TRUST & ESTATE CONTROVERSY VIRTUAL FORUM

OFFSHORE ROUNDUP

McDermott Will & Emery

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OVERVIEW

- Reporting obligations for EU intermediaries under EU Directive 2018/822 (DAC6)
- The DSB Bank decision and Anti-Bartlett clauses: Can trustees really turn a blind eye to investments in the modern world?
- Trust insolvency priority of rights
- Removal of trustees and protectors: A recent case study

DAC6

WHAT IS DAC6 & HOW DOES IT WORK?

- DAC6 = EU Directive aimed at deterring potentially aggressive cross-border tax planning arrangements by requiring disclosure of certain types of cross-border transactions to relevant tax authority.
- EU member States required to implement by 31 December 2019 and bring into force by 1 July 2020 (including UK, despite Brexit).
- Intermediaries (or if none, relevant taxpayers) to disclose “reportable cross-border arrangements” (RCBA) to tax authority of home Member State within 30 days of RCBA being made available for implementation.
- Tax authority then exchanges RCBA information with other EU tax authorities.
- RCBAs implemented between 25 June 2018 and 1 July 2020 need to be reported by 31 August 2020 in some member states; others (including UK) have extended the deadline by 6 months due to COVID-19.
- HMRC technical guidance; Law Society guidance.

WHO MUST REPORT & WHAT MUST BE REPORTED?

- “Intermediaries” = promoters, service providers (but not where RCBA information protected by legal professional privilege).
- “Relevant taxpayer” = any person to whom RCBA made available for implementation.
- RCBA:
  - Arrangement or series of arrangements involving at least one EU Member State in which one or more of the participants conducts activities in more than one jurisdiction (whether by virtue of residence, a PE or otherwise) and which contains at least one of the prescribed risk indicators of tax avoidance, known as “hallmarks”.
- Arrangements bearing certain hallmarks must also have main benefit of obtaining an tax advantage (the “main benefit” test) in order for the arrangement to be disclosable.
- Arrangements bearing certain other types of hallmarks need NOT have a main benefit of obtaining a tax advantage in order for the arrangement to be disclosable.

KEY RELEVANT “HALLMARKS”

Category	Description	Does “main benefit” test apply?
B2	Converting high-tax income to low or no-tax income, or converting income to capital	Yes
B3	Circular transactions involving the round-tripping of funds	Yes
C(1)(b)(i)	Deductible cross-border payments between associated enterprises where recipient taxed at 0% or “almost zero”	Yes
C(1)(b)(ii)	Deductible cross-border payments between associated enterprises where recipient is in an EU “blacklisted” tax haven	No
C(1)(c)	Deductible cross-border payments between associated enterprises where recipient fully tax-exempt	Yes
C(1)(d)	Deductible cross-border payments between associated enterprises where recipient benefits from a preferential regime	Yes
D1	Circumventing/ undermining effect of CRS	No
D2	Concealing ID of UBOs through opaque ownership structures with little economic substance	No

KEY RELEVANT “HALLMARKS”

Category	Description	Does the “main benefit” test apply?
C4	Transfer of assets where there is a material difference in the amount of consideration for tax purposes in the jurisdictions involved	No
E1	Transfer pricing: unilateral safe harbour	No
E2	Transfer pricing: transfers of HTV intangibles	No
E3	Transfer pricing: transfer of functions/ risks/ assets where 3-year projected EBIT post-transfer is more than 50% lower than it would have been had the transfer not occurred	No

HAVE YOU IMPLEMENTED PROCEDURES, TOOLS AND/OR SOFTWARE FOR DAC6 ASSESSMENT & REPORTING?

A. **Yes**
B. **No**
C. **In the process of doing so**

HOW MUCH PROGRESS HAVE YOU MADE IN YOUR DUE DILIGENCE EFFORTS TO IDENTIFY REPORTABLE CROSS-BORDER ARRANGEMENTS IMPLEMENTED BETWEEN 25 JUNE 2018 & 1 JULY 2020?

A. **Significant**
B. **Moderate**
C. **Some**
D. **None**

UK SANCTIONS FOR NON-COMPLIANCE

- Failure to file a return of reportable information: £5,000 per RCBA return.
- HMRC may apply to FTT for daily accrued penalty determination (£600/day), capped at £1m.
- HMRC may impose further penalties of up to £600/day for continued failure, even if it exceeds £1m cap.
- Mitigation:
  - Reasonable excuse.
  - “Special circumstances.”
  - (Maybe) “reasonable prevention procedures” under Part 3 Criminal Finances Act 2017.

PART 3 CRIMINAL FINANCES ACT 2017

- **Use CCO reasonable prevention procedures under Part 3 CFA 2017 to help mitigate DAC6 penalties.**
- Possible that HMRC could use the CCO review/investigation process to monitor DAC6 non-compliance.
- HMRC: 10 live investigations, 22 businesses under review: 12/32 in financial services sector. Other sectors include oil, construction, labour provision and software development.
- Corporate criminal offences (CCO) of failure to prevent facilitation of UK or foreign tax evasion by “associated persons.”
- “Reasonable prevention procedures” defence: risk assessment and policies.
- Best practice:
  - Identify DAC6 RCBAs as part of CCO risk assessment.
  - Document procedures/processes for internal and external reporting of RCBAs.

HAVE YOU IDENTIFIED ANY REPORTABLE CROSS-BORDER ARRANGEMENTS THAT WERE ENTERED INTO DURING THAT PERIOD?

A. **Yes**
B. **No**

THE DBS BANK DECISION & ANTI-BARTLETT CLAUSES

BARTLETT

- One of the fundamental duties of the trustee is to invest the trust assets to a prudent investor standard.
- When the assets are held through a substantial interest in a private company, the trustee has an obligation **to monitor** the management of the business beyond merely reviewing regular financial disclosures and **to intervene**.
  - *Re Lucking's Will Trusts* [1968] 1 WLR 866.
  - *Bartlett v. Barclays Bank Trust Co. Ltd. (No.1 and No.2)* [1980] Ch D 139; [1980] 1 Ch 515.

ANTI-BARTLETT CLAUSES

- Even before Bartlett, practitioners drafted trust clauses purporting to limit the obligation on trustees **to interfere** in closely held companies, where desirable.
- Typically these clauses limit the obligation to interfere to instances where they are aware of dishonest or fraudulent (or grossly negligent behavior).
- However exoneration from the duty to interfere does not limit the duty to investigate: *Appleby Corporate Services (BVI) Limited v. Citco Trustees (BVI) Limited* [2014] 17 ITELR 413.

ANTI-BARTLETT ON STEROIDS: THE AMSUN TRUST

- Recent decision of the Hong Kong Court of Appeal addressed an anti-Bartlett clause with these provisions (amongst others) in *Zhang Hong Li and others v. DBS Bank (Hong Kong) Limited and others* [2019] HKCFA 45:

ANTI-BARTLETT ON STEROIDS: THE AMSUN TRUST

- Provisions Removing Duty to Interfere:
  - *The Trustees shall not be under any duty nor shall they be bound to interfere in the business of any company in which this Settlement is interested…*
  - *… the Trustees shall not be under any duty to supervise such directors officers or other persons so long as the Trustees do not have actual knowledge of any dishonesty relating to such business and affairs on the part of any of them…*
  - *The Trustees shall assume at all times that the administration management and conduct of the business and affairs of such company are being carried on competently honestly diligently and in the best interests of the Trustees … until they shall have actual knowledge to the contrary and … the Trustees shall not be under any duty at any time to take any steps at all to ascertain whether or not the assumptions contained in this sub-clause are correct.*

ANTI-BARTLETT ON STEROIDS: THE AMSUN TRUST

- Provisions Removing Duty to Monitor:
  - *The Trustees shall not be under any duty to obtain or seek to obtain in any way whatsoever any information regarding the administration management or conduct of the business or affairs of any company in which this Settlement is or may be interested ...*
  - *The Trustees shall assume that such information as is supplied to them … is accurate and truthful … and shall be under no duty at any time to ascertain whether or not the information is accurate or truthful.*

MORE THINGS IN HEAVEN & EARTH: NO DUTY TO MONITOR OR INTERVENE?

- **Bribery Act 2010**:
  - Created the criminal offence of failing to prevent corruption foreign and domestic by associates.
  - Bribery expanded to included facilitation payments.
  - Bribery expanded to cover non-governmental people and entities.
- Strict liability offence whose only defence is that you have appropriate procedures in place which reasonably prevent bribery.

MORE THINGS IN HEAVEN & EARTH: NO DUTY TO MONITOR OR INTERVENE?

- **Criminal Finances Act 2017**:
  - Created the criminal offence of failing to prevent the facilitation of tax evasion foreign and domestic by associates.
- No requirement that the foreign tax evasion is prosecuted.
  - Strict liability offence whose only defence is that you have appropriate procedures in place which reasonably prevent tax evasion.

MORE THINGS IN HEAVEN & EARTH: NO DUTY TO MONITOR OR INTERVENE?

- **Proceeds of Crime Act 2002**:
  - Any individual or corporate that deals in criminal property may be liable under the Proceeds of Crime Act 2002 (POCA) for one of the three primary money laundering offences: concealing, disguising, converting or transferring the proceeds of crime (section 327); assisting or abetting such conduct (section 328); or handling the proceeds of crime (section 329).

NO DUTY TO MONITOR?

Do you think that the Courts will uphold clauses that either prevent the trustee from monitoring or suggest they are under no duty to enquire into or monitor the companies in which they are a sole or controlling shareholder given these criminal law concerns?

DBS: THE RESULT

- The Court agreed that the trustee had no duty to monitor and was prevented from intervening in the affairs of Wise Lords, the underlying company which made the investments.
- Why?
- Bad facts? The investment decisions were being made by one of the settlors and the Court of Final Appeal did not seem convinced that the speculative investments in currency markets were in truth that poor.
- Bad law? The decision does not address the argument that these provisions were inconsistent with the trustee's obligations in these other spheres and so it is not clear the argument was advanced.

TRUST INSOLVENCY PRIORITY OF RIGHTS

TRUST INSOLVENCY: PRIORITY OF RIGHTS

- A trust has no independent legal identity.
  - Trust operates through its trustees.
  - Trustee personally liable for liabilities incurred as trustee.
  - Trustee's right of indemnity against the trust assets to pay liabilities.
- Jersey, Guernsey and BVI – Trustee's liability limited to value of the trust assets if it is known to be acting qua trustee.
- Creditors claims v. trust assets are subrogated to the trustee's right of indemnity.
- 'Insolvent' Trust: "*Trust whose assets held on trust are … insufficient to meet the claims to its assets.*"

THE Z TRUSTS – JERSEY

- Eight trusts (including Z II Trust) established subject to Jersey law.
- 2006 – Equity retired as trustee in favour of Volaw.
- 2012 – Underlying trust company of Z II trust, Angelmist, in liquidation.
  - Liquidators sue former directors of Angelmist and Equity and obtain summary judgment.
- 2015 – Equity seeks to claim £18m in damages and costs from Z II Trust under indemnity.
- Z II Trust's assets = £6m.
- Z II Trust's total liabilities = £211m.
- Z II Trust 'insolvent.'

Should a former trustee’s claims have priority over a successor trustee’s claims in a situation where a trust is ‘insolvent’?

Z TRUSTS – FIRST INSTANCE ROYAL COURT OF JERSEY (2018)

- Equity asserted that its claim took priority over:
  - Creditors because its claim has the better equity; and
  - The successor trustee because its equitable interest was created first.
- Royal Court held: Trustee's claims for personal liabilities under right of indemnity rank *pari passu* with:
  i. Creditors; and
  ii. Successor trustee's claims – no "scooping the pot."
- Rationale of fairness and good trust administration.
- Impact = Equity recovers £330k instead of £6m.

Z TRUSTS
JERSEY COURT OF APPEAL (2019)

- Equity's appeal allowed.
- Trustees have a right of indemnity against the trust assets for liabilities properly incurred in their capacity as trustee.
- Indemnity is secured by way of an equitable lien over the trust assets:
  - Lien arises from date of appointment of trustee.
  - Covers existing, future and contingent claims.
  - Lien possessed separately and individually by each trustee.
  - Lien operates as a first floating charge over the entire trust fund.
- Trustee's lien takes priority over the beneficiaries' interests.

PRIORITISATION – JERSEY COURT OF APPEAL SUCCESSOR TRUSTEES

- Successor trustees take trust property subject to the former trustee's equitable lien.
- Court applied English law principles concerning prioritisation of competing equitable securities:
  - Interests primarily rank in the order in which they are created – 'First in time' principle.
- Former trustee's interests take priority over successor trustee.

PRIORITISATION – JERSEY COURT OF APPEAL CREDITORS

- Obiter comments:
  - Creditors of the former trustee take priority to the successor trustee and its creditors.
  - Claims of the trustee take priority over the claims of creditors claiming via its indemnity.
- Potential impact on practice:
  - Creditors and successor trustees vulnerable.
  - Reluctance of creditors to novate liabilities to successor trustee.
- Appeal pending to Privy Council.

INSOLVENT TRUSTS: CURRENT STATUS OF PRIORITISATION OF CLAIMS

1. Former trustee
2. Creditors of former trustee
3. Successor trustee
4. Creditors of successor trustee
5. Beneficiaries

REMOVAL OF TRUSTEES & PROTECTORS

REMOVAL OF TRUSTEES AND PROTECTORS

- When relationships between trustees and beneficiaries break down, beneficiaries often wish to consider removing and replacing the trustee.
- If the trust instrument empowers someone - usually a protector, but sometimes the majority of the beneficiaries - to remove and replace the trustee, this may be the solution.
- But if no such power exists, or if the person empowered to remove the trustee does not wish to exercise the power, the beneficiary may have to apply to the court to order the removal and replacement of the trustee.

REMOVAL OF TRUSTEES AND PROTECTORS

- The leading case on trustee removal is the 19th century case of *Letterstedt v Broers*, in which the court found it has inherent jurisdiction to remove trustees:
  - "…if satisfied that the continuance of the trustee would prevent the trusts being properly executed, the trustee might be removed. It must always be borne in mind that trustees exist for the benefit of those to whom the creator of the trust has given the trust estate".
- However, rather confusingly, the court also stated that "friction or hostility between trustees and the immediate possessor of the trust estate is not of itself a reason for the removal of the trustees."

REMOVAL OF TRUSTEES AND PROTECTORS

- In the 2007 case of *Thomas and Agnes Carvell Foundation v Carvell*, which concerned the removal of personal representatives, the court held that “the overriding consideration is…whether the trusts are being properly executed” and that “the main guide must be ‘the welfare of the beneficiaries’”.

REMOVAL OF TRUSTEES AND PROTECTORS

- This ruling was applied three years later, in the 2010 cases of *Augus v Emmott*, where a dispute between estate executors was hampering the administration of the estate, and *Kershaw v Micklethwaite* and others, in which a beneficiary had applied for the removal of executors.
- In that case, the court held that friction or hostility between an executor and a beneficiary would not, in and of itself, suffice to remove an executor.
- On the other hand, “a breakdown in relations between an executor and a beneficiary will be a factor to be taken into account, in the exercise of the court’s discretion, if it is obstructing the administration of the estate, or even sometimes if it is capable of doing so”.

REMOVAL OF TRUSTEES AND PROTECTORS

- What is clear from all of these cases is that where the breakdown in relations between trustee and beneficiary is well founded and involves misconduct by the trustee, the court would (and should) be very vigilant of the welfare of the trust and its beneficiaries.
- Misconduct can range from deliberate breach of trust to failure to consider the beneficiaries' interests, taking a partisan approach or taking a *laissez faire* approach to the affairs of the trust.
- In the BVI case of *Gany Holdings v Khan*, in an unreported decision, the court had summarily suspended the powers of a protector in circumstances where a bitter beneficiary dispute had arisen.

REMOVAL OF TRUSTEES

- A similar decision was made by the English High Court in the recent case of *Schwartz v VGV (UK) Ltd,* in which the Court found that trust documents were forged after the Settlor's death and held the protector in contempt of court.
- But as always, prevention is the best cure, and careful thought to a removal and replacement mechanism at the drafting or structuring stage may avoid litigation when things go wrong.

THANK YOU