

Offshore trusts: What you need to know and the likely pitfalls

JMiles & Co held a webinar on 18 March 2022, which was hosted by John Miles - Managing Director, Nikhil Desai - Director, Laura Lusiji - Senior Associate and Elizabeth Kageni - Associate. The webinar captured the firm's vast experience in advising clients who have established trusts in various offshore jurisdictions such as the British Virgin Islands, Guernsey, Cayman Islands, Jersey and Gibraltar. The discussion surrounded common disputes that arise in offshore trust family disputes, and our advice on mitigation of the said disputes based off our experience. A summary of the discussion is outlined below.

Types of Trusts

Discretionary trusts

This is the most common trust that settlors opt for. The key characteristic here is the trust assets are not legally or beneficially held by the Settlor or the Beneficiary but rather the Trustee. Under the terms of a discretionary trust the Trustee is given wide discretionary powers as to when, how much and to which Beneficiaries he should distribute the income and capital of the trust. Such a form of trust is useful where at the time of creation of the trust the future needs of Beneficiaries cannot be accurately determined.

The Beneficiaries are not regarded as having any direct legal rights over any particular portion of the trust fund but only a right to be considered to benefit when the Trustee exercises his discretion. The arrangement is governed by a Trust Deed which will assign powers to a Trustee, Settlor and Protector and list the Beneficiaries. The Trustee is usually given wide powers to manage the assets of the trust and in its sole discretion, to distribute income and capital assets at the disposition of the Trust assets, to Beneficiaries.

The Settlor can name Beneficiaries of the Trust and can give a letter of wishes to indicate to the Trustees how the Settlor would have dealt with those assets if they had retained ownership. The wishes of the Settlor will not be binding on the Trustees but, in practice, Trustees would be reluctant to deviate unless a change in circumstance or other matters would make it clearly disadvantageous to the Beneficiaries to act in such a way.

A key individual in a discretionary trust is a Protector. A 'Protector' may be appointed to exercise some degree of control over the trust property and veto decision of the actions of trustees and potentially change trustees. In our view, it is unwise for a Protector to be given anything other than powers to veto decisions or actions of the trustees. A Protector that is empowered to direct the trustees actively might be deemed as a 'quasi-trustee' and this could have harmful consequences for the trust.

Of significance in discretionary trusts is the level of control given to the Trustees and the fact that in principle, the Settlor actually gives away legal and beneficial ownership of the trust assets to the Trustee. Plainly, any Settlor would want to have some say or influence over at least issues such as change in beneficiaries. It is important to ensure that your trust deed retains all the powers that a Settlor or Protector can retain under law. In the BVI, the new Trustee Act allows a Settlor or Protector to retain the following powers, without being considered a Trustee:

- to revoke the trust;

- to vary or amend the terms of the trust;
- to advance, appoint, pay, apply or otherwise distribute trust property (or to direct the trustee to take such actions);
- to act as director of a company owned by the trust, or to direct the trustee to appoint or remove a director of such company, or to direct the trustee on the manner in which it exercises voting rights attaching to shares owned by the trust;
- to direct the trustee to purchase, retain, hold, sell, etc. trust property (i.e. a power of investment);
- to appoint or remove the trustee, protector, enforcer, etc.;
- to add, remove or exclude beneficiaries;
- to change the trust's governing law and the courts that have jurisdiction over the trust; and
- to restrict the exercise of any power or discretion unless the consent of, for example, the settlor or protector, is first obtained (i.e. veto powers).

These powers will only apply if expressly permitted in the Trust Deed.

Bare Trusts

These are simple trust structures where the Trustee holds the property for the Beneficiaries as nominee. The Trustee has no power to deal with the asset or make any decisions regarding the asset. The Trustee only has the power to hold the asset for the beneficiary and must follow all instructions given by the beneficiary. This is important as the Trustee cannot withhold assets from the beneficiary. Likely disputes concerning a bare trust would be between Beneficiaries where the Trustee simply follows instructions of one Beneficiary over another.

Fixed interest in possession trusts

In this type of trust, the principal Beneficiary will normally be granted a vested interest in the income of the trust fund throughout his lifetime and the discretion of the Trustee regarding the disposition of the trust fund will be limited.

Common disputes arising from offshore discretionary trusts

Disputes arising from distribution of trust assets

In cases we have handled, we have seen some listed Beneficiaries commencing claims against the Trustees, Settlers and other Beneficiaries in connection with the manner in which trust assets have been distributed. In order to avoid such claims, we recommend that Settlers: (i) reserve their power to amend their list of Beneficiaries in the trust deed, as in certain instances, amendments as to the list of Beneficiaries proposed by Settlers are not taken into account by the Trustees, and this may result in court action brought by an individual who considered himself to be a Beneficiary, and did not receive an entitlement upon distribution; (ii) follow up with trustees after issuing letters of wishes to exclude a Beneficiary, to know if their wishes have been accepted, bearing in mind that for discretionary trusts, Trustees are not bound by a Settlor's letter of wishes; (iii) communicate clearly to the Trustees the reasons why the Settlor wishes to take out an individual from the list of beneficiaries. An example of this would be if the Beneficiary received equitable compensation outside of the trust assets in exchange of such an exclusion.

Third party claim

In certain instances, a third party may commence proceedings against a Trustee / Settlor / Ultimate Beneficial Owner. We have been involved in proceedings where a third-party creditor commenced proceedings against the directors of a company held by a trust, for breach of director duties (usually, directors of a company under a trust would be employees of the trustee of the trust) that resulted in mismanagement of the company. In these types of cases, the employees of the Trustees will seek to join the Settlor and Beneficiaries in order to: (1) indemnify themselves against any liability found against the employees of the trust; or (2) advance an argument that the directors acted under the influence of the ultimate beneficial owner. In matters involving companies under trusts, we recommend that the Settlor or the Ultimate Beneficial Owner sit in as a director, so as to be directly involved in the affairs of the company or alternatively, recommend the engagement of professional team with experience relevant to the business of the company so as to ensure that there is proper management of affairs of the company held by the trust.

Death of the Settlor

What should be borne in mind is that upon the death of a settlor, his estate does not comprise trust assets. The trust assets are a separate matter that should not be brought into probate proceedings.

Poor record keeping and mismanagement by Trustees

We have been involved in cases where the Trustee had no record of key trust documents such as a trust deed setting out the basis of the trusteeship. We were also involved in case where the Trustees did not ensure the trust deed was signed by the Settlor. The Trustees also wrongfully listed the Settlor as both a Beneficiary and as an Excluded person in the deed. In this case, the court held that the Trustee was negligent in managing the trust and record keeping. In order to avoid such negligence, we encourage Settlers/Beneficiaries to seek legal advice in reviewing their trust documents. We also advise them to continuously request information relating to their trust documents and assets, as documents record rights and obligations of different parties.

Disputes surrounding a settlor's letters of wishes

We have been involved in proceedings where a Settlor communicated his intentions to amend the list of Beneficiaries through letters of wishes to the Trustees. The Trustees failed to communicate that they had not taken his letters of wishes into consideration and this raised issues during proceedings. It should be noted that this was unusual case as Trustees often will consider letter of wishes from a Settlor, however are not bound by the same. In the circumstances, we recommend that Settlers follow up with Trustees after issuing letters of wishes to ascertain if their wishes have been actioned on, and if not, the reasons for the deviation. We have also been involved in a case where the Trustees acted on all letters of wishes from a Settlor as instructions without questioning whether the actions adversely affected the Beneficiaries. We therefore recommend that when issuing letters of wishes to Trustees, it is structured as a recommendation as opposed to instructions as this could be construed negatively. We also recommend that the letter of wishes provide reasons justifying the wishes requested by the Settlor.

Fees charged by Trustees; Trustees' right to indemnification

Once you set up a trust, you will incur annual administration fees. We recommend that you monitor the fees, and raise queries that may arise as much as possible. Where necessary ask for timesheets to monitor the breakdown of time spent.

Separately and away from administration costs, Settlers and Beneficiaries are often liable to pay legal fees to lawyers representing Trustees in proceedings commenced against them. This obligation is based off a standard clause that appears on most trust deeds, that requires Settlers to agree to indemnify the Trustees, its employers, its duly appointed shareholders, directors and other officers against all actions. In our experience these fees can be very exorbitant. We have seen Trustees charging upwards of USD 500,000 annually in legal fees payable by the Settlor and Beneficiaries. Without directing it to any particular trust company, these high legal fees can be attributed to the fact that some trust companies receive kickback from the law firms. We recommend that Beneficiaries/Settlers request for detailed time sheets and ask their Trustees to hold their lawyers accountable for any bill undertaken.

Termination of trusts

A trust may be terminated upon the death of a Settlor, in the event of dissipation of assets, or where a company is wound up. We recommend that upon distribution of assets after termination that Settlers ensure that Beneficiaries have signed letters of indemnity and disclaimers to avoid potential dispute.

We also recommend that whenever a major event occurs (such as exclusion of a Beneficiary, the transfer of assets or distribution to Beneficiaries etc.) the Trustee requests the court to grant a Beddoe order for extra protection against future dispute.

Conclusion

In conclusion, we recommend three harmonies for a successful trust: (i) engaging local lawyers in Kenya and the country where the Trust is located, (ii) maintaining a good relationship with Trustees and (iii) ensuring good communication among all the parties involved with the trust.

Recent work carried out by JMiles & Co. on offshore trusts

JMiles & Co. has represented numerous client in East Africa concerning offshore trusts in the usual offshore trust jurisdictions of British Virgin Islands, Guernsey, Cayman Islands, Jersey and Gibraltar. The firm has excellent relationships with law firms in key offshore jurisdictions and has successfully represented clients in setting-up and managing offshore trusts, in addition to representing clients and managing complex offshore trust litigation and arbitrations. JMiles & Co. has offices in Nairobi and London and this always the firm to provide clients with the cross-border support that is required when dealing with offshore trust.

Some of JMiles & Co.' s offshore trust work includes:

1. Acting for a client in a matter relating to a family dispute concerning an offshore trust in Gibraltar. The Claimant was seeking various declaratory orders, which included an order that he was a beneficiary of a trust. and the Claimant was also seeking an account and inquiry of the assets of the Trust since its formation, The Court found in favour of the Claimant and ordered an account of all assets and transactions conducted in the name of the Trust.
2. Acting for a client in an ongoing family dispute where the Claimant is seeking orders that he is a beneficiary of an offshore Trust. The Claimant does not rely on a written instrument (Deed of Settlement or Trust Deed) evidencing his claim that a trust was constituted in his favour. Instead, he relies on alleged representations from his family over the years and alleged common intention and understanding within the family to hold the offshore wealth in trust. It is noteworthy that even in the

absence of a trust document, the court can still declare a constructive trust which is basically an implied trust based on the evidence submitted. The court may decide that, even though there was never a formal declaration of a trust, there was an intention on the part of the property owner that the property is used for a particular purpose or go to a particular person.

3. Involvement in proceedings commenced by an aggrieved party that considered that he is entitled to a share of assets attached to an offshore discretionary trust in Jersey, that have since been distributed. The proceedings were occasioned by the failure of the Trustees to uphold the intentions of the Settlor, as set out in various Letters of Wishes, and further failure to notify the Settlor of their intention not to uphold the said intentions. The Court is therefore required to determine: (i) whether the aggrieved party was in fact a beneficiary of the trust; and (ii) the extent of the aggrieved party's entitlement if (i) is in the affirmative.
4. Representing the interests of an Ultimate Beneficial Owner in a matter where a Third-Party Creditor has commenced proceedings against the directors of a company held by a trust, for breach of directors' duties. As mentioned above, for companies held by trusts, the directors would normally consist of the employees of the trust.

For further enquiries, please feel free to contact our Director, Nikhil Desai, on: ngd@jmilesarbitration.com or +254 708242 260