Can you still trust in trusts?

Bircham Dyson Bell's Nicholas Holland summarises recent trends in trusts litigation

No-one wants their estate or their estate planning to devolve into litigation and family feuds. Everyone would like to minimise the tax exposure of their estate on death. Why do so many otherwise highly successful people fail on both fronts? The failure flows from a toxic combination of current trends and human nature.

First, there are no secrets anymore. Information is in hands which are potentially hostile to any number of trusts from the conventional government revenues, excluded beneficiaries, and disinherited heirs to some very modern new enemies.

WikiLeaks, Google, Facebook and other internet media have eased the search for and multiplied the amount of information about people. Financial institutions and professional advisers have become agents of state revenues through the erosion of national privacy laws, confidentiality and legal privilege.

Trustees cannot be sure that privilege attaches to legal advice (at least in with respect to dealings with the beneficiaries, enforcer or protector) nor can they be assured that they will be able to fully rely on the historical position that the trustees were not obliged to produce the details of their reasoning. US discovery is expanding, not contracting, and trustees visiting the US might find their holidays prolonged to accommodate a deposition in support of foreign proceedings.

Second, we live in turbulent times. The Arab Spring, the economic collapse of 2007 (Bear Stearns) and 2008 (Lehman Brothers) and following (Royal Bank of Scotland, Lloyds, the 'big three' car companies, AIG) followed by massive absorption of private debt by the public purse and now the threatened default of governments, from Greece to Spain, increased longevity and decreased investment performance, rapacious government revenues and weak-kneed bankers, distrust of fiduciaries, the retirement of the baby boomers and the poor performance of the busters or waiters make for, or are symptomatic of, an explosive cocktail of wealth, envy and disappointed expectation.

Third, it's a small world after all. Historically, a typical trust held local assets, was governed by local laws and held by a local trustee and multijurisdictional trusts were almost exclusively the purview of lawyers in federal jurisdictions like Canada and the US. No-one with money lives like that and no-one creates trusts like that anymore. A typical English law trust is now drafted by US lawyers to hold assets exclusively outside the UK. A typical trust to govern assets held in the UK holds shares in the British Virgin Islands and is governed by the laws of Jersey or Guernsey. All modern trusts work is now multijurisdictional.

These are not atomistic developments. In a typical example, an ageing disgruntled investor with flat investment returns (if they are lucky) wonders if she will have sufficient funds to pay for her retirement, nevermind pass on any funds to underperforming children.

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Fortunately, they are the beneficiary of a large trust fund to which they never thought they would need to turn. However, when she now turns to review the performance of the trust, she is horrified to see negative performance.

When she consults with a lawyer about the trust's investment performance, they suggest that she not only review whether there is a potential accounting action but that they review the administration of the trust more generally for other perhaps simpler claims that might replenish the trust fund. The lawyer is concerned to press on because some assets were transferred into the trust in 2006, the last year there was global economic optimism. Claims may be going stale in 2012 as limitation periods expire.

When the lawyers review the trust's administration, they uncover myriad errors and that the trust is not tax compliant in one or more onshore jurisdictions, in part because the tax laws have changed during the administration. The lawyers advise they are required to bring the errors to the attention of HM Revenue & Customs (HMRC) unless the trustees can and will remedy the situation. The trustees find they cannot remedy the difficulty without significant expense, further draining the trust fund, but advise there are a number of parties against whom they intend to commence proceedings. And so it begins…

Human nature is also to blame. The grim reality of death evades the imagination of even the most sophisticated and successful. Indeed, sometimes the successful are the least well suited to grasp their end. The very drive and thirst for control that makes individuals successful in the first place leaves them ill equipped to imagine a world without their controlling influence.

Settlors who have controlled the family and the family finances or business in life do not fundamentally change when they walk into a trustee's, wealth planner's or lawyer's office to discuss estate planning. They want their control to extend beyond the grave: they want this family member to be disinherited or excluded, they want their funds kept in a certain vehicle, they want certain vanity projects fulfilled and they want to control their legacy. In moderation, these can be laudable and productive aspirations so long as they are combined with proper planning which is well executed. In excess, they are disastrous.

Historically, trusts law provided various controls of its own to prevent more extreme solipsism: valuable assets could not be tied up in trusts indefinitely (the rule against perpetuities), the courts permitted the beneficiaries to agree to collapse the trust (the rule in *Saunders v Vautier*) and the legislatures created statutes requiring for the provision of certain classes of beneficiary (for example, the English Inheritance (Provision for Family and Dependants) Act 1975). All of these efforts to curb the will of the solipsistic settlor have more or less been undermined by contrary legislative efforts in various offshore jurisdictions with the side benefit of dramatically reducing tax liabilities.

L-R: Katten Muchin Rosenman's Joshua Rubenstein, Sullivan & Cromwell's Basil Zirinis; Bircham Dyson Bell's Nicholas Holland; and Ogier's Matthew Thompson at the *Legal Week* event

This was not going to go unnoticed indefinitely. The economic downturn and consequent unprecedented public assumption of massive private debt invited the economically disadvantaged into the tax affairs of the wealthy. Politicians facing or embracing rising and intense pressure to find and punish those who were not paying their "fair share" has resulted in an expansion of sovereignty for the Revenues of onshore jurisdictions. The Fair and Accurate Credit Transactions Act (FACTA) has expanded the US Government into virtually every financial institution, law and accounting firm on earth. HMRC is now appearing as a party to litigation in offshore jurisdictions. Most significantly, though, the erosion of legal privilege has turned lawyers in certain jurisdictions into virtual extensions of their government's Revenue for reporting purposes.

Perhaps the ultimate disincentive to trusts and estates litigation, the *in terrorem*, or no contest, clause appears to be in vogue again. Essentially, such clauses provide that if any beneficiary challenges the validity of the will or trust or its administration, they are automatically excluded or disinherited. Many, if not most, jurisdictions have protections minimising the effect of such clauses or rendering them void for public policy. However, cleverly drafted clauses or other devices may be able to accomplish a similar end.

As a final word of caution, in a world of changing expectations, automatic defaults in trusts and wills can prove perilous and result in catastrophic events. If you circumscribe the discretion of your trustees and executors, they may be forced to take steps that have unforeseen potentially disastrous consequences.

As current events continue to demonstrate, in the modern age one cannot even know the present, nevermind adequately predict the future. If your planning has too many bells and whistles, someone will hear them during a crash.

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Nicholas Holland is head of contentious trusts and estates at Bircham Dyson Bell. He spoke on this topic alongside Ogier's Matthew Thompson, Katten Muchin Rosenman's Joshua Rubenstein and Sullivan & Cromwell's Basil Zirinis at *Legal Week's* Trust and Estates Litigation Forum, held in Provence earlier this month.