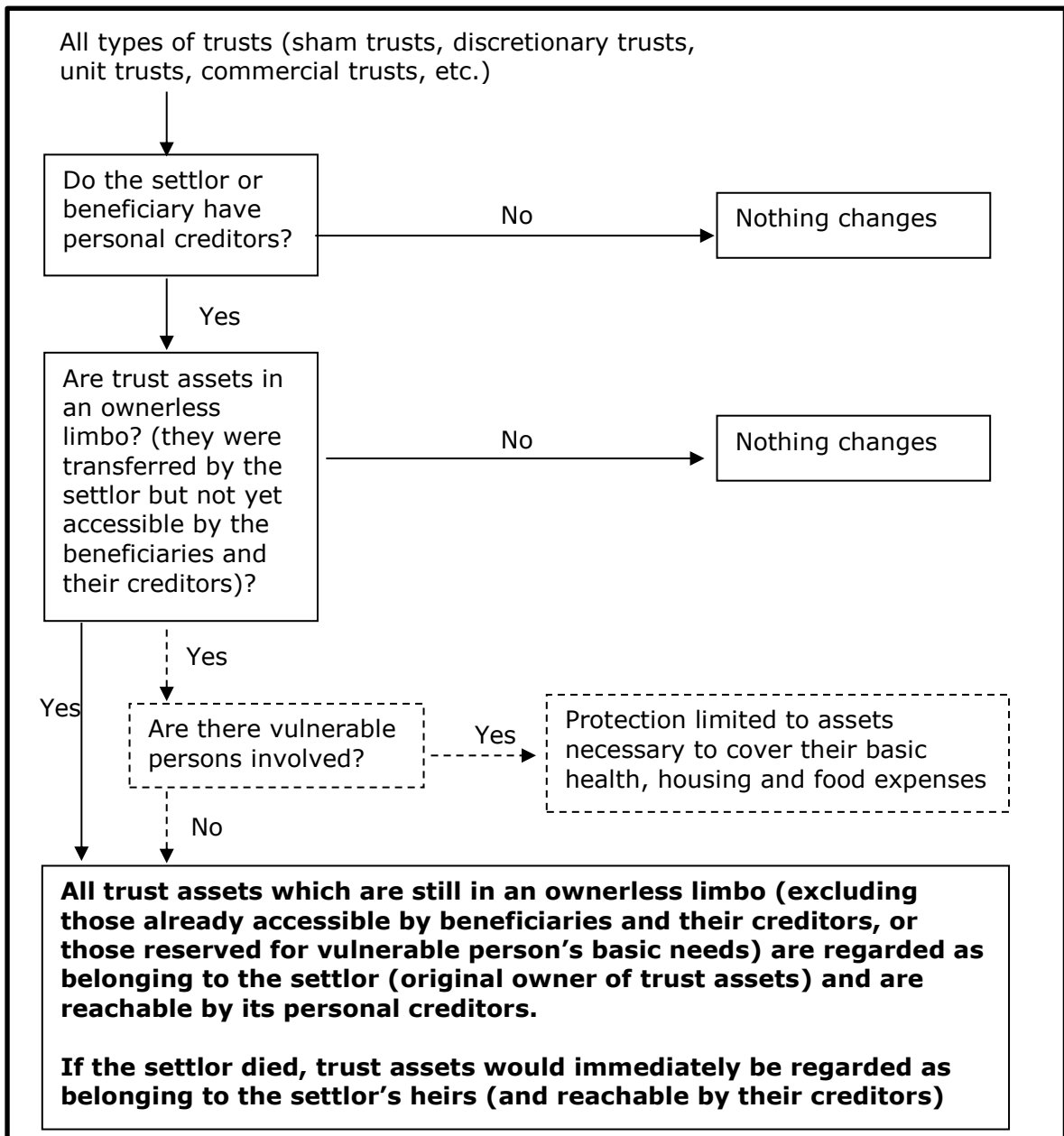
As explained above, vulnerable persons should not have to rely on trust law for protection but should be subject to other legal protections crafted to meet their needs. Nevertheless, if vulnerable persons were still to be protected by trusts, as decided by say a judge, such protection should be limited to the person's essential medical, food or housing needs. It should not be unlimited and indiscriminate.

Meanwhile, trust functions that do not affect parties outside the trust would still be able to operate as normal.

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<sup>41</sup> If beneficiaries have no vested interests in trust assets, beneficiaries' creditors wouldn't have access either. If the settlor is considered the owner of the assets, only the settlor's creditors would have access to them, but not the beneficiaries' creditors (who would not be able to claim a better right or access than the beneficiaries themselves).

## Summary



### 3.4 Avoidance of taxes levied on the holder of assets (e.g. inheritance tax)

Inequality is reaching politically unsustainable levels. Many countries seek to curb this through, among other things, inheritance tax or gift taxes. Yet wealthier sections of society have found trusts to be fabulous ways to thwart tax authorities, without needing to change laws.

Trusts' 'ownerless limbo' allows people to use and enjoy the trust assets without taking ownership of them. When someone dies, this legal limbo means they don't own the assets, so the death won't trigger inheritance

tax. For example, Britain's [Duke of Westminster avoided paying £3.6 bn in inheritance taxes](#)<sup>42</sup> after his father died, leaving an estate of £9 billion held in a trust. The trust arrangements infuriated many in Britain<sup>43</sup>.

These types of dynasty trusts that can last for hundreds of years (see Box 9) help families escape gift and inheritance taxes from generation to generation.

These schemes may be *legal*, but *why should they be?* What is the value of these mechanisms to society?

Taking an economic and political perspective, trusts in this case help worsen inequality, allowing wealthier segments of society to escape contributing to the social contract, leaving poorer sections effectively to pay their taxes for them, or leaving countries with higher debt or poorer public services.

## 4 Abusive trust regimes

As if the ordinary trust provisions were not advantageous enough (or abusive enough, depending on your perspective) tax havens and other places are engaging in a race to the bottom to offer even more troubling trust regimes, in a bid to attract the hot money by offering ways to help their users (settlers and beneficiaries) escape foreign laws that would give rights to creditors and former spouses. These abusive trust regimes are usually combined with a lack of income tax and other taxes.

Tax havens may also offer special provisions in favour of trusts created under their laws to protect them from foreign laws, foreign judgments and even local legal actions by foreign creditors. To protect their own economies from harm, they sometimes insist that their trusts can be used only by non-residents and cannot own land or property locally (Sterk 2000).

Some generic examples of these types of abusive trust provisions and procedures are provided below. The following section looks at various jurisdictions offering abusive regimes.

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<sup>42</sup> <https://www.theguardian.com/money/2016/aug/11/inheritance-tax-why-the-new-duke-of-westminster-will-not-pay-billions>; 26.1.2.17.

<sup>43</sup> The reasoning was that, because the Duke's assets were in a trust when he died, he wasn't legally their owner, and no one immediately 'inherited' them either. They remained in the trust (in an 'ownerless' limbo), so no inheritance tax was triggered on death. Meanwhile, the trust beneficiaries or potential beneficiaries (e.g. the new Duke) may be able to use and benefit from those assets indefinitely. (Hudson 2010). In the UK, however, there are other taxes that may apply to trusts such as entry and exit charges, and a tax every 10 years. In any case, [these other tax rates are lower than the inheritance tax rate](#) and trusts may benefit from other tax exemptions, depending on whether [beneficiaries are minors or vulnerable](#), or if [there are investments in farmland](#). In fact, the same family of Westminster benefitted from another exemption as described by [Mirror](#): "In 1944 the 4th Duke was injured (...) at the tail end of World War 2. In UK law those who die in service of their country do not have to pay any inheritance tax - currently set at 40% for the rich. Even though the Duke went on to live for another 23 YEARS - and eventually died of cancer - Hugh's grandfather Robert Grosvenor successfully argued that the wound caused infections which became the cancer which killed his brother" (<http://www.mirror.co.uk/news/uk-news/how-tax-row-over-wwii-8614175>; 26.1.2017).

#### 4.1 Abusive clauses and provisions to be included in the trust deed

- Self-settled trusts (the settlor as the beneficiary): These trusts permit the settlor to be named as the unique beneficiary. Such arrangements are a sham<sup>44</sup>: the settlor is not appointing a trustee to manage assets in benefit of others (children, spouse) but only tries to shield assets from outsiders for personal benefit<sup>45</sup>.
- Settlor never giving up control (settlor as trustee or with control over it). Some trust instruments give settlors various mechanisms to maintain control of the trust assets. The settlor might also be allowed to serve as the trustee or set up a 'revocable' trust (see Box 3) where the trust can be revoked by the settlor at any time and the trust assets are returned to the settlor. Alternatively, the settlor might provide a secret 'letter of wishes' alongside the trust deed, with instructions on how the trust should be handled. Or they may be permitted to name a trust 'protector' or 'enforcer' to ensure the trustee does what the settlor commands, perhaps with rights to remove and replace the trustee, or veto discretionary actions by the trustee. Alternatively, the settlor may choose as a trustee someone they trust or control, such as a spouse, brother, old school friend, or someone with whom the settlor has a business relationship. The trustee could also be a company which was created by the settlor, and which the settlor still controls as a major shareholder or chair of the board. And so on.
- Duress clause: Some trusts contain a clause in the trust deed which commands the trustee to refrain from any action or instruction sent by the settlor, protector or beneficiary (e.g. "Make a distribution from the trust so that a creditor or the tax authority gets paid") if the instruction was given under duress – such as a foreign court order. This duress clause helps shield the trustee from compliance with foreign court actions.
- Flee Clause: Some trusts may contain a clause obliging the trustee to change the trust address, its governing law, or the trustee itself under certain circumstances. Flight is commonly triggered as soon as the trust becomes subject to, say, an investigation by a foreign authority, or a change of laws that could affect the trust, like a new

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<sup>44</sup> While we refer to sham trusts as trusts where the settlor retains control or benefits (as if the trust did not exist), under [English law](#), "sham" trusts refer to trusts where both the settlor and trustee did not intend it to operate according to the structure reflected in the trust instrument. If the trust instrument were explicit about the settlor being the only beneficiary, it wouldn't necessarily be considered a "sham".

<sup>45</sup> In contrast, many jurisdictions also prohibit settlors from being a trustee, because then they would still have control over the assets, as if the trust did not exist. Some jurisdictions also don't allow the trustee to also be a beneficiary: to avoid moral hazard and prevent "trustee-beneficiaries" from managing trust assets to benefit themselves, to the detriment of other beneficiaries.



tax. This clause is incredibly simple yet hard to detect. It only requires the trustee to state on a piece of paper that the trust is now governed by X jurisdiction's laws, or that the trustee is now Y person, and – *voilà* – the trust has relocated to a jurisdiction thousands of kilometers away, with no registration or external approval.<sup>46</sup> Flee clauses allow trusts to remain under the radar. A settlor may choose the law of a supposedly "respectable" jurisdiction (like New Zealand) that would not tend to raise suspicion by any authority. Flee clauses typically relocate the trust so that it is governed under the laws of a debtor-protecting jurisdiction, such as the Cook Islands or Belize.

- Spendthrift clause: Some trusts contain a spendthrift clause in the trust deed. This provision thwarts the voluntary or involuntary alienation (a disposal, such as a sale) of a beneficiary's interest in a trust (Rosen 1996). While the trustee would still be able to sell trust assets if it were in the interest of the trust, spendthrift provisions allow trusts to act like an impregnable legal fortress keeping the assets 'safe' from outsiders, including beneficiaries and their creditors. Spendthrift clauses are inherent in many if not most asset-protection trusts and promote wealth concentration. See Section 4.4.5 on the degradation of U.S. trusts, below.
- Forfeiture clause: Some trusts contain a "forfeiture clause." This strengthens the trust's asset-protection function by suspending or cancelling automatically the beneficiary's status as such, whenever a beneficiary tries to transfer her interest in the trust, or her creditors try to access the asset, or if he or she becomes bankrupt.
- Trust Decanting: Some trusts contain a "decanting" clause which permits the assets of one trust to be 'poured' into another trust for the purposes of achieving particular ends. This may be abusive if, for example, "a trust set to terminate when the primary beneficiary reaches a certain age could be decanted to another trust that continues for the life of the beneficiary [... or] if some of a trust's beneficiaries have capital gains in a given year, trust property with a capital loss could be decanted to another trust that sells the property

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<sup>46</sup> For example: "The assets will . . . be removed to a separate foreign jurisdiction which is deemed suitable for maintaining investments. At the same time, the individual domestic trustee would resign (subject to reinstatement by the foreign trustee) and, under the terms of the trust agreement, the foreign trustee would be unable to comply with any instructions as may be communicated by the grantor or trust protector (if given under duress)... in the event of a creditor's claim, the assets of the foreign trust will have become so undesirable to the creditor (in terms of the cost of pursuing an action in one or more foreign jurisdictions, with limited expectations for a favorable result), that the creditor will have the incentive to settle the matter for a much-reduced sum. When the threat of creditor claims has subsided, the design would revert to the original structure in order to again provide the client with direct access to the trust income and principal as a trust beneficiary" (Tanzi 2013). A similar scheme was described in a paper on the "death of liability" (Lopucki 1996).

and then terminates, passing the loss on to such beneficiaries” (Culp 2010).

#### **4.2 Abusive trust laws and provisions**

- Non-recognition of foreign laws: Some trusts set up in offshore jurisdictions remain valid even if they breach marital, divorce or inheritance laws in the foreign jurisdictions where the settlor and beneficiaries are resident. Often, creditors will have to fight it out in the trust’s local courts, with the deck stacked against them.
- Non-recognition of foreign judgments: Some foreign jurisdictions empower trustees to ignore the orders and sentences of foreign courts, such as an order invalidating the trust or requiring the trustee to do a distribution. These foreign judgments would have no effect in the offshore jurisdiction.
- Fixed fees (instead of contingency fees): Lawyers in offshore jurisdictions (where the creditor may be forced to file a lawsuit against the offshore trust) may be allowed to accept only fixed fees paid up-front, rendering the recovery process more expensive for creditors than if they were to accept contingency fees, where they are paid only on success.
- Higher burden of proof for fraudulent conveyance: Some jurisdictions may impose a high burden of proof to establish fraudulent conveyance to a trust. For example, the creditor may have to prove not merely that the settlor “intended” to defraud, but that this was the *principal* purpose of setting up the trust, using criminal-law standards of proof “beyond reasonable doubt”. Not only is this standard almost impossible to meet, but the debtor-settlor may escape by proving a “legitimate” reason to set up the trust, such as estate planning (Marty-Nelson 1994).
- Short Statute of Limitations for Fraudulent Conveyance: Most legal actions have a statute of limitations, limiting the time within which a legal action can be taken: usually, several years. However, for fraudulent conveyance in offshore jurisdictions, the allowable time span might be especially short--it may be, for instance, only, such as one or two years after the settlor transferred the assets to the trust. Not only is this a short period, but it may be almost impossible to find out that (or when) a settlor transferred assets in the first place, since neither trusts nor their assets have to be registered.

Extended limit for duration of trusts: Some trusts may last for 100 years, more, or even indefinitely. Trusts may be created in jurisdictions where the rule against perpetuities does not apply, or create a type of trust that is exempted from the rule, such as a charitable or purpose trust.

### 4.3 Commonly abused trust forms

#### 4.3.1 Charitable Trusts and Foundations

Charitable trusts and foundations are often used for good causes – but they are frequently abused.

In a legitimate charitable trust, assets and income are harnessed for good causes, and are paid out to those causes over time. In illegitimate versions, however, a designated charity is a token beneficiary whose role is (just) real enough to justify the existence of the trust. They might be entitled to receive tiny distributions here or there or at some point in future – and a designated beneficiary may not even be aware that it is a beneficiary! Meanwhile, the main action takes place hidden inside the trust, where the trust's flexibility allows all sorts of shenanigans.

#### Box 14: Foundations

Foundations, which are more common in civil law countries, may have the same effects as a trust, though with some differences. A foundation is considered a legal entity, and usually has to register, but like a trust, it has no owner. The founder (like the settlor) transfers assets into the foundation for a specific purpose, which may or may not be charitable (e.g. family wealth concentration). The foundation assets are typically managed by a "Council" (like the trustee) in favour of determined or determinable beneficiaries. A way to abuse even charitable foundations is to accumulate assets without distributing them to beneficiaries, or choosing only family members to receive distributions (e.g. scholarships), or hiring them as staff with very high salaries. Famous examples of foundations are Panama's Private Interest Foundation or the Dutch STAK to hide someone's ownership.

For instance, when the British bank Northern Rock collapsed in 2007, it was discovered that a Jersey-based offshore trust called Granite owned three quarters of Northern Rock's billions of pounds' worth of mortgage-backed securities. On paper, the beneficiary of this trust was a small charity for disabled children run out of a small semi-detached house near Newcastle in northern England. The charity was entirely unaware it was named as a beneficiary until contacted by journalists exploring Northern Rock's collapse.

In addition, in 2009 the OECD published a Report on Abuse of Charities for Money-Laundering and Tax Evasion<sup>47</sup>. It describes real cases where for example, "In 2000, Foundation 'A' raised \$13 million. In July 2004, the US charged Foundation 'A' and seven of its officers with criminally conspiring to provide millions of dollars to Terrorist Group –'H' and the families of suicide bombers". Another example in England: "a family in the North

<sup>47</sup> <http://www.oecd.org/ctp/exchange-of-tax-information/releaseofreportonabuseofcharitiesformoney-launderingandtaxevasion.htm>; 26.1.2.17.

England owned a number of businesses. The family members were all very closely knit and each member of the family played a significant role in the running of the businesses. [...] The family, very early on in the frauds, also established a charity [...]. HMRC were alerted through intelligence that the charity was being used by the family for uncharitable purposes i.e. to fund their own expensive lifestyles. The Investigation into the various bank accounts in the charity name and managed by the family members showed that in excess of £2.5 million had been deposited. All funded through undisclosed income of the businesses directly diverted in the banks. Several of the bank accounts were held offshore in the charity name.”

Depending on a jurisdiction’s legal framework, a charitable trust or foundation could be a tax-exempt framework, where transfers into the trust can be deducted against the settlor’s taxes. Then the settlors’ family might, for instance, have full use of the luxury apartments owned by the charitable trust, receive scholarships or large ‘consultancy fees’ (paid for token services) from the trust, or valuable “loans” (which may never be repaid). The assets are fully shielded from creditors – and the settlor gets tax perks too.

Charitable trusts are often exempted from the rule against perpetuities, too, which is useful for genuine charitable trusts that seek to provide long-term endowments to protect, say, the poor or for endowments supporting public programs, for example in the arts.

Some jurisdictions deliberately indulge the abusive versions. For example, they might relax conditions on making genuine charitable contributions, allow some of the assets to be distributed for non-charitable purposes, or fail to require disclosure of (or simply turn a blind eye to) what is really going on inside the trust<sup>48</sup>.

To summarise, charitable trusts and foundations tend to receive unusually generous treatment from society, because of their association with good causes, but this generosity is prone to abuse.

#### **4.3.2 Purpose trusts**

“Purpose Trusts” are a new and radical innovation in trust law, which have become widely used. They are created for a specified purpose such as to hold shares in a company, but have no beneficiary whatsoever (Averill 2013). As Beckett (2016) puts it, “The Purpose Trust takes the triangle [settlor, trustee, beneficiary] and cuts off the third corner.” While the trustee continues to manage the trust assets, there are no distributions during the life of the trust because there are no beneficiaries<sup>49</sup>. The assets

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<sup>48</sup> “Charitable trusts receive enormous benefits from the public, justified by the public nature of the trust itself. The law does not require any proportionality between the benefits-tax exemption, existence in perpetuity, and public enforcement-and actual service to the public. Instead, the law focuses almost entirely on the enforcement of donor intent and donor-specified purposes. As long as the trust purposes fall into one of six broad categories, all the benefits of classification as a charitable trust will accrue” (Einsenstein 2003).

<sup>49</sup> When the trust terminates, it’s possible that there are “surplus assets” left over and these may pass to an individual or institution, as determined by the trust deed (Beckett 2016).

may have been placed in the trust by a bank in order, say, to keep assets off the banks' (settlor's) balance sheet. Once the trust terminates on account of time, trust assets (if any remain) are considered "surplus assets" that pass on to whoever was designated by the trust deed (an individual or institution) as recipient of surplus. The problem with this trust form is that it undermines the very reason for a trust in the first place – to protect a specified beneficiary.

### 4.3.3 Discretionary Trusts

The discretionary trust is one of the most common trust forms. In essence, there is no identifiable beneficiary because the trustee has 'discretion' to decide how, when, and to whom to distribute the trust assets. This trust form could, say, prevent a bankrupt beneficiary from receiving trust assets that would end up in creditors' hands (the trustee will simply choose not to make a distribution when a potential beneficiary has creditors). It also enables intended beneficiaries to deny any ownership interest in existing trust assets if questioned by a court, spouse, or creditor (they can claim that they only hold contingent and potential interests in the trust, but depend on the trustee's discretion). In practice, the trustee often knows all too well who is to receive the trust distributions, as determined for instance by a letter of wishes, rendering their 'discretion' a fiction.

#### Box 15: Politicians' blind trusts

Some politicians, especially elected presidents, announce that they will put all of their assets in a blind trust to prevent any conflict of interest (and any accusation of corruption). The idea behind "blind trusts" is that the politician will create an irrevocable trust during their presidential term and will not be able to give any instructions to the trustee who will have discretion on managing the trust assets. Again, this sounds well in theory. However, a politician may have plenty of ways to give directions to the trustee (either with a protector, letter of wishes or any means of communications). In addition, the trustee's client is the politician, not society or an NGO, so it is unlikely that the trustee would do any investment that goes against its client. In other words, a blind trust is as assuring as believing in the politician's honesty. The problem with trusts is that they are not registered, their assets are not disclosed and they do not need to publish accounts. For this reason, it would be much better for all politicians to disclose what assets they have either directly or through a trust (i.e. interests in which companies), so that society may directly check that no conflict of interest is taking place for example in a tender process or a procurement contract.

### 4.4 Abusive Regimes around the world

While many of the most abusive regimes are located in 'wild and exotic' jurisdictions like the Cook Islands where the faint-hearted may be reluctant to venture, a number of supposedly 'reputable' jurisdictions, like New Zealand, are taking part in these abusive games.

Since trusts usually enjoy full flexibility, in principle a settlor could write any provision he wants, as long as it is not strictly forbidden. In addition, some provisions may be considered "abusive" by local courts through common law, even if not explicitly forbidden. So some tax havens clarify in their trust

laws that certain provisions which clearly undermine well-settled foreign limitations on trust use are valid and enforceable. Some examples follow (see Annex IV for a summary table).

#### **4.4.1 Cook Islands**

This group of islands in the South Pacific, associated with New Zealand, is considered by some to be the most abusive of all trust regimes. ([NYTimes<sup>50</sup>](#), 14.12.2013). Its trust regime, originally set up by a Denver-based U.S. lawyer, focuses on one thing: the strongest, most aggressive asset protection.

The Cook Islands regime has several devious features<sup>51</sup>. First, neither foreign laws (e.g. inheritance, marital or divorce provisions) nor foreign judgments can invalidate a trust created under Cook Islands laws. To fight a case against a Cook Islands trust, it is necessary to fly out your lawyers to submit to Cook Islands courts, knowing that your case is all but unwinnable.

Second, it is almost impossible to prove fraudulent conveyance in the creation of a Cook Islands trust. For instance, one has to prove “beyond reasonable doubt” (the standard used in criminal law) that the trust was created with the “principal” intent to defraud a creditor (so if the principal intent could perhaps have been estate planning, for instance, it won’t be possible to invalidate the trust). Not only that, but you have to prove that the creation of the trust is what rendered the settlor insolvent when the trust was created. To make matters still worse, the statute of limitations for fraudulent conveyance is both short and highly complex.

In addition, under Cook law, the settlor may also be the trustee and beneficiary, or may retain a large degree of control over the trust (for example, to revoke the trust, remove a trustee, benefit from spendthrift provisions, and appoint a protector). Readers will hardly be surprised to learn that Cook Islands trusts can also last forever.

#### **4.4.2 Nevis**

This Caribbean island amended its trust law in 2015 to copy many of the Cook Islands’ provisions<sup>52</sup>. As in many other tax havens, neither foreign laws nor foreign judgments may invalidate a Nevis International trust. Statute of limitations restrictions for fraudulent conveyance are the same as in the Cook Islands. The settlor may also be beneficiary, or may retain a large degree of control over the trust (revoke the trust, remove the trustee, etc.), benefit from anti-duress clauses, and appoint a protector. Nevis trusts may last forever.

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<sup>50</sup> <http://www.nytimes.com/2013/12/15/business/international/paradise-of-untouchable-assets.html>; 26.1.2017.

<sup>51</sup> Cook Islands International Trust Act, Sections 6.2.c, Section 13 B.1, B.3, C, D, E, F and I, and Section 20.

<sup>52</sup> Nevis International Exempt Trust Act, Sections 5, 6, 9, 13, 24, 28, 29 and 47.

### 4.4.3 Belize

This Central American country is also famous for its abusive trust laws<sup>53</sup>. Neither foreign laws nor foreign judgments may invalidate a Belize trust. While trusts may last for “only” 120 years, what is striking about Belize is that since there is no fraudulent conveyance law, it appears that no creditor may easily invalidate a trust on account of fraud after it was created. Protectors are available and the settlor may also be a trustee.

### 4.4.4 Bermuda

This British Overseas Territory also offers<sup>54</sup> non-recognition of foreign laws and judgments for its trusts. Duration of trusts is limited to 100 years<sup>55</sup>. While the law does not have any explicit provisions on trust protectors, they are common practice and recognized by the Bermuda Supreme Court’s case law<sup>56</sup>.

### 4.4.5 The United States: examples of Alaska, Delaware, Nevada and South-Dakota<sup>57</sup>

USA states promote “domestic” trusts (“domestic” from the perspective of American clients) which avoid the stigma of offshore trusts, and are thus less likely to attract the Internal Revenue Services’ attention (Russo 2014). Yet many state trust regimes contain abusive features. In an effort to “compete” with offshore jurisdictions, Alaska was the first state to allow self-settled spendthrift trusts, where a trust may contain spendthrift clauses even if the settlor is one of the beneficiaries of the trust (Hirsch 2006).<sup>58</sup> Spendthrift trusts are increasingly available in the United States, even though they have been described as anti-democratic and anti-American, for over a century. As one account in 1895 put it:

“It is hard to see the Americanism of spendthrift trusts. That grown men could be kept all their lives in pupilage, that men not paying their debts should live in luxury on inherited wealth, are doctrines as undemocratic as can well be conceived. . . [T]he general introduction of spendthrift trusts would be to form a privileged class, who could indulge in every speculation, could practice every fraud, and yet, provided they kept on the safe side of the criminal law, could roll in wealth. They would be an aristocracy, though certainly the most contemptible aristocracy with which a country was ever cursed.”<sup>59</sup>

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<sup>53</sup> Trust Act, Chapter 202, Part I, Sections 7.6, 11, 16, 17.2 and 18.

<sup>54</sup> Trust Act of 1989, Sections 3.1, 11 and 23

<sup>55</sup> Id Note 23, Section 3.1

<sup>56</sup> Von Knierem v. Bermuda Trust Co. Ltd., Bermuda Supreme Court Civil Jurisdiction, No. 154 (July 13, 1994)

<sup>57</sup> Bergman, Pamela, “Asset Protection Trusts (the Good, the Bad, and the Uncertain)”, Family Law Update 2005.

<sup>58</sup> Relevant regulations are subject to some conditions, however: for example that the settlor did not intend to defraud creditors or that the trust is not revocable. Many other States, including Delaware and Nevada followed suit, and also offer self-settled spendthrift trusts.

<sup>59</sup> John c. Gray, Restraints on the Alienation of Property § 211, at 246- 47 (2d ed. 1895). Quoted in (Alexander 1985).

Delaware, Nevada, South Dakota and other states all offer self-settled spendthrift trusts and other facilities for the 'wealth defence industry.'

Both Alaska and Delaware have a statute of limitations for fraudulent conveyance, of four years from the transfer of assets to the trust, while Nevada specifies only two years. Trusts may continue<sup>60</sup> perpetually in Alaska, except if someone uses a power of appointment, in which case it is limited to a thousand years. Delaware trusts may also be perpetual, unless they hold real estate, in which case they are limited to 110 years. Nevada trusts may last 365 years.

The South Dakota trust industry is booming: "With no personal or corporate income tax, no limit on 'dynasty trusts' and strong asset protection laws — shielding assets from soon-to-be ex-spouses — [South Dakota has leapt to the top of annual rankings for the trust industry](#)<sup>61</sup>."

#### **4.4.6 Cayman Islands<sup>62</sup>: excluding the beneficiaries**

In an effort to differentiate itself from the stigma of ultra-abusive trust regimes such as the Cook Islands, the Cayman Islands (an Overseas Territory of the United Kingdom), enacted in 1989 the Fraudulent Dispositions Law to allow creditors to invalidate fraudulent transfers of assets into a trust. And while Cayman is not the only jurisdiction to have such regulation, the statute of limitations (for a creditor to be allowed to invalidate a transfer) is six years after the disposition of property, in contrast to other tax havens' limit of one or two years.

However, the Cayman Islands still has many typical tax haven provisions that go beyond the lack of taxes and lack of registration and disclosure of trusts. They include protecting the validity of its trusts against any foreign law trying to invalidate them, for instance, for breaching the foreign jurisdiction's inheritance rights. In other words, Cayman still caters to foreigners seeking to thwart foreign rules and regulations.

The Cayman Islands' Special Trusts Alternative Regime (STAR)<sup>63</sup> trust also deviates from fundamental trust principles, in two main ways. First, it makes it difficult for beneficiaries to enforce the trust. Normally, beneficiaries can go to court to make sure that trustees are doing their job properly. That is not the case with the STAR trust, where powers to enforce the trust are in the hands of "Enforcers" appointed by the settlor. Beneficiaries may also be unable to find out information about the trust<sup>64</sup>.

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<sup>60</sup> Oshins, "Dynasty Trust States", available in: <http://www.oshins.com/dynastytruststates.html>; 26.1.2.17.

<sup>61</sup> <https://www.ft.com/content/cc46c644-12dd-11e6-839f-2922947098f0#axzz489JOb55d>; 26.1.2017.

<sup>62</sup> <http://www.applebyglobal.com/publication-pdf/guide/guide-to-trusts-in-the-cayman-islands---january-2016.pdf>; <http://www.applebyglobal.com/publication-pdf/guide/guide-to-star-trusts-in-the-cayman-islands.pdf>; <https://www.ogier.com/publications/star-trusts>; 26.1.2017.

<sup>63</sup> The name is because of the 'Special Trust Alternative Regime' (STAR) law of 1997.

<sup>64</sup> Originally, beneficiaries are said to have 'equitable interests' in the trust and should know about the trust existence to ensure that the trustee is not affecting them, but acting in their best interest, especially if the settlor has died.



Second, the STAR trust can operate either on behalf of beneficiaries, and/or for 'purposes.' The absence or powerlessness of beneficiaries effectively 'cuts off one corner of the triangle' of settlor, trustee and beneficiaries – and thus allows the settlor to retain greater powers, making it more like a sham arrangement.

STAR trusts are also exempted from the rule against perpetuities, so they may last forever and become dynasty trusts for family wealth concentration.

Many STAR trusts are [used for creating Special Purpose Vehicles<sup>65</sup>](#) that can take risks off banks' balance sheets (for regulatory purposes, though generally not from an economic perspective). Experience shows that when these vehicles go bankrupt the off balance sheet risks often reappear on the banks' balance sheets via bank guarantees for these vehicles. The financial crisis showed that these vehicles can be lucrative for Cayman and its lawyers, but they can be implicated in costs (on a far greater scale) for societies elsewhere, in banks bailouts.

#### **4.4.7. British Virgin Islands**

The British Virgin Islands, another Overseas Territory of the UK, offers confidentiality for trust participants via lack of registration and no taxation, as well as popular discretionary trusts and non-charitable purpose trusts. It also offers non-recognition of foreign laws that could invalidate a BVI trust<sup>66</sup>. The rule against perpetuities (which excludes purpose trusts) was extended from 100 years to 360 years.

The BVI is well known for its abusive VISTA<sup>67</sup> (Virgin Islands Special Trust Act) trusts, which allow the settlor (or any person appointed by him/her) to retain control of and manage a company held by the trust, i.e. a family business, without the trustee's interference. So the VISTA trust will hold shares of a BVI company (which may in turn hold cash, assets or shares in other companies). As one offshore provider explains:

"The trustee's monitoring and intervention obligations under the general law are removed and it is disengaged from all management responsibility in the company which can instead be carried out by the directors without concern for any unwanted interference in the company's affairs by the trustee<sup>68</sup>".

This is in one sense even more of a step away from the trust concept than the Cayman STAR trust. Here, it isn't the beneficiary who can't control or manage the trust but the trustee who can't interfere in the trust. These mechanisms with strong settlor control (which renders them shams) were

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<sup>65</sup> [https://www.conyersdill.com/publication-files/Pub\\_Cay\\_Cayman\\_Islands\\_Securitizations-0.pdf](https://www.conyersdill.com/publication-files/Pub_Cay_Cayman_Islands_Securitizations-0.pdf); 26.2.2017

<sup>66</sup> For instance, it does not consider a person with inheritance rights (under a foreign law) to be a creditor. In other words, , the fact of having an inheritance right under a foreign law does not mean that you have any powers to invalidate the trust--you will simply be treated as having no claim.

<sup>67</sup> The name is because of the 'Virgin Islands Special Trusts Act' of 2003.

<sup>68</sup> [http://www.applebyglobal.com/publication-pdf/guide/guide-to-vista-trusts-in-the-british-virgin-islands-\(january-2015\).pdf](http://www.applebyglobal.com/publication-pdf/guide/guide-to-vista-trusts-in-the-british-virgin-islands-(january-2015).pdf); 26.1.2017.

set up with the aim of attracting Asian and other clients uncomfortable with the idea of giving up control to trustees.

#### **4.4.7 New Zealand**

New Zealand usually flies under the radar as a tax haven, but its trust regime has abusive offshore-like characteristics. As of May 2016, 11,671<sup>69</sup> foreign trusts<sup>70</sup> were registered in New Zealand, with a registration of about 1,000 new foreign trusts every year, with a particular rise since 2010.

A New Zealand government “Inquiry into Foreign Trust Disclosure Rules” published in June 2016, following the Panama Papers scandal which unearthed many New Zealand trusts, concluded that New Zealand is used as a trust jurisdiction for a variety of reasons: low registration and disclosure requirements; a tax exemption regime that removes incentives or justifications for any audits; and unusual rules about determining the trust’s tax residence status, which allow arbitrage with different jurisdictions with different classification systems.

NZ tax authorities require little information when a foreign trust is established: not the names, addresses or country of residence of the settlor, protector (if there is one), non-resident trustees, other persons who may control or influence the trust, or beneficiaries.<sup>71</sup> When minimal trust registration requirements were imposed in New Zealand in 2006 following pressure by Australia, registration of new foreign trusts fell by almost 60%.<sup>72</sup> In addition, the Inquiry stated, “Foreign trusts which do not derive New Zealand source income or distribute income to New Zealand resident beneficiaries are exempt from New Zealand tax” (NZ 2016: 13). This has disclosure implications. The Inquiry report added, “As there is no New Zealand tax to verify or pursue, dedicating audit resources to this sector is justified only to the extent required to discharge obligations to foreign tax authorities” (ibid.: 23).

Moreover, in New Zealand the residence of the settlor (and not of the trustee, like in many jurisdictions) is relevant to determine the trust’s residence status. This may create arbitrage situations where a trust has no residence for tax purposes whatsoever. For example, consider a situation where a settlor from jurisdiction X (where the trustee’s residence determines the trust’s residence) creates a NZ trust and appoints a NZ

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<sup>69</sup> NZ 2016, pages 15-16. The report quotes *offshore-protection.com*: “New Zealand provides all the advantages of traditional offshore financial centers, but is primarily recognized as a mainstream onshore financial center”. An exception is where the settlor is resident in Australia.

<sup>70</sup> A New Zealand foreign trust is a trust established in NZ but where no settlor is ever resident in NZ.

<sup>71</sup> For the details required on the form, see NZ 2016, pages 22-24. Although record-keeping requirements are significantly more extensive than the disclosure form, “the name and address of the settlor or settlors, and of the recipients of distributions from the trust, are required to be maintained (and therefore able to be provided) only *if known*. The NZ Inquiry added “there is no obligation to report distributions to beneficiaries, no annual returns of any kind are required, there is a low likelihood of IRD [Tax authorities] requesting records and exchanging any information with offshore authorities, no information obtained under the AML rules as part of customer due diligence is likely to be disclosed to any government agency, information on the source of funds in foreign trusts is required to be obtained but in many cases verification is not mandatory, and the definition of beneficial ownership, and in particular the concept of effective control, is complex and may not be well understood or consistently applied” (NZ 2016: 48).

<sup>72</sup> From 2350 in 2006 to 902 the following year (NZ 2016: 15).

trustee. Neither jurisdiction X nor New Zealand would consider such a trust to be resident for tax purposes.

The Inquiry’s overall conclusion was that “The rules are not fit for purpose in the context of preserving New Zealand’s reputation as a country that cooperates with other jurisdictions to counter money laundering and aggressive tax practices” (NZ 2016: 47).

#### 4.5 Consequences of trusts that are festooned across different jurisdictions

Imagine a settlor originally resident in, say, Argentina, which has forced heirship<sup>73</sup> laws placing restrictions on what he can leave to whom. He creates a Cook Islands discretionary trust in favour of his friend, not only to disinherit his estranged son (his only heir, who would have inherited under Argentina’s heirship laws), but also to defraud his creditor: both are resident in Argentina. The son or creditor learns of the Cook Islands trust. What can they do? The table below outlines possible treatment of the assets and rights to the assets in different scenarios.

Location of Trust Assets	Current Residence of Settlor	Residence of Trustee	Laws/Judge in Argentina	Resulting Level of Asset Protection
Cook Islands*	Cook Islands*	Cook Islands*	Irrelevant: even if Argentina’s laws or judges invalidate the trust, it would be impossible to enforce it.	<b>Full</b>
Cook Islands*	Cook Islands*	Argentina	Irrelevant, if trustee is a company (and may be dissolved) or if a flee clause easily migrates the trust and trustee	<b>Very High</b>
Cook Islands*	Argentina	Cook Islands*	Depends on whether it holds settlor in contempt, but unlikely if settlor proves it has no control over trustee (e.g. <a href="#">Arline</a> )	<b>High</b>

<sup>73</sup> For example in Argentina, a man may only dispose of 20% of his assets to decide who will obtain them after he dies. The remaining 80% belong, by law, to his spouse and/or children. This means that if a man donates his only house to his lover before dying, either his children or spouse could get the house back because 80% of it would belong to them by law.

			<a href="#">Grant case in the U.S.)</a>	
Anywhere other than Argentina	Anywhere other than Argentina	Irrelevant	May declare the trust a sham and invalidate it, but difficult to enforce it abroad	<b>Medium– <u>applicable to trusts or any other type of entity</u></b>
Argentina	Outside Argentina	Outside Argentina	While the trust would likely be invalid regarding the son after the father’s death for violation of inheritance rights (who could claim the assets), it may still be valid with respect to the creditor – unless it violates Argentine fraud law	<b>Potentiall y High (with regard to creditor), Low (with regard to son)</b>
Argentina	Argentina	Argentina	If the trust also violates creditor’s rights in Argentina’s laws, a judge may declare the trust a sham and invalidate it, and initiate legal actions against both the settlor and trustee. <u>However, the fact that a foreign trust exists creates many obstacles for creditors (obtaining trust documents, translations, interpretations of foreign law, etc. which is much costlier than if the settlor or a nominee held the assets directly)</u>	<b>Little (but not zero)</b>

\* The same applies for a country that would recognize Cook Islands trusts as valid

## Conclusion: identifying the problem

Some users of trusts are vulnerable people who need and deserve protection. But in solving particular problems for particular people, trusts may also wreak widespread and indiscriminate collateral damage to society. By boosting inequality, trusts also undermine democracies and economic systems.

Most if not all of the genuinely *socially* useful properties of trusts could be achieved in other ways. Many of the features of trusts that make them especially useful to their participants are precisely the features that make them the most harmful to wider society. That is because trusts are “wealth defence mechanisms” for their users. And who are they defending against? Well, society: the rest of us.

Given what we now know about how trust law has evolved in many tax havens, it is inconceivable that any society would tolerate setting up the current system from scratch. It is bizarre – not to mention politically dangerous – to have a situation where societies put in place, for example, inheritance taxes – and then provide facilities for the wealthy and well-advised to escape those taxes.

It is not unfair to describe these mechanisms for defending wealth from society as weapons of mass financial injustice – and it is time to subject them to a proper democratic debate, and root and branch reform.

This paper asks whether the benefits trusts confer are proportional to the damage they may cause, and proposes ways to curb or eliminate the harms while preserving the benefits.

### The multi-layered onion

Trusts pose dangers on multiple levels. Peel back one, and others appear.

The first is **secrecy**. Allowing trusts to provide secrecy for anyone who wants to use them clearly creates potential but indiscriminate collateral damage in terms of tax evasion and other crimes, frauds, market rigging, money laundering and many other abuses.

Yet even if the secrecy problem were solved, other problems would remain.

A second problem is that many abusive trust regimes and abusive trust forms have evolved in a way which diverge completely from the original conception of a trust as a mechanism enabling someone to place assets into a legal arrangement where trusted managers will manage those assets on behalf of deserving beneficiaries. Many “trusts” are sham trusts set up purely for anti-social purposes where, say, the original donor into the trust (or settlor) *pretends* to give away the assets, but in reality retains some (or full) control over them, and may even get the assets back later. These “sham trusts” are not actually trusts, but many legal systems indulge or

encourage them and treat them as if they were trusts. Again, these provide particular private benefits at heavy cost to society.

A third problem, even for trusts that aren't shams and aren't secret, concerns the **asset protection function**. If competently crafted, trusts can provide full immunity against legitimate creditors (such as tax authorities or lenders). There is no reason why society should provide such indiscriminate protection to anyone, no matter how vulnerable: for example the case of Princess Christina in Box 11 where it was argued that an eye condition somehow was justification for her using a trust to escape millions in tax.

At the core of the asset protection function, and the secrecy, is the fact that trusts put assets into an "**ownerless limbo**" where ownership rights are carefully divided between settlor, trustee and beneficiary, allowing each to claim that they don't own the assets. This enables endless abuses, such as allowing the rich to concentrate wealth across generations without paying inheritance taxes and escaping other normal responsibilities which ordinary mortals have to submit to.

How did society ever come to accept this state of affairs?

The answer is clear: it is the rich and powerful who benefit most from these arrangements and have ensured their continued existence. Remember the *Golden Rule*: those who have the gold make the rules.

## 5. Solutions

For centuries societies have tried to wield defences against some of the problems we've identified.

For example, the long-standing Rule Against Perpetuities was designed to guard against concentration of dynastic family wealth. Many jurisdictions also provide defenses against sham trusts, which as Section 3.2.2 explains can be pierced in court under certain conditions (most of which can also pierce genuine trusts).

Global campaigns for transparency on trusts are in their infancy, but Section 2.1.1 outlines some patchy transparency initiatives. Civil society groups are now gearing up to push for more, and this document aims to support and influence that push.

Yet all these defences against trust abuses are hard to implement. It is usually exceedingly difficult to pierce a trust, not least when relevant people or assets flee to more hospitable jurisdictions, and especially if it contains 'spendthrift' provisions and a discretionary element.

And there is a constant degradation of trust laws around the world, a 'stripping of the trust', as jurisdictions seeking to attract trust business engage in a race to the bottom by enacting ever more indulgent trust laws

provisions, and as lawyers and tax advisers constantly seek devious new trust forms and laws to get around any defences societies try to erect.<sup>74</sup>

Clearly, more fundamental remedies are needed.

Some of those fundamental reforms are described below. We deliberately have not tempered our suggestions on the basis of what is politically possible or feasible right now. We have found that in the financial transparency space what may be politically unacceptable one year may be the topic du jour the next.

Our main aim is not to offer precise technical fixes but to initiate and stimulate debate about what roles these arrangements should play in our societies, and how to repair the damage with least disruption.

### **Solution 1: Transparency**

This solution comes in two parts: registration and publication.

All relevant persons and assets connected to a trust should be **registered** with public authorities, and information exchanged with those persons' home jurisdictions as necessary. Registration should be a precondition of a trust's legal existence and validity, as with most legal entities (e.g., companies). Registration should happen not only in jurisdiction under whose laws the trust is formed, but in all jurisdictions with connection points to the trust – whether it is the trust's governing law, the location of trust assets, or residence of any of the trust's related persons (settlers, trustees, beneficiaries, protectors, enforcers, and so on.)

The next step is **publication** of the registration information (not the full trust deed, but the identity of the trust's beneficial owners). Nobody is forced to set up these structures. If people choose to secure trust privileges, it is fair for society to ask for transparency in return<sup>75</sup>. And this is not so radical: companies are granted the privilege of limited liability in exchange for (among other things, in many jurisdictions) transparency. Democratic debate is required to decide what information should be made public but we propose complete transparency of all relevant information as a starting point for discussion. As Section 2.1.1 explains, we are now seeing the first stirrings of public transparency of trusts, as the European Union considers public access to ownership information for some types of trusts.

### **Solution 2: No 'ownerless' assets**

So-called "ownerless assets" should not be tolerated<sup>76</sup>. Where a settlor has placed assets into a trust, but no beneficiary has received them yet or is

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<sup>74</sup> Oshins, for instance, suggests Hybrid Domestic Asset Protection Trusts: third-party irrevocable trusts where the settlor is not a beneficiary, but can be added in as a beneficiary by a trust protector at a later date when the coast is clear and there is no creditor issue. See: [http://www.oshins.com/images/Dahl\\_Supreme\\_Court.pdf](http://www.oshins.com/images/Dahl_Supreme_Court.pdf); 26.1.2017.

<sup>75</sup> For a useful discussion about finding the right balance between privacy and publication, see [Waiving the Right To Privacy](#), from UK barrister Jolyon Maugham, on his blog *Waiting for Tax*, April 22, 2016.

<sup>76</sup> The same would apply to purpose trusts, whose assets should be considered to be owned by the creator or settlor, or by the person who will receive the "surplus assets".

identifiable as being entitled to the assets, then from the perspective of their creditors (which include the settlor's tax authorities) the assets should be deemed to still be the property of the settlor, as if the trust did not exist. When the settlor dies or makes a distribution, inheritance taxes or gift taxes would be triggered.

Once the trust has made a distribution to a beneficiary, ownership of those assets passes definitively away from the settlor to that beneficiary, and should be treated as a gift or donation. When that beneficiary dies, inheritance tax is triggered. Fraudulent conveyance rules would apply as usual (in case the settlor and beneficiaries start switching assets from one another).

We suggest one large and important exception. For matters that are internal to the trust and don't impact on other third parties outside the trust or wider society, trust law should continue to function as it is.

So a settlor would create a trust to create binding rules on how assets are to be distributed, as long as this is legal under the laws of his jurisdiction of residence or where his assets are located<sup>77</sup>. The trust would then operate rather like a will. But the settlor could not use the trust to escape, say, inheritance taxes, or to defraud legitimate creditors.

### **Solution 3: Explicitly prohibit abusive trust provisions**

Since all trusts (and all of their related documents such as letters of wishes, powers of appointment, etc.) would under our proposals have to be registered (but not necessarily disclosed) to give them legal validity, authorities could scrutinize abusive provisions in trust documents. Prohibitions should be applied to, for example, self-settled spendthrift provisions (Hofri-Winogradow 15-5, Gingiss 1999), anti-duress and anti-forfeiture provisions, flee clauses, or high degree of control by the settlor or regulations disregarding foreign laws and foreign judgments. It would be relatively straightforward to create lists of such prohibitions, though these would need to be updated regularly to keep pace with harmful innovations in trust laws.

### **Solution 4: Target abusive offshore regimes**

As with tax haven and money-laundering blacklists, jurisdictions with abusive trust regimes should be subject to countermeasures such as blacklisting (Lopucki 1996). Lists should be based on objectively verifiable criteria, such as the Financial Secrecy Index<sup>78</sup>, rather than on politicised lists set up by bodies susceptible to influence from powerful countries.

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<sup>77</sup> For example, if the law imposes forced heirship, those heirs will be considered the new owners of trust assets. If there is no forced heirship, and the law allows the settlor to appoint heirs by writing a will, those appointed to inherit assets (i.e. beneficiaries of the trust) will be considered the new owners.

<sup>78</sup> These lists should include jurisdictions which allow, for example, non-recognition of foreign laws and judgements, flee clauses, anti-duress and forfeiture provisions and self-settled spendthrift trusts. Also see, for instance, The False Promise of Tax Haven Blacklists, (<http://www.taxjustice.net/2016/05/31/the-false-promise-of-tax-haven-blacklists/>; 26.1.2017). See



Trusts created in such places could be deemed invalid, and persons involved (as settlors, protectors, etc.) could be held in contempt if they refuse court orders to repay creditors by invoking, say, anti-duress or anti-forfeiture clauses (Gingiss 1999). Jurisdictions which allow holding assets (like bank accounts) under trusts governed by the laws of abusive offshore regimes could also be blacklisted. Being involved in a trust related to a blacklisted jurisdiction could include removing any benefits awarded by the trust (as if the trust did not exist) and perhaps imposing criminal charges (Sterk 2000).

An alternative would be to blacklist trust regimes (e.g. Cayman STAR trust) but not all other types of trust of one jurisdiction.

### **Solution 5: Sham trusts are not trusts: call them something else**

Sham trusts containing prohibited abusive provisions should also be prohibited from claiming trust status. This cosmetic-sounding approach could have important cultural and political effects: using the term 'trust' to denote a sham confers social acceptability, which is unwarranted. It is time to design some (pejorative) new terms to denote these structures where the settlor retains control or is one (or the only) of the trust beneficiaries.

### **Solution 6: Tax assets directly**

Although this sounds rather like a topic of fiscal reform, taxing trust assets directly may be a partial solution for those cases where the tax is levied on the holder of assets (e.g. inheritance tax) and the trust confuses this ownership. For example, an approach available in some countries, although with poor enforcement, are property taxes -- or, much better, a Land Value Tax (LVT). Land is immovable and the tax can be applied directly to it, regardless of which people or structures own it. Non-payment can potentially result in forfeiture of the title to the land<sup>79</sup>.

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also Lessons from the Last War on Tax Havens, ([http://www.taxjustice.net/cms/upload/pdf/Tax\\_Notes\\_0707\\_Lessons\\_from\\_the\\_war\\_on\\_tax\\_havens.pdf](http://www.taxjustice.net/cms/upload/pdf/Tax_Notes_0707_Lessons_from_the_war_on_tax_havens.pdf); 26.1.2017).

<sup>79</sup> This tax ultimately reaches far beyond the land itself: many financial securities in the modern global economy essentially involve land value, capitalised and packaged into revenue streams: a land value tax effectively taxes such instruments at source.

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## Annex I: Global cases of trust registration

Registration with any authority of all domestic law trusts and/or all foreign law trusts with a resident trustee<sup>80</sup>:

<b>All Domestic law trusts and all foreign law trusts domestically managed</b>
Czech Republic, Hungary, San Marino
<b>All foreign law trusts domestically managed (Domestic law trusts cannot be created)</b>
Italy, Monaco
<b>Only domestically managed trusts (both foreign and domestic law trust<sup>81</sup>)</b>
Australia, Canada, India, Ireland, Japan, Korea, New Zealand, Philippines
<b>(Domestic law trusts cannot be created), but No registration of domestically managed foreign law trusts)</b>
Andorra, Aruba, Belgium, Brazil, Cyprus, Denmark, Estonia, Finland, Greece, Iceland, Latvia, Macao, Macedonia, Maldives, Montenegro, Netherlands, Norway, Poland, Portugal (Madeira), Russia, Slovakia, Slovenia, Spain, Sweden, Switzerland
<b>Domestic law trusts but No registration of domestically managed foreign law trusts</b>
Belize, Cook Islands, Curacao, Dominican Republic, France, Marshall Islands, Saudi Arabia, Seychelles, South Africa, St Kitts and Nevis, Uruguay
<b>Foreign law trusts domestically managed but no registration of domestic law trusts</b>
Chile
<b>Neither domestic law trusts nor foreign law trusts domestically managed have to register</b>
Anguilla, Antigua & Barbuda, Austria, Bahamas, Bahrain, Barbados, Bermuda, Bolivia, Botswana, British Virgin Islands, Brunei, Cayman Islands, China, Costa Rica, Dominica, Gambia, Germany, Ghana, Gibraltar, Grenada, Guatemala, Guernsey, Hong Kong, Isle of Man, Israel, Jersey, Lebanon, Liberia, Liechtenstein, Luxembourg, Malaysia (Labuan), Malta, Mauritius, Mexico, Montserrat, Nauru, Panama, Paraguay, Samoa, Singapore, St Lucia, St Vincent & Grenadines, Taiwan, Tanzania, Turkey, Turks & Caicos Islands, United Arab Emirates (Dubai), United Kingdom, US Virgin Islands, USA, Vanuatu, Venezuela

<sup>80</sup> Analysis based on the [Financial Secrecy Index](http://www.financialsecrecyindex.com/jurisdictions/database) 2015 Edition, see: <http://www.financialsecrecyindex.com/jurisdictions/database>; 23.6.2016. It does not include the EU AMLD because as of December of 2016, the Directive only covers trusts that generate tax consequences.

## Annex II: Real-life abuses with trusts

- **In re Wilson (tax evasion, tax authorities as the creditor)**

“Looking at the terms of the Huval Trust so as to ascertain and effectuate the intent of the Settlor, it is clear to this court Mrs. Huval did not intend trust fund income distributions to go to her daughter's creditors. As a mother, Mrs. Huval wanted to provide for her daughter but, apparently, she had concerns about her daughter's financial abilities. So she chose two methods, each well recognized and established under Texas law, to protect her daughter from improvidence. First, she established a trust in which the Trustee has absolute discretion in the distribution of available funds. The Trustee could either withhold funds or pay them for the benefit of the Debtor/Beneficiary. The Trustee is not required to pay funds directly to the Debtor/Beneficiary. Mrs. Huval specifically provided that any income and/or accumulated income not distributed at the date of [the Debtor/Beneficiary's] death shall be distributed to her descendants. This is a clear statement that the Trustee is not obligated to distribute anything to the Debtor/Beneficiary during her lifetime. Both parties agree that where a beneficiary is entitled only to so much of the trust property as the trustee in its uncontrolled discretion decides to give to the beneficiary, the beneficiary cannot compel the trustee to pay anything to or on behalf of the beneficiary **and there is no property right to which an IRS lien might attach**. The court finds that is the case with the Huval Trust.

Second, Mrs. Huval specifically directed in the spendthrift clause that no part of trust estate, under any circumstances, should ever be liable for or charged with any of the debts, liabilities, or obligations of the beneficiary or subject to seizure by any claimant or creditor of the beneficiary. Spendthrift clauses are well recognized in Texas as a method of preventing creditors from reaching any part of a trust. **To allow the IRS to reach any part of the trust in question would frustrate Mrs. Huval's intentions and deprive the residual beneficiaries of what is rightfully theirs.**

At this time there is no property to which an IRS lien may attach. The Debtor/Beneficiary cannot compel distributions. Therefore there will be no property in the future against which the IRS may place a lien. **The IRS must await a distribution from the Trustee”**<sup>82</sup> (emphasis added).

- **"The Grant case on Tax Evasion (tax authorities as creditors)**

“In 1983 and 1984, Raymond Grant settled an offshore trust in Bermuda and another one in the Isle of Jersey, with one trust benefitting himself and the other benefitting his wife, Arline. The evidence was overwhelming that Raymond managed the trusts and their affairs, and that Arline had little to do with them. Raymond also mis-managed the couple's tax affairs, leading to a \$36 million tax judgment in favor of the United States. Raymond died so the U.S. tried a variety of strategies to get at the money in the Grants' offshore trusts, including trying to force Arline to appoint a new Trustee. None of this worked, and finally the U.S. moved to hold Arline in contempt

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<sup>82</sup> <https://www.courtlistener.com/opinion/1549467/in-re-wilson/>; 26.1.2017.



of Court until the money came back to the U.S. However, the court decided "I am reluctant to fault Mrs. Grant for her trustees' denial of her requests to repatriate the funds. Accordingly, I find that Mrs. Grant has sufficiently established that she is not able to repatriate the offshore funds and deny the motion for an order to show cause". Had Arline acted more wisely, she would have got away with it. However, what the U.S. found, in 2011, was that although Arline had previously disclaimed any control over the Trusts, she had since received \$221,000 from the Trusts, which were paid into her children's bank accounts. Bingo!

While the IRS finally got it its way, an analyst described how tax evaders could have prevailed, had they been better assessed: Let's say that before Raymond Grant entered into the tax shelters that caused him trouble, Raymond and Arline instead funded a good old-fashioned domestic irrevocable estate planning trust (non-self-settled, i.e., not a DAPT) for the benefit of the Grant children. Into this plain-vanilla trust, Raymond and Arline gifted the bulk of their assets — not so much as to render them technically insolvent, but a goodly amount. In such a case, the assets that Raymond and Arline would probably have been protected from their later creditors, and then presumably distributions could have been lawfully and transparently made to their children, who then provided Raymond and Arline with support if their world turned upside down."<sup>83</sup>

- **Scheffel v. Krueger (beneficiary's assets shielded even under sexual abuse against minor)**

The New Hampshire Supreme Court decided on July 26, 2001 when the mother of a minor boy who was sexually assaulted by a trust's beneficiary sought to attach the beneficiary's interest in the trust to satisfy a tort judgment. The lower court dismissed the action. On appeal, the New Hampshire Supreme Court held that: 1) the trust's spendthrift provision barred a claim to satisfy a tort creditor, and 2) the trust qualified as a spendthrift trust even though the beneficiary exerted significant control over it<sup>84</sup>.

- **Duvall v. McGee (beneficiary's assets protected even against victim of murder)**

Katherine Ryon was beaten to death during the course of a robbery that occurred in her home. After James Calvert McGee was convicted of felony-murder for his participation in the robbery and murder of Ms. Ryon, a money judgment was entered against him pursuant to a settlement agreement, in which McGee compromised civil claims brought against him by Robert Duvall, the Personal Representative of the Estate of Ms. Ryon. The majority today concludes that Ms. Ryon's estate cannot enforce its judgment against McGee's interest in an \$877,000.00 spendthrift trust

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<sup>83</sup> <http://www.forbes.com/sites/jayadkisson/2013/04/25/the-one-foreign-asset-protection-win-turns-out-to-be-a-dud-after-all-in-the-arline-grant-case/3/#2b025cc33014>; 26.1.2017.

<sup>84</sup> <http://wealthmanagement.com/news/scheffel-v-krueger-effectiveness-statutory-spendthrift-trust>; 26.1.2017.

established for him by his deceased mother. The majority acknowledges that claimants seeking alimony, child support, and unpaid taxes may attach a beneficiary's interest in a spendthrift trust, but concludes that the victim of a violent tort may not, reasoning that such a victim is only "a mere judgment creditor."<sup>85</sup>

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<sup>85</sup> <http://caselaw.findlaw.com/md-court-of-appeals/1364227.html>; 26.1.2017.

## Annex III: Difference between asset protection for companies and trusts

<b>Corporate Limited Liability</b>	<b>Abusive Offshore Trust</b>	<b>Regular trust</b>
<p>In 1990 John incorporates a company and capitalises it with \$10M. He is the only shareholder. In 2016 John runs over Mary with a car by accident. John has no assets under his name, except for the company shares (which still holds \$1 Million in corporate assets). <b>Mary may claim some or all of John's shareholdings to cover her damages.</b></p>	<p>In 1990 John created a trust in the Cook Islands as its only settlor and beneficiary, and put in \$10M. He controls the trustee through a protector. In 2016 John runs over Mary with a car by accident. John has no assets under his name. <b>Mary may never find out that John is the settlor and beneficiary of a trust.</b> Even if she finds out, Mary cannot claim fraudulent conveyance because it's been too long since the trust was created: she wasn't a creditor in 1990. If her country of residence disallows sham trusts, she may try to prove that the trust is a sham (because John retains full control), or try to have a different law applied to the trust. Depending on Mary's luck, she <i>might</i> eventually reach trust assets, after time and effort.</p>	<p>In 1990 John created a trust in the U.S. in benefit of his son Paul, and put \$10 M in the trust. The trust is managed by an independent trustee. The trust has spendthrift provisions and says that Paul can only receive a distribution after 2030. In 2016 John runs over Mary with a car by accident. Paul, driving behind John, also hurts Mary with a car. Neither John nor Paul hold any assets. Mary may never find out about the trust's existence, <b>but even if she does, she would have no claim against John (he has no control over the trust) nor Paul (he is only entitled to receive a distribution 14 years later, in year 2030), so Mary would have to wait 14 years to reach (only) as much as that distribution.</b></p>

## Annex IV: Comparison of some abusive trust regimes

	Cook Islands	Nevis	Belize	Bermuda	U.S.A.		
					Alaska	Delaware	Nevada
Non-recognition of foreign laws (marital, divorce, inheritance, etc.)	X	X	X	X			
Non-recognition of foreign judgements	X	X	X	X			
Statute of Limitations (in years) for Fraudulent Conveyance (F.C.)	2 or 1	2 or 1	No F.C.	6	4	4	2
Trust duration limit (in years)	No limit	No limit	120	100	No limit/1,000	No limit/110	365
Self-settled spendthrift trust (settlor is also beneficiary)	X	X			X	X	X
Settlor with high degree of control over trust	X	X					
Protector	X	X	X	X			
Anti-Duress clauses		X					