

April 2020

Our quarterly update is designed to keep you up to speed with developments in the private wealth world. In this edition we explore sham trusts, heritage property and removing trustees. We also keep pace with the latest developments in the art sector. If you have any feedback on this update or would like to know more about the issues covered, or anything else, get in touch.

Sotheby's, settlement and a fake Franz Hals

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The big question

Is it all a sham?

It is common for property to be transferred into a trust for tax planning reasons and for the individual creating the trust (the settlor) to retain a degree of control over who benefits from their wealth. However, a trust may be an invalid “sham trust” if it is intended that the settlor will effectively retain complete control over the trust, despite the terms of the trust documents.

What is a sham trust?

A sham trust is created when trust documents are put in place which are intended to give third parties the impression that certain rights and obligations have arisen, when in fact the parties to those documents intend to create quite different rights and obligations. For example if trust documents purport to transfer the title and control of property to a trustee, and it is in fact intended that the settlor will manage the property, then the trust may be a sham. In that situation the trust documents are not intended to govern the relationship between the trustee and settlor.

A sham trust is void, which means that if property was transferred into the trust then ownership of that property will be considered to have remained with the original owner. This can lead to serious tax implications which the trust may have been designed to avoid.

Who needs to know?

Sometimes a trust is created by a settlor declaring that property is held on trust, in which case it is the settlor’s intentions as to how that property is to be managed which counts. More usually a trust is created by an agreement between the settlor and the trustee. In these circumstances, the trustee must also intend that the trust documents will not govern the parties’ relationship or be recklessly indifferent to the settlor’s intentions.

In other areas of law the court will look only at the documents themselves in order to decide what the parties intended by them. However, in deciding whether a trust is a sham a court will look at circumstantial evidence in order to work out what the parties did in fact intend.

Is it possible to fix a sham trust?

If the original trustee is replaced by a trustee who intends to follow the letter of the trust documents, then the trust will cease to be a sham. By contrast, if a trust is not a sham at the outset, and the settlor and trustee subsequently decide not to manage it in accordance with the trust documents, then it does not become a sham trust. Instead, the trustees have committed a breach of trust in failing to comply with the terms of the trust documents.

Divorce proceedings – the battleground

The courts have not shied away from finding that trusts are shams, particularly when the trustees or assets are offshore. Allegations that a trust is a sham often arise in divorce proceedings, with one spouse arguing that the other has transferred property into an offshore trust “in name only” so that those assets are not available as part of a settlement. However, a sham trust will not arise just because the settlor has an ulterior motive in creating the trust, such as an intention to deprive their spouse of assets in the event of divorce. If the settlor and trustees intended the arrangements to govern the relationship between them then they are not a sham, even if they are artificial or uncommercial.

In one case¹, a trust was found to be a sham when the settlor had written two separate letters explaining how he wished the trustees to exercise their discretion. The letters were signed on the same date but named different beneficiaries. The court decided these had been written so that one could be dishonestly selected depending on the circumstances. It was also clear that

1. *Minwalla v Minwalla* [2005] 1 FLR 771



Is it all a sham? contd...

the trustees had allowed the settlor to behave as if he still owned the trust property. By contrast, a trust created by a father for his children was not a sham just because he had falsely represented to a bank that he was the sole beneficial owner of the trust².

If it is too difficult to establish a sham trust, a spouse may be able to show that the property in the trust should nevertheless form part of the pool of assets which is divided in any settlement. For example, they could argue that the property was not validly held on trust because they already had an interest in it before it was transferred into the trust. Similarly, they could claim that their former spouse is entitled to a fixed interest in the trust or that it is likely that assets from the trust will be transferred to them in the foreseeable future, such that these assets should be considered in any settlement.

Lessons learned?

Fortunately it is possible to take steps to reduce the likelihood that it will be argued a sham trust has been created:

- appoint an independent, professional trustee
- ensure the trust deed contains basic rights for the beneficiaries, such as the right to a copy of the trust accounts and the right to complain

- trustees should record the reasons for their decisions, particularly if they are repeatedly complying with requests made by the settlor
- the settlor should act strictly within the scope of any powers which they have.

Trusts can be a powerful tool to distribute wealth across generations in a tax efficient way. However, settlors should consider carefully whether they really want to relinquish control over their property. If the terms of the trust documents are not complied with from the outset then the trust may be found to be a sham.

2. *ND v SD* [2017] EWHC 1507



What's hot?

Delay, delay, but it's all ok

Claims for reasonable financial provision from a deceased's estate should usually be made within six months of issue of a grant of probate.

As we explored in our last update, the Court of Appeal has indicated that this time limit exists in order to avoid unnecessary delays in the administration of estates but the court will consider late applications on a case by case basis.

In a recent decision³, the Court of Appeal has provided further guidance on when the court will be willing to extend the six month time limit. The wife of the deceased in that case was sixteen months late in bringing a claim and risked losing her home if the court did not give permission for her to make an application out of time.

The Court of Appeal extended the time for the widow to bring the claim and decided that the court has an “unfettered discretion” to give such extensions. Although this discretion should be exercised with regard to the proper administration of the estate, it is also relevant to consider prejudice which would be suffered if an extension was given (or withheld).

The decision recognises that in particular circumstances delay in bringing a claim for reasonable financial provision will not be fatal. However, it is usually preferable for parties to agree that the time for doing so can be extended.

3. *Begum v Ahmed* [2019] EWCA Civ 1794



What's hot?

A strange signature, an impersonation and an invalid will

The court⁴ recently considered a case in which strange circumstances led the deceased's nieces and nephews to challenge her will. There is a presumption that a will which appears to be validly executed on its face is valid. However, the court was satisfied that in this case the oddities surrounding the execution of the will were sufficient to overturn this presumption.

The deceased's signature prompted suspicion as her first and last name did not appear in a straight line, with the last name being at an angle to the first name. Inconsistent witness accounts, and the fact that the deceased was fastidious in using correct grammar and spoke with an "RP" accent also led the court to decide that she had been impersonated in conversations with her pension provider. The court was also troubled by the fact that the beneficiary under the will had used a multitude of different names during the relevant events.

All of this persuaded the court that the deceased's will had not been validly executed, and this conclusion was compounded by the absence of key witnesses giving evidence in the proceedings. If there are suspicious circumstances surrounding the execution of a will, it certainly pays to make sure everyone involved gives evidence.

4. *Re Joyce Relton (Deceased) (also known as Mason and others v Robinsons Solicitors and others)* [2019] EWHC 4055



RPC asks...

Trusts registration and MLD5- what's happening?

On 24 January 2020, HMRC and HM Treasury published a consultation on the proposed changes to HMRC's Trusts Registration Service (TRS) to implement MLD5. The TRS was launched in 2017 by HMRC. HMRC requires that trustees of "relevant taxable trusts" must register with the TRS and provide details of the trust's beneficial owners and assets. Initially, only express trusts with a tax consequence had to be registered. A tax consequence is where the trust has incurred liability to pay income tax, capital gains tax, inheritance tax, stamp duty land tax or stamp duty reserve tax.

MLD5 has removed the tax consequence requirement and now all UK resident express trusts and some non-EU resident trusts must register irrespective of whether they have incurred a tax liability.

The government has repeated its guidance that a non-EU trust must register with the TRS where the trust enters into a business relationship with an obliged UK-based entity or acquires land in the UK.

Under MLD5, individuals who have "a legitimate interest" in information concerning the beneficial ownership of the trust can apply to access this information. Those with a legitimate interest will have to provide information to substantiate that interest, such as why the applicant

suspects that the trust has been used for money laundering. Individuals with a legitimate interest will be provided with the following information:

- individual beneficiaries: Name, month and year of birth, country of residence, nationality, nature and extent of beneficial interest
- corporate beneficiaries: Corporate or firm name, registered or principal office, nature of the entity's role in relation to the trust.

The consultation on the technical aspects of the service included:

- the nature of the "business relationship" necessary to bring a non-EU trust within the scope of the TRS
- the penalties for failing to register and update details
- when an individual will have a "legitimate interest" in information concerning the ownership of the trust such that they are entitled to information about it.

The consultation closed on 21 February 2020 and the results have not yet been published - watch this space!



RPC asks...

How do you remove trustees if you are not a beneficiary?

Trustees are usually removed using either an express power in the trust deed or statutory powers.

However, statutory powers can only be invoked by another trustee or a beneficiary, and express powers are usually conferred on a protector. This causes difficulty where a third party that is connected to the trust wants to remove the trustee. The court can exercise its inherent jurisdiction to bridge that gap.

The court recently considered an application to remove a trustee by the company that was financing the products held on trust. It made the exceptional decision to exercise its inherent jurisdiction and remove the defendant company as the trustee. The court considered that there would be a conflict of interest if the defendant company remained as trustee, which was exacerbated by how slow it had been in both recognising such conflict of interest and taking steps to deal with it. The key question was whether the welfare of the beneficiaries would be maintained if the defendant were to remain as trustee, and the court decided it would not.

A court will only remove a trustee in this way if it has real concerns about the welfare of the beneficiaries. It does not need to be satisfied that any wrongdoing has taken place but equally will not remove trustees just because they have fallen out with the party seeking to remove them. The court's power to help third parties wishing to remove a trustee will only be exercised in exceptional circumstances.

5. *London Capital & Finance Plc (in administration) v Global Security Trustees Ltd* [2019] EWHC 3339



RPC asks

Heritage property – special IHT treatment?

Property may qualify for a conditional exemption from inheritance tax (IHT) if it is heritage property. This exemption defers the IHT which would usually be payable where there is a transfer of qualifying property on death, a gift to a trust, or a lifetime transfer of property and the transferor dies within seven years. The claim for the exemption must be made within two years of these events.

Heritage property includes buildings and other assets with pre-eminent national, scientific, historic or artistic importance. In the context of land and buildings, heritage property must be one of the following classes:

- buildings, estates or parklands of outstanding historical or architectural interest
- land of outstanding natural beauty and spectacular views
- land of outstanding scientific interest including special areas for the conservation of wildlife, plants and trees, or
- objects with national scientific, historic or artistic interest, either in their own right or due to a connection with historical buildings.

If you own property which constitutes heritage property, you can claim the exemption from HMRC. It is necessary to make undertakings to HMRC, which typically include:

- allowing the public access to the property
- retaining the property in the UK, and
- preserving and maintaining the property.

An exemption from IHT would be granted, conditional on the fulfilment of the agreed undertakings. If the undertaking is breached IHT and capital gains tax will be charged on the current value of the property. Owners of heritage property would be well advised to consider if the exemption applies and how the undertaking can be complied with.

And in the art world...



Sotheby's, settlement and a fake Franz Hals

Sotheby's has finally recouped millions of dollars on behalf of a private buyer after a long legal battle over the authenticity of a Franz Hals painting.

Mark Weiss, a London dealer, originally purchased the work for £3.4 million from French dealer Guiliano Ruffini in a joint purchase with Fairlight Ventures in 2010, who claimed it was an original Frans Hals. Sotheby's brokered the subsequent sale to a private buyer in 2011 for \$11.2 million. However, Ruffini was later revealed to have sold multiple paintings purporting to be Old Master works which were ultimately uncovered as fakes, compelling Sotheby's to reverse the sale. Sotheby's then sued Weiss and Fairlight Ventures for the purchase price.

Weiss settled with Sotheby's in April 2019 for \$4.2 million, insisting that he believed the painting was authentic but that he ultimately wanted to resolve the dispute 'amicably'. Fairlight however refused arguing that it was not liable to return any money on the basis it was not a party to the contract between the auction house and the buyer. The claim went to trial, and judgment was recently handed down against Fairlight. The court's finding centred on the fact that the contract between Fairlight and Sotheby's had expressly provided for Fairlight to return its share of the purchase price in such circumstances.

The authenticity of the painting was never proved, with experts for both Sotheby's and Fairlight unable to come to a certain conclusion either way. However, commentators suggest that it will be very difficult to sell now that it has been the subject of such a publicised dispute and its origin is in doubt.

Anti-money laundering compliance hits the art market

Art businesses will be subject to regulation aimed at cleaning up money laundering in the art world. Read more [here](#).

The RPC private wealth disputes team

Disputes can get complex. As one of the few top law firms handling private wealth litigation, our large team of lawyers has an impressive track record of handling disputes both in and out of court. We act for trustees, family offices and other asset and wealth holders and commonly act against HMRC. Drawing on extensive tax, asset management and commercial expertise, we can help resolve any type of dispute, from family settlements and inheritance issues to conflicts over assets, including art and valuables. We have a global reach with offices in London, Hong Kong and Singapore, and access to the TerraLex network of lawyers in over 100 jurisdictions.



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