

Sham Trusts An Introduction

In ordinary parlance, a sham is a hoax, something contrived to delude or disappoint expectation. The Oxford English Dictionary defines a sham as a thing that is intended to be mistaken for something else, or that is not what it is pretended or appears to be. In law, the sham doctrine is best illustrated by reference to Diplock L.J.'s statement in *Snook v. London and West Riding* [1967] 2 QB 786 at 802:

"I apprehend that, if it has any meaning in law, [a sham] means acts done or documents executed by the parties to the 'sham' which are intended by them to give to third parties or to the court the appearance of creating between the parties' legal rights and obligations different from the actual legal rights and obligations (if any) which the parties intend to create. The one thing, I think, is clear in legal principle, morality, and the authorities ... is that for acts or

documents to be a 'sham', with whatever legal consequences follow from this, all the parties thereto must have a common intention that the acts or documents are not to create the legal rights and obligations which they give the appearance of creating. No unexpressed intentions of

a 'shammer' affect the rights of a party whom he deceived".

This dictum has been cited and adopted as an authoritative statement of the sham doctrine in common law jurisdictions around the world, indicating that the conceptual basis for the sham doctrine lies in the court's ability to see through acts or documents which are intended as a facade or disguise, designed to conceal "the real truth of the matter". There are a number of different elements to Lord Diplock's speech which we will consider in turn in the following briefing.

Necessity of intention

The importance of identifying the parties' intention to mislead is reinforced in Arden L.J.'s restatement of the sham doctrine in *Hitch v. Stone* [2001] EWCA Civ 63: *"It is of the essence of this type of*

sham transaction that the parties to a transaction intend to create one set of rights and obligations but do acts or enter into documents which they intend should give third parties, in this case the Revenue, or the court, the appearance of creating different rights and obligations."

Whilst it might be tempting to regard the sham doctrine as a subset of the general principles of the law relating to certainty of intention required for a valid trust, it is clear that sham is quite a separate legal animal. Whereas the certainty of intention principle generally focuses on the negative fact that the court has been unable to identify a clear objective intention to create a trust, the sham doctrine focuses on a positive finding that the parties involved subjectively did not intend to create a trust such as that recorded in the sham documents.

Subjective Intention and Dishonesty

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In *Hitch v. Stone*, Arden L.J. made clear that the relevant test of intention is subjective. The parties must have intended to create different rights and obligations from those appearing from the relevant document. To rely solely on the objective intention of the parties would give direct effect to the sham: a sham can only work its mischief if its objective appearance is treated as the reality. How dishonest need the intention be? According to *Midland Bank v. Wyatt* [1997] 1 B.C.L.C. 242 a fraudulent motive need not be established in order to prove that the transaction was a sham or pretence transaction. However, this has since been called into question, on the basis that “a finding of sham carries with it a finding of dishonesty” (*National Westminster Bank plc v. Jones* [2001] 1 B.C.L.C. 98, at [59]). In other words, while dishonesty is not a formal prerequisite for finding a sham, it clearly is a prerequisite that there be an intention to mislead, and it is hard to see how it could be denied that there is “a degree of dishonesty” in such a case.

Common Intention

The requirement of common intention is key. Thus, in *A v. A* EWHC 99 (Fam), at [49] and [86], Munby J. concluded that an allegation that a trust was a sham must fail where it was clear, as a matter of fact, that the trustees honestly and sincerely had intended to hold on the stated trusts. In *MacKinnon v. Regent Trust Co. Ltd.* [2005] JCA 066, the Jersey Court of Appeal struck out an argument that a trust was a sham, irrespective of the trustee’s intention, on the basis that the claimant refused to allege that the settlor (his mother) had any intention to mislead others. Common intention is also a logical progression from the premise that trust instruments are bilateral agreements. Furthermore, reckless indifference will be taken to constitute the necessary intention. Per *Midland Bank PLC v Wyatt* a sham transaction will still remain a sham” even if one of the parties to it merely went along with the ‘shammer’ not either knowing or caring about what he or she was signing”.

Burden and Standard of Proof

The burden of proof is on the party asserting sham and the standard of proof is the civil standard – i.e., on the balance of probabilities.

Relevant Evidence

Since the Court looks to the subjective intention of the parties, it cannot be confined to the four corners of the relevant documentation in reaching a conclusion as to sham but must examine external evidence. Subsequent conduct may be relevant but only to the extent that it shows that the agreement was a sham from the outset.

Another relevant factor is the extent to which the settlor is able to exercise control over the trustee’s decision-making powers. For example, in *Rahman v. Chase Bank* [1991] JLR 103, the settlor purported to create a trust but retained dominion and control over the trust fund throughout his lifetime. The trust was held to be a sham because the “trustee was never made master of the assets”. Similarly, in *Minwalla v. Minwalla*, [2005] EWHC 2823 (Fam) Singer J. held that the settlor “never had the slightest intention of respecting even the formalities of the trust and corporate structures that had been set up at his direction ... [his] intention always was that the resources were his and would continue to be his”.

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However, there is a limit to this. The mere fact that the Trustee will invariably follow the wishes of the settlor does not mean, without further ado, that there is a sham. The Court in *Esteem* (2003} JLR 188 noted that the settlor had made numerous requests of the Trustee none of which had been rejected. But this did not mean that the trust was a sham:” [The trustee] considered each request in good faith as an independent trustee, applied its mind to the issue at hand, decided whether to go along with the request and reached its own conclusion having regard to its fiduciary duties. [The trustee] paid great attention to the views of [the settlor] but it was perfectly in order for them to do so.”

Similarly, in *Shalson v Russo* [2003] EWHC 1637 (Ch.) Rimer J rejected an argument of sham based on Russo’s control of the trust because it was not made out on the evidence: in particular, it was possible to point to specific examples where the trustee had refused to accede to Russo’s requests as to disposition of the trust assets.

It is important in this regard to emphasise that the mere fact that the trustee has abdicated some of its decision-making powers to the settlor after the trust was created does not necessarily indicate that the trust was a sham when it was originally created. Such subsequent conduct may instead amount to no more than a breach of trust on the trustee’s part (or potentially a valid delegation of powers by the trustee). But where the pattern of conduct indicates that the trustee has never exercised its discretionary powers and has always been prepared to act simply as the settlor directs, the court may legitimately conclude that both the settlor and the trustee never intended to give effect to the trust instrument and instead entered into it only in order to disguise the true arrangement.

Consequences of a sham

What consequences flow where it is established that a trust is a sham? The cases favour the view that a sham transaction is “void and unenforceable” and “wholly invalid and of no effect” and not merely voidable. This view is taken in order to give practical effect to the underlying purpose of the sham doctrine: to enable the court to “see through” the false facade and “look at the real transaction”. It is also important that this approach be taken for the benefit of third parties. Third parties who have been induced to enter into further transactions by reason of the existence of the sham transaction will normally have a right to rescind those further transactions on the basis of fraudulent misrepresentation.

Sham and Divorce

The sham doctrine is a powerful weapon to attack trusts in the divorce context. The, at best, sceptical attitude of the Family Division towards trusts can be summed up in the dicta of Coleridge in *JvV* (*Disclosure: Offshore Corporations*) [2003] EWHC 3110: “these sophisticated offshore structures neither impress, intimidate, nor fool anyone. The Courts have lived with them for years”.

However, a more measured approach was recently articulated by the High Court Family Division in *A v A St George*. Mr Justice Munby stressed that the Court should not run roughshod over established legal principles. Least of all where there are or appear to be third party interests involved. He also asserted that the law of sham is the same whichever division one happens to be in. *A v A* considered the interesting issue of whether a trust which is a sham can subsequently become a sham and, conversely, whether a trust which is a sham can subsequently lose that character. Munby J held that

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as a matter of principle a trust which is not initially a sham cannot subsequently become a sham whilst indicating that a trust which is a sham might in certain circumstances lose that character subsequently.

“A trustee who has bona fide accepted office as such cannot divest himself of his fiduciary obligations by his own improper acts. If therefore, a trustee who has entered into his responsibilities, and without having any intention of being party to a sham, subsequently purports, perhaps in agreement with the settlor, to treat the trust as a sham, the effect is not to create a sham where previously there was a valid trust. The only effect, even if the agreement is actually carried into execution, is to expose the trustee to a claim for breach of trust and, it may well be, to expose the settlor to a claim for knowing assistance in that breach of trust.”

Conclusion

In summary, there is a doctrine of sham known to English law and it applies in the context of trusts. The doctrine is concerned with situations where the parties to an apparently valid transaction have purported to enter into it in order to mislead third parties. The relevance of the sham doctrine, and the difference between it and normal processes of construction, lies in the fact that it justifies the court in ignoring (as opposed to construing) the usual primary material regarding that transaction, and focusing its attention instead on all other material factors which indicate the arrangement that the parties in fact intended.

In determining whether the transaction is a sham, the court is therefore concerned with the subjective intentions of the parties to the transaction. Before a transaction can be ignored as a sham, all of the parties to the transaction must be shown to have had the requisite intention to mislead third parties. Similarly, the onus of establishing a sham rest on the party asserting that the transaction is a sham. The consequences of finding that a trust is a sham are less clear, but it is suggested that it makes most sense if the sham trust is treated as void, with the caveat that issues of estoppel and rights to rescind will need to be borne in mind when that conclusion is given effect vis à vis innocent third parties.

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