

Foundations, STAR Trusts and VISTA trusts: Flexible Tools or Crooks' Charters?

Hon Mr Justice David Hayton, Caribbean Court of Justice

Before considering whether they are flexible tools or crooks' charters, we need to know more about foundations, STAR trusts and VISTA trusts

Foundations

A foundation, like a company, is a legal entity capable of suing persons or of being sued and of owning property. Like a company, it is the full legal beneficial owner of its assets to be used for stipulated purposes but, unlike a company limited by shares, it has no shareholders that own it and can sell it so as to realise the underlying value of their investment. A private foundation normally carries out investment activities only but a few States' laws also allow a foundation to carry out trading activities. Foundations will be registered in a register, often a private register but even where there is a public register, a foundation's charter will set out a minimum of skeleton details (not including any details as to any beneficiaries) which are fleshed out in private and confidential regulations or by-laws.

A Board (or council) will manage the foundation with as many powers conferred on it and as many duties imposed on it in favour of the foundation as the regulations provide. The Board members will normally be exempted from liability to the foundation for their conduct unless amounting to wilful misconduct or dishonesty. Often, it will expressly be made clear that the board members owe no duties of a fiduciary nature to the beneficiaries capable of being benefited by the Board. Under standard trust law a trust for beneficiaries cannot exist unless beneficiaries have rights against the trustee but there can be a valid foundation without there having to be beneficiaries with rights against the foundation or its director, though in such a case it is often open to the founder to appoint a guardian or supervisor or protector to look after the interests of beneficiaries.

The beneficiaries have no interest in the foundation's assets fully owned by the foundation and may be in a very weak position whether due to difficulties in obtaining information as to the operation of the foundation or if a supervisor or guardian or protector appointed by the founder fails to look after their interests,

which could well occur if it is permitted for the founder or his nominee to be the supervisor, guardian or protector.

While some States' legislation on foundations, like the Antiguan Foundation Act, for example, looks after the interests of beneficiaries, other States, like the Seychelles¹, have legislation that enables beneficiaries to be kept in the dark.

By the Seychelles Foundation Act s 61(1), "*Subject to a contrary term in the charter or regulations, a beneficiary is entitled on request to inspect and obtain a copy of –*

- (a) the charter and any amendments thereto,
 - (b) the regulations and any amendment thereto,
 - (c) any audit report or other report on the financial position of, and any financial statements of, the Foundation,
 - (d) minutes of any meetings and written consent resolutions of council
- enables the founder to exclude the right of beneficiaries to see the charter, regulations, accounts and minutes of meetings."

By s 63 "A beneficiary under a Foundation is not owed-

- (a) by the Foundation;
- (b) by a person appointed under the charter, regulations or this Act; or
- (c) by a person appointed by such other written instrument

a duty that is analogous to a fiduciary duty."

Even if a beneficiary discovers enough to challenge any matters, the charter or regulations are permitted by s 64 to "provide that a beneficiary shall forfeit any benefit, right or interest thereunder in the event the beneficiary challenges-

- (a) the establishment of a Foundation;
- (b) the transfer of any assets to or by a Foundation;
- (c) the charter or regulations or such other written instrument; or
- (d) any decision of a founder, a councillor or a supervisory person" [the founder having an option to provide a supervisory protector if he wishes].

¹ See Panama Private Foundations Law 1995 art 20 and Liechtenstein Persons and Companies Act 1926 (as amended) Art 552 paras 10 and 11.

Generally, the founder may reserve extensive rights e.g. to revoke transfers to the foundation or to have the board liquidate the foundation, to appoint and remove Board members or councillors, to amend the charter or regulations, to direct investment activities, to direct distributions to beneficiaries, to add or exclude beneficiaries, to exclude rights of beneficiaries for the period during which he is the living sole beneficiary. The “legal” founder often is not the real or “economic” founder but someone ready to do his bidding under a contract of mandate.

It can thus be seen that, depending upon which State’s statutory foundation law is chosen, there is considerable scope for the economic founder to have his foundation secretly doing what he wants without interference from beneficiaries. Often the economic founder is the sole beneficiary interested in capital and income in his lifetime. In such cases he often had the benefit of a general power of attorney enabling him whenever he wanted to access the foundation’s bank accounts and other assets. This practice, however, has largely been discontinued, while some Foundation Acts prohibit this (e.g. Seychelles Act s 27 proviso) because it leaves the founder wide open to arguments of the Revenue or creditors or, after his death, his heirs alleging that the foundation was a nominee for him or that his apparent transfer of legal and beneficial ownership of property to the foundation was a sham, the property remaining his beneficially. The Board or council thus needs to have some independent function to avoid claims by the founder’s creditors in respect of foundation property located, say, in the UK or USA.

There is a significant impediment to the creation of foundations in some civil law States like Liechtenstein, which has about 30,000 foundations, in that if a founder purports to create a foundation with intent to evade tax or carry on another criminal activity this will be void as an abuse of legal form (*Rechtsmissbrauch* in Liechtenstein law)². In common law countries with foundations such criminal intention will lead to the Foundation’s assets being held on a resulting trust for the founder.

STAR Trusts- Cayman Special Trusts Alternative Regime Trusts

A trust, of course, is not a legal entity, so that it is not the trust but the trustees that are capable of suing or of being sued in respect of dealings with third parties.

² *Hamilton v Hamilton* [2016] EWHC 1132 (Ch)at [31].

To avoid this liability trustees instead may own limited company that deals with third parties. The trustees own the trust property, but it is not part of their own estate or patrimony, having to be held by them as a segregated fund for the benefit of the beneficiaries or for the furtherance of some lawfully permitted purposes. These purposes had to be charitable purposes except for some anomalous testamentary trusts concerning maintenance of graves and pet animals and saying masses in private for deceased Catholics.

The Belize Trusts Act 1992 introduced a general valid category of non-charitable purpose trusts enforceable by an appointed “protector” before the Cayman Islands trumped this with its Special Trusts (Alternative Regime) Law 1997 capable of covering trusts for non-charitable purposes as well as trusts for beneficiaries and only enforceable by an “enforcer”.³ These STAR trusts must be declared to be STAR trusts, now trusts subject to Part VIII of the Trusts Law (2011) Revision.

STAR trusts require there to be an enforcer appointed by or pursuant to the terms of a trust or by order of the court. The STAR legislation further provides that only appointed enforcers can enforce trusts, whether the trusts are for non-charitable purposes or for beneficiaries or for both, so that beneficiaries have no rights unless appointed to be an enforcer. A beneficiary does not, as such, have standing to enforce the trust, or an enforceable right against a trustee or an enforcer or an enforceable right to the trust property. It is the enforcer alone who, though having no proprietary interest under the trust, has the same rights as a beneficiary under an ordinary trust e.g. to be informed of the terms of the trust, to receive information concerning the trust and its administration from the trustee, to inspect and take copies of documents, to make administrative applications to the court and to exercise personal and proprietary remedies against the trustees and third parties. Thus, if the trustee and the enforcer bona fide settle a breach of trust claim by a dispute resolution process this will bind the beneficiaries.

Subject to evidence of a contrary intention, an enforcer is deemed to have a fiduciary duty to act responsibly with a view to the proper execution of the trust, but it is possible for an enforcer to be a voluntary enforcer with a right, but no

³ Further see A Duckworth, ‘STAR trusts’, (2013) 19 Trusts & Trustees 215

duty, to enforce the trust, as can be the case if a beneficiary is appointed to be an enforcer.

In practice, when a STAR trust holds or will be holding assets situate outside Cayman for the benefit of individuals, at least one beneficiary should be an enforcer. The reasoning underlying this precaution is that it can be alleged that if no beneficiary is an enforcer, then the position of a beneficiary is that of an object of a non-fiduciary personal power vested in the trustee, such object merely having an unenforceable hope that he may receive a benefit from the trustee. Furthermore, he does not even have the *Schmidt v Rosewood Trust* right to invoke the supervisory jurisdiction of the court. It follows that the settlor has not disposed of his beneficial interest in the transferred trust property which is held on a resulting trust for him and under which the trustee is authorised to benefit objects of the personal power until such authorisation is withdrawn by the settlor. The apparent express trust is characterised as a resulting trust recognised under the Recognition of Trusts Act 1987 that implemented the Hague Trusts Convention. Any trust property outside Cayman is thus available to claims of the Revenue, divorcing spouses, heirs and creditors generally.

An alternative analysis that ousts any resulting trust alleges that the trustee can have legal and beneficial ownership of the trust property in the same way as the executor of a deceased person owns the deceased's property that he is administering. Such an analogy, however, is imperfect since the settlor is alive and so can retain the beneficial interest. Furthermore, the executor owes equitable fiduciary duties to the deceased's will beneficiaries to ensure they receive the property to which they are entitled, but the STAR trustee owes no duties to any beneficiaries, no beneficiaries having any locus standi to apply to the court to receive any consideration from the trustee.

Where, however, the STAR trust is not for individuals but for non-charitable purposes or mixed charitable and non-charitable purposes, there ought not to be any problem in recognising this as a valid trust under the private international law rules of jurisdictions outside the Cayman Islands. Lack of positive enforceability of English non-charitable purpose trusts prevents them from being regarded as creating a valid trust obligation but the statutory enforceability of such a foreign trust by an appointed enforcer overcomes this problem to enable recognition of

such trusts as valid under English private international law, taking account of the Recognition of Trusts Act 1987.

To help ensure the integrity of a STAR trust there has to be a licensed Cayman trust corporation or a registered private trust company acting as trustee (or one of the trustees), though a registered private trust company must have its registered office with a fully licensed corporation which has the responsibility to undertake due diligence for anti-money-laundering purpose. The trustees are under a duty to have a documentary record of the trust's terms, the identity of the settlor and the enforcer, the trust property at the end of each accounting year and all applications or distributions of property.

The settlor can himself be the enforcer and can be involved in the running of the private trust company, leading to the settlor recovering the property for himself. However, if the enforcer or a trustee takes the trust property as the enforcer's or the trustee's own patrimony (other than lawfully as a beneficiary under the trust) the criminal offence of theft is committed.

VISTA trusts - Virgin Islands Special Trust Act trusts

The Special Trusts Act 2003, as amended by the Special Trusts (Amendment) Act 2013, is designed to establish trusts of BVI company shares which may be retained indefinitely and are such that the management of the companies may be carried out by the directors free from interventions of the trustees⁴. The Act thus circumvents problems caused by the duty of trustees with a controlling interest in a company to monitor the conduct of the directors of the company and, where necessary, to intervene in the affairs of the company e.g. to prevent the company entering into an unduly speculative venture as in *Bartlett v Barclays Bank Trust Co Ltd [1980] Ch 515*.

It is especially useful where the controlled company is a trading company but also helps for investment companies and where the settlor wants himself or his nominee to be left to run the controlled company as much better qualified than the trustees to do this. Indeed, indemnity insurance for trustees with controlling

⁴ Further see D J Hayton (ed) *The International Trust* 3rd ed, 2011, Jordans Chap 13 'VISTA trusts' by C McKenzie and J Russen QC, H Mander & W Burnell 'The BVI VISTA legislation: refining the law to promote flexibility' [2015] JTCP 251.

shareholdings could be prohibitively expensive or even unobtainable in some circumstances unless advantage is taken of VISTA trusts.

One might wonder why some anti- *Bartlett* exemption clause in the trust instrument should not be able to minimise the liability of trustees and cheapen any insurance cover. A clause could provide that a trustee is to be under no duty to inquire into or to interfere in the affairs of the company unless having actual knowledge of dishonest conduct of one or more directors of the company. Nevertheless, he still has power to obtain information and interfere in the company's affairs which he might be under a duty to exercise because of his duty to exercise his powers to safeguard and further the interests of the beneficiaries⁵ as part of his overriding duty to perform the trust honestly and in good faith for the benefit of the beneficiaries⁶. Thus if a trustee stood by, doing nothing, when there was a significant drop in trust capital or income crying out for an explanation it is likely that he would be liable for breach of trust.

This might also be the case even if the clause went further and purported to provide that a trustee should positively be subject to a duty not to inquire into or interfere in the affairs of the company unless having actual knowledge of dishonest conduct by one or more directors, especially when actual knowledge extends to "blind-eye" knowledge. Where there are features which, if left unexplained to a trustee, are indicative of wrongdoing then, unless a reasonable explanation is sought and obtained, the trustee will be treated as having knowledge of the wrongdoing.⁷ Such a restrictive clause also has the danger that it could lead to a trustee committing an offence under anti-money-laundering legislation.

To deal with this and other issues, VISTA enables a shareholder to establish a trust of BVI company shares so as partially or wholly disengage the trustees from their normal responsibilities and to allow the shares e.g. in a family company, to be retained as long as the directors wish. Originally, there could only be a sole trustee that had to be a BVI licensed trustee company but now there can be more than one trustee so long as there is at least one "designated trustee" in office at all times. "Designated trustee" now extends beyond licensed BVI trustee

⁵ *Cowan v Scargill* [1958] Ch 270

⁶ *Armitage v Nurse* [1998] Ch 241,253

⁷ *Crédit Agricole Corporation and Investment Bank Ltd v Papadimitriou* [2015] UKPC 13 at [33].

companies to BVI private trust companies, a move similar to that made for STAR trusts.

VISTA only applies where there is a direction to that effect in the trust instrument and where BVI shares are the subject matter of the trust, but a BVI company may have foreign companies as subsidiaries. Shares held by a non-VISTA BVI trust can now be added to a VISTA trust and powers can be exercised in any BVI trust with a designated trustee to create a VISTA trust. Scope is afforded for VISTA trusts to switch out of the regime and come back in again if so provided by “trigger directions” in the trust instrument.

Subject to the terms of a trust, unless a trustee is implementing the “office of director rules” (ODRs) or acting on an “intervention call”, it shall not use its powers to interfere in the management or conduct of any business of the company and shall leave the conduct of every such business and all decisions as to the payment or non-payment of dividends to the directors of the company. Moreover, except in the two mentioned cases, the trustee must not take any steps, inter alia, to instigate or support any action by the company against any of its directors for breach of duty to the company or procure the appointment or removal of any of the directors.

The ODRs in the trust instrument determine the manner in which the trustee is to exercise its powers in respect of appointment, removal and remuneration of directors. Originally, the trustee could exercise its own judgment if concluding in good faith that to follow the ODRs would be “plainly inconsistent with the wishes of the settlor.” Now a trustee must follow the ODRs unless it would be “impossible, unlawful or impracticable” to do so.

An intervention call to the trustee can be made in writing by a beneficiary or interested person if there are permitted grounds for complaint set out in the trust instrument, in which event the trustee must provide documents and information about the trust. A beneficiary, however, would often be in difficulties in ascertaining grounds for making a permitted complaint. The settlor can, however, provide for there to be an “appointed enquirer” to consider at least once every twelve months whether there might be grounds for such complaint, and the

trustees are obliged to provide the appointed enquirer with documents and information about the trust.⁸

Firewalls

Assets may be transferred to a foundation or trust by a founder or settlor with intent to avoid claims of creditors or a divorcing spouse or an heir, whether with a forced heirship claim or a claim under discretionary legislation like the English Inheritance (Provision for Family & Dependants) Act 1975.

In common law jurisdictions assets transferred by way of gift or at an undervalue to third parties for the purpose of avoiding creditors' claims will be set aside if the action is brought within six years. Bermuda and Cayman follow this approach, though having a narrower concept of "creditor" than English law.⁹ Some countries have a shorter period and require proof beyond reasonable doubt (as opposed to the balance of probabilities) of the intent to defraud. Civil law has a similar approach to common law countries but based on the Roman Law Pauline action.

As for heirs and spouses, in Part VII of the Cayman Trusts Law (2011 Revision) protection is provided against such claims by Cayman law applying and ousting foreign laws and not recognising or enforcing foreign judgments. This will not assist however if the underlying trust property is located in another jurisdiction. Bermuda has a similar approach in its Trusts (Special Provisions) Act 1989 based on the Cayman 1987 Act that is the origin of the provisions in the 2011 Revision. Virtually all offshore jurisdictions have legislation providing similar firewalls.

Flexible tools or crooks' charters?

Our examination of foundations, STAR trusts and VISTA trusts reveals that they can be very sophisticated vehicles for carrying out any private purposes so long as not illegal. Indeed, because of the confidential obligations of foundation directors or councillors or of trustees it can be difficult to ascertain what purpose the vehicle is being used for and, in particular, whether beneficiaries are complying with their taxation obligations. Hence the USA's Financial Accounting Tax

⁸ Virgin Islands Special Trusts (Amendment) Act 2013 s 8(8A)

⁹ Bermuda Conveyancing Act 1983 (as amended) s 36(C) (3) and Cayman Fraudulent Dispositions Law 1989 s 4(3).

Compliance Act and the OECD Common Reporting Standards that so many countries have signed up to.

It is possible for there to be internal monitoring of the operation of a foundation or trust by a guardian or supervisor or enforcer or beneficiary. However, the scope of the vehicles' structures is exceptionally broad in that there may or may not be many checks and balances on the conduct of foundation directors or councillors or of trustees, while the founder or settlor may or may not have very extensive powers.

The flexibility of all these vehicles makes them very attractive to good guys and bad guys. The vehicles are not intrinsically good or bad. As with companies or knives, it is the goodness or the badness of their users that makes their use good or bad.

Before World War II settlors set up their trusts which mainly created fixed beneficial interests for three generations and left the trustees to get on with running the trust. Thereafter, with increasing taxes as to income, capital gains and property passing on death, flexible discretionary trusts were created. With booming businesses being developed after the War there came to be a substantial number of settlors who were exceptionally wealthy, whether due to businesses owned by them or the proceeds of sale of such businesses.

For tax reasons and to avoid the need for public probate on the settlor's death if he had retained the property, it made sense to give property to trustees more than seven years before death and to create offshore trusts. Perhaps the settlor might emigrate to an offshore jurisdiction and reserve extensive powers in his trust instrument to himself or remain onshore but have a protector with extensive powers to consider and give effect to most of his wishes. Alternatively, he could hope to rely on the trustees considering and giving effect to most of his wishes, providing a letter of wishes to guide them before and after his death.

Offshore jurisdictions developed liberal trust laws to allow for longer perpetuity periods for trusts and expressly to recognise that the settlor or a protector could intervene much in trust affairs pursuant to express powers in that behalf. This could involve the administration of the trust property, the settlor or his nominee advising on the investment portfolio he had transferred to trustees or acting as director or shadow director of the companies he had transferred to trustees.

Separately or additionally the settlor or a protector could have power to make distributions of income or capital to discretionary beneficiaries or their consent could be necessary to any such distribution by the trustees.

As discussed, offshore legislation afforded plenty of scope to diminish the rights of beneficiaries. After all, there were too many instances of a family going from rags to riches to rags in three generations, so it could help to keep young beneficiaries in the dark so that they would find it hard to obtain good academic or professional qualifications and make a successful career for themselves or be ready to take a responsible position in a family business, rather than go off the rails on a life of pleasure. Moreover, the settlor and the trustees would often like the trust funds to be employed without the possibility of interference from beneficiaries, especially if the trust instrument envisaged going much beyond standard investments into speculative investments.

Indeed, the fewer rights beneficiaries have the less chance of them or their creditors seeking to attack the trust e.g. if beneficiaries tried to obtain disproportionately large forced heirship rights against trusts funds created by settlors from civil law jurisdictions. Take a settlor making a will leaving \$5million to each of his three children, having transferred assets worth \$65 million to trustees on discretionary trusts for his descendants and their spouses over a 250 years trust period. Why should he allow his three children to claim a three quarters share of his notional estate at death, comprising the \$15million actually in his estate at death and the \$65 million gifted to trustees a few years earlier? This would give them three quarters of \$80 million viz \$60 million, requiring the trustees to transfer \$45 million out of the trust and enabling each child to receive the huge amount of \$20 million and retire immediately to spend his way through the money selfishly and lavishly and die within ten years as a result of his excesses.

Secrecy may be very important as for Jews, like David Zwingerman, later changing his name to Hamilton, who was the settlor in *Hamilton v Hamilton*.¹⁰ He, as sole survivor of his family, had suffered greatly under Hitler's Holocaust but he had gone on to make a successful business life for himself. He wanted to be able to hide his funds offshore in case circumstances arose where the State would seek to

¹⁰ [2016] EWHC 1132 (Ch).

confiscate his assets for discriminatory reasons, though this may also happen to assist the State escape a financial crisis (as in Cyprus not so long ago when Cypriot's bank accounts were "scalped" to help the Government out). Secrecy may also be important for persons living in fairly lawless countries and wanting to look after their families where kidnapping is common or where the State can be sure of getting convictions on trumped up charges involving large fines and/or imprisonment.

At the heart of a trust there is, however, an irreducible core content: if beneficiaries have no rights there can be no trust obligation. Hence STAR trusts where the rights are vested in an enforcer. Moreover, trustees have core duties to monitor the management of companies owned by them. Hence VISTA trusts designed to enable the settlor or his nominee run companies owned by the trustees without interference from the trustees. For civil law "settlers" fearful of the strange trust concept they can transfer their assets to a foundation, which is a legal person unlike a trust, but where the internal documentation can resemble that of trusts so as to provide beneficiaries with some protection, but it is also possible in some extreme cases for them to be without protection.

Conclusion

Liberal developments in countries' trust and foundation laws arose to meet the flexible bona fide needs of settlors who were good guys but they also enabled bad guys who wanted to use such vehicles for nefarious purposes to make such use of them.

Thus the use of these vehicles is now being monitored. International pressures caused by fears of these vehicles being used to facilitate crime, including tax evasion and terrorism, have led to national legislation so that the use of such vehicles is being made as transparent as possible. Even if the public is kept in the dark, relevant government agencies can discover what is going on in the interests of both national security and the national revenue. This is to enable us all to work and sleep in a safe, well-maintained environment. Settlers and their families in States where corruption is rife, where kidnapping is common and where criminal trials are influenced by the Government will not sleep so soundly. You cannot, however, keep all the people happy all of the time: the greatest good of the greatest number prevails.

