

Sham trusts

October 2015

A substantive sham is where the terms of a trust appear to create equitable rights in others, but in fact the terms do not represent the true terms. Substantive trusts can be divided into two different categories. Firstly, a total sham where there is no intention of the apparent settlor to transfer legal ownership and control to the trustee. Secondly, a partial sham where there is a real intention of the apparent settlor to transfer legal ownership to the trustee, but in reality, it is intended that the equitable beneficial ownership remains solely with the settlor rather than with the beneficiaries, and the trustees only manage and distribute the trust property as the settlor directs.

The substantive partial sham is the most common sham alleged in litigation in respect of offshore trusts. That is not to say that other types of sham might not be applicable to offshore trusts in appropriate circumstances.

Jersey case law

The leading offshore judgment is the Jersey judgment of Grupo Torras S.A. and Culmer v Al Sabah and Four Others (also known as In the matter of the Esteem Settlement). The Royal Court (looking to English case law for guidance) concluded it was necessary for all parties to have a common intention that the acts or documents do not create the legal rights and obligations which they give the appearance of creating. Therefore it is not sufficient that the trustee merely went along with the intention of the settlor, but if one party goes along with a shammer who does not either know or care what he is signing (i.e. who is reckless), then he is to be taken as having the necessary intention to create a sham. The Royal Court's findings found approval in the English High Court case of Shalson & Others v Russo & Others where Rimmer J. regarded the approach adopted by the Royal Court as correct. Furthermore the Jersey Court of Appeal in Mackinnon v Regent Trust Co. Ltd and Eight Others reiterated that the prerequisite to declaring a trust to be a sham is a common intention of a settlor and trustee to give a false impression to third parties, including other beneficiaries and the court. Therefore, it is necessary for a litigant alleging a sham to prove dishonesty.

How sham arises and guarding against it

The trust deed itself might assist to show evidence of a sham, but the court will also examine external evidence such as parties' explanations, their conduct and circumstantial evidence.

Evidence of sham can be demonstrated by control of the trust property being unilaterally vested in the settlor whilst the trustees exercise no independent discretion or take any actions consistent with the terms of trust deed. In addition, trustees will display reckless indifference if they do not take steps to check the valid source of property or ensure they become the legal owners of property transferred to them by the settlor.