SANCTIONS

AND THE PROBLEM WITH TRUSTS...

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Thoughts by an insolvency practitioner on the issues caused by trusts in recovering assets in insolvency, their interaction with section 423 and a possible solution.

Following Russia's disgraceful invasion of Ukraine, the world's leaders have scrambled to condemn Vladimir Putin's actions and – in a rare but headlines-friendly show of unity – sought to impose a series of wide reaching and extreme-sounding sanctions against the oligarchy's riches across the globe. Pictures of (alleged) kleptocrats' superyachts, private planes and palatial estates as they were impounded and raided by government agencies quickly swept through the world's media.

UK parliament hastily passed the Economic Crime (Transparency and Enforcement) Act 2022, promising the establishment of the long-mooted register of overseas entities to provide transparency over the ownership of UK property assets through foreign entities.

Whilst a register of beneficial owners of opaque offshore entities sounds like a dream come true for FIRE practitioners, such as trustees in bankruptcy looking to recover assets for the benefit of creditors, the jury is out as to its likely effectiveness.

One immediately apparent flaw is the continued recognition of trusts: As regards trust-owned property, the registrable beneficial owner will be the person able to exercise "significant influence or control over the activities of that trust". In the case of the dreaded discretionary trust that sounds rather like a trustee, as opposed to the beneficiary?

Indeed, a mere seven days after the passing of the act, the BBC noted that Alisher Usmanov's assets had already been placed into irrevocable trusts, with his spokesperson reported to have confirmed that Usmanov no longer owned them, and that he was no longer "*able to manage them or deal with their sale, but could only use them on a rental basis*" [1].

So whilst Usmanov has found himself on the UK's sanctions list, and his Sutton Place estate with a restriction in favour of the Office of Financial Sanctions Implementation, it seems that the authorities are about to experience one of the usual frustrations of trustees in bankruptcy when dealing with (allegedly former) high net worth individuals: the Trust is arguably one of English law's proudest achievements, but in the context of an officeholder looking to recover assets for the benefit of creditors also probably one of the cleverest and most (ab)used gadgets in any financial Houdini's toolbox of scammery.

Picture being faced with this…

So it might look like I live in a 50-bedroom mansion with a private airport and a herd of unicorns, but in reality, I'm only renting it from the trust that I set up years ago, at the mercy of its (of course!) wholly independent trustees, who are continually charging me rent. If I pay the rent, I'm successfully swelling the trust's assets further, and if I don't then I accrue a huge loan account, which can either serve to control my bankruptcy if I find myself in a pickle or to reduce any inheritance tax I might have to pay if I die. Plus, I can tell the Sanctions Police to get off my manicured lawn, because I actually don't really own any of this.

So clever, so effective, but not at all revolutionary.

Despite the headline grabbing news of impending transparency of foreign ownership, it seems the register of beneficial owners also has no intention or requirement to make information about trusts publicly available, suggesting that the trust is to remain a protected species.

In the wake of the current public outrage against the permeation of our financial systems, property markets and service sectors by the oligarchy's allegedly unethically obtained riches, is it now time to acknowledge what many trusts for private benefit really are – namely nothing more than what the Insolvency Act has long codified in section 423 as a transaction for the purpose of "putting assets beyond the reach of a person who is making, or may at some time make, a claim against" them.

If Mr Clitheroe's attempt at protecting his home from potential future creditors by gifting his share of the house to his wife failed as it did in *Sands v Clitheroe* then why should the position be any different for an individual who happens to have sufficient funds or determination to pay for the privilege of opening offshore companies in opaque jurisdictions and the services of (of course!) wholly independent trustees?

In situations of individuals holding themselves out to be "high net worth" until it comes to paying back creditors in bankruptcy, when all assets of any note are suddenly purely discretionary, those creditors should not continue to suffer at the mercy and ability of a trustee in bankruptcy to challenge a complex, opaque and uncooperative trust structure (not to mention the trustee's ability to fund the cost of such an endeavour). This is especially so in situations where creditors' funds have been misappropriated and dissipated. Perhaps it is time for a wholesale overhaul of the recognition and legality of private benefit trusts, and for those to suffer the same fate as bearer shares and other relics.

On the flipside, it may also be time to recognise one of the understandable drivers of the trust and offshore secrecy industries, namely a desire to protect the fruits of one's labour from potential creditors in years to come. Ambition, hard work, entrepreneurship and responsible enterprise, along with the wealth it generates should not be discouraged. In a time of increasing focus on environmental, social and governance standards, those that create value and wealth through ethically responsible ways and with regard to ESG values should be applauded and celebrated. A focus on those values may leave little room for the historic examples of worship of extreme wealth and status (one wonders whether space tourism really is a priority for humanity?).

For those who conduct their business fairly, honestly and ethically, the introduction of a concept of limited personal liability as a default position may begin to dispel the attractions that the segregation of legal and beneficial ownership through trusts may have held.

Implementing a longstop lookback period for any assets or income generated before that point may encourage more transparent behaviour and structuring of affairs.

Clearly, there are other factors at play here, not least an overly convoluted, onerous and growing domestic tax code, as well as the global cooperation of jurisdictions that have historically had little incentive to work together. But the changes in the world's attitudes to the creation and preservation of wealth in the current climate should serve as a sufficient trigger to start a wider discussion in an area that will be familiar to most FIRE practitioners.

1 https://www.bbc.co.uk/news/business-60825983