OVERSEAS CHAMBERS OF PETER HARRIS

E: oc@overseaschambers.com
T: +44 (0)1534 625 879
F: +44 (0)1534 491 195
www.overseaschambers.com

Maison de la Boucterie
Rue de la Boucterie
Saint Saviour
Jersey, JE2 7ZW

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Article : Recent unappealed judicial authority on what is a "Sham Trust": a correlation with the forthcoming assault by Tax administrations on trusts via the OECD CRS information on Protectorships

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Please contact Peter Harris at peter.harris@overseaschambers.com for assistance and advice in any case.

Quoting Bertrand Russell in this context is a dangerous affair. The fact that most NGO Chairmen ranting on about trusts being shams were educated at Oxford implies that for lack of science, they have adopted the art of Rhetoric, and inverted it to prove falsehood by assertion. I neither share their *logos*, nor their created populist *ethos* nor have any *pathos* with their propagated bezerking terminological falsehoods. I have to put my words in the context of Russell's wisdom in order not to misquote the learned Judge in *Pugachev*.

The decision of Birss J. in *JSC Mezhdunarodniy Promyshlenniy Bank v Pugachev* [2017] EWHC 2426 (Ch) highlights the current position on the definition of what can be considered a "sham trust". By inverse logic, it also give guidance as to what a Court might not find to be a "sham trust". That has a direct impact on the use of the term in a tax context.

The first point to note is that the learned judge confirmed that there is really no such thing as a "sham trust".

Taken from the Common, Reporting Standard's perspective, which was certainly not before the High Court - what is more, the judge held that despite an allegation of sham being made, the trust so maligned still exists, and third parties, such as beneficiaries can still rely upon it. Having lectured on the case of *Snoop* and its relevance to tax administration intervention, this is of cardinal importance to the reckless usage of the term sham in tax matters:

He states:

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"145. ***Despite the frequent references to a "sham trust", there is not really any such thing.*** *What may or may not be a sham are the acts or documents which purport to set up the trust. The famous passage on sham in the judgment of Lord Diplock in Snook v London and West Riding Investments [1967] 2QB 786 at 802 is as follows:*

"..it is I think, necessary to consider what, if any, legal concept is involved in the use of this popular and pejorative word. I apprehend that, if it has any meaning in law, it means acts done or documents executed by the parties to the "sham" which are intended by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create. But one thing, I think, is clear in legal principle, morality and the authorities ... that for acts or documents to be a "sham," with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating. No unexpressed unexpressed intentions of a "shammer" affect the rights of a party whom he deceived".

146. The same point was made in New Zealand Official Assignee v Wilson [2008] 3 NZLR 45 at paragraphs 48/49: "The two situations (valid trust and sham trust) do not fall into combination. The finding that the purported trust is void as a sham does not amount to an invalidation of a trust. It is not the trust as such which is a sham. There is no trust to be a sham. It is the trust documentation that is the sham.

147. To find that a document is a sham, the focus is on the intentions of the relevant parties. In Hitch v Stone [2001] STC 214 at paragraph 66 Arden LJ put it this way: "The test of intention is subjective. The parties must have intended to create different rights and obligations from those appearing from (say) the relevant document, and in addition they must have intended to give a false impression of those rights and obligations to third parties".

148. Both parties referred to the same authorities: Snook v London West Riding Investments Ltd; Official Assignee v Wilson; and Hitch v Stone as well as further cases: Natwest Bank v Jones [2001] 1 BCLC 98; Re Abacus (CI) Ltd (Trustee of the Esteem Settlement) 6 ITELR 368 [2003] JRC 092; Shalson v Russo [2005] Ch 281; Painter v Hutchison [2007] EWHC 758 (Ch); A v A [2007] EWHC 99 (Fam) and Clayton v Clayton [2016] 1 NZLR 551. I was taken to all of these cases in argument or, in the case of Painter, although not taken to it during the trial I reviewed it afterwards. Re: Nurkowski[2005] BPIR 842 was also mentioned but no one took me to that.

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149. In opening there seemed to be a disagreement of principle about who had to be a party to the sham in a case like this one in which the settlor transfers an asset to a separate trustee, on the face of it to be held on the trusts in a deed. The claimants seemed to be arguing that only the settlor's intention mattered for a finding of sham but it soon became clear that that was not really the submission and in fact there was nothing between the parties on the principles. The debate was based on the decision of David Young QC in Midland Bank v Wyatt [1997] 1 BCLC 242. In that case the judge considered a declaration of trust which was executed by a husband and wife, declaring that the property was held on trust by the husband for the wife and his daughters, was a sham. The judge found that the wife gave no thought to the content of the document or its effect so she did not share any shamming intention with her husband."

The basis of this decision is important as, even if unappealed by the Settlor's children acting through their mother as *amicus curiae*, the notion of a Sham Trust is likely to be employed, if not abused, by tax administration's seeking to fiscally repatriate assets or income flows into their jurisdictions. It is at that point that the British legal definition of what is and more importantly what is not a "sham" and shamming can be produced in aid.

I am approaching the issue therefore from the judicial viewpoint, as to me it is clear that any trust as a proprietary mechanism can only be overturned as a sham by a judicial decision, and not by an administrative reinterpretation outside a Court's jurisdiction.

However that issue, is one that is likely to come under question in the coming years.

I can do no better than to cite Erskine Chamber's summary of the case and of the judgment published at http://www.erskinechambers.com/jsc-mezhdunarodniy-promyshlenniy-bank-v-pugachev-ors-2017-ewhc-2426-ch/. However this gloss is intended to draw a line between the legal issues and the undoubted alliterated frenzy that it will provoke amongst foreign Tax administrations, and others.

There were five trusts in issue which had been constituted under the laws of New Zealand, which had been drafted by a New Zealand lawyer, who also gave evidence.

Birss J's judgment shows the judicial processing of the arguments raised by the Claimants seeking to recover money diverted from a bank later put into liquidation.

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It is not a tax case. That is the important point. The definition of a sham is a legal one, not a fiscal one. The *Pugachev* case involved a Bank's creditors attempting to recover assets, not an administration attempting to challenge a proprietary disposition, to which is was not a party, and requalify it as something else.

Birss J;'s judicial analysis went firstly to the Trust deeds, and the powers of the protector, who was also the settlor, whom the Claimant alleged had not in effect divested himself of the beneficial interest over the assets in the trusts. The settlor in this case was also a discretionary beneficiary of the trust, and could therefore exercise the Protector's powers in his own favour.

That argument is the basis of the tinctured flavouring of the OECD Common Reporting Standard. Why? The OECD not only requires the identification of Protectors, but also that of the Settlor, whilst they are alive. There is therefore an assumption, leading to a presumption, undergirding the CRS that any settlor is capable of retention of dominion over the trust assets even though he or she may in fact have no proprietary or real legal control over the assets or in law over the trustees. The case of *Pugachev* therefore provides a reference point at which the OECD Information Exchange under the Common Reporting Standard may, theoretically, be countered. The sham argument is in principle less likely to prosper where the Settlor has no discretionary hope of benefit under the trust, even where he is a protector of it. That presupposes that the trustees in fact respect their rôle as owners and do not allow any benefit to pass to the settlor. The recent Jersey case of *Crociani* is abut one example where the trustees did not so do, without the trust thereby becoming a sham.

That is the first point at which the future administrative use of the concept of a sham is unlikely to pass muster in front of a Court following judicial principles, as opposed to a tax tribunal pandering to an administration's fancies with no irrebuttable presumptions of fiscal or proprietary entitlement upon which to rely.

The other point which the Court addressed was the effect of the deeds. Birss J found that the drafting of the deeds and the allocation of powers placed the settlor / protector in the position of the beneficiary of a bare nominee trust. This is the referred to by the Claimants as the "Illusory Trust argument". To be able to get to the point where they could assert that there was full beneficial reappropriation of the assets by Mr Pugachev, they had to show that he had settled the entire trust

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fund, and that there were no assets settled independently by a third party, in this case, a certain Victor acting on their own account and not as a nominee for Mr Pugachev

When analysed, the case and the judgment do not really advance a fiscal sham argument at all.

Why? Because the fundamental common law definition of a sham so ably defined by Lord Diplock is the basis of a common law proprietary or contractual remedy, and what is more does not invalidate the deed as its stands for third parties relying on it. They can invalidate it by proving it to be a sham, but otherwise the deed stands against the shammers, but not against those parties to it who were not shamming.

Put succinctly, a tax administration alleging a sham has to show that all the parties involved, including beneficiaries are parties to the sham, and shammers by intent.

That is frankly impossible where a beneficiary has already taken benefit and the trust has been treated and functioned as operative and operational.

I reiterate in conclusion the felicitous phrase of the judge: " ***Despite the frequent references to a "sham trust", there is not really any such thing."***

Peter Harris
Barrister in overseas practice
LLB. (Hons.) Dip. ICEI (Amsterdam)
Revenue Bar Association, Mediator
E: peter.harris@overseaschambers.com