

## BVI INTRODUCES IMPORTANT TAX LAW CHANGES

The British Virgin Islands introduced, effective March 1, 2004, important and innovative changes to its trust law. The changes will be of interest to our clients as they make the BVI, already a recognised and widely used trust domicile, more attractive to the structuring needs of settlors from civil and Islamic law countries and for the use of trusts in commercial transactions.\*

### Summary of Changes

- Trustees will be permitted to hold shares in a company without fiduciary responsibility for the management or success of the company.
- Third parties (e.g. lenders) dealing with trusts will be able to enforce claims directly against the assets of a trust.
- Existing protections for trusts against forced heirship claims are strengthened.
- Settlor can prevent beneficiaries from unanimously agreeing to terminate a trust for a period of up to 20 years.
- Existing rules governing purpose trusts are expanded.

### The Virgin Islands Special Trusts Act, 2003

The most significant of the trust law changes are those introduced by the Virgin Islands Special Trusts Act, 2003, now commonly referred to as the VISTA legislation.

The significance of the VISTA legislation is that for trusts electing to be governed by its provisions, trustees are released from the rule of English trust law known as the “prudent man of business rule”.

### The Prudent Man of Business Rule

The rule, as developed by the English courts, places on trustees the obligation to monitor the conduct of the directors of companies in which a trust holds shares and to intervene where necessary (for example, to prevent the company from entering into an unduly speculative venture).

The rule also obliges trustees to exploit to maximum financial advantage the shareholding in a company in which the trust owns shares. For example, the trustees may, in applying the rule, be required to accept an attractive takeover bid for the company irrespective of the wishes of the settlor. Similarly, the trustees are under an obligation to look for opportunities of spreading the financial risk of trust assets through diversification, which may involve a sale of the company with underlying assets.

The application of the “prudent man of business rule” will frequently conflict with the wishes of the typical owner of a family business who wants to continue to manage the company on a day-to-day basis. In situations involving private investment companies, many families want to manage the investments held by the company without having to answer to a trustee. In many cases settlors also want to continue to remain as the directors of an underlying company.

*\*Trident Trust Company (BVI) Limited will shortly have available for client review a sample trust deed which includes the VISTA provisions and the other changes introduced by amendments to the Trustee Ordinance. To request a copy of the sample trust deed please contact your nearest Trident Trust office or Mr. Kenneth Hodge in the BVI at [khodge@tridenttrust.com](mailto:khodge@tridenttrust.com).*

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A further complicating factor for trustees of trusts that own shares in a family business is that professional trustees cannot be expected always to have the skills relevant to the particular business and the monitoring procedures necessary to ensure that trustees avoid exposure to claims against the trustees. This factor can add substantially to the cost of trust administration.

The above situations have raised significant difficulties for trustees holding shares in companies involved in such businesses as they highlight the inherent conflict between the professional trustee and the settlor and beneficiaries for which the trustee has a fiduciary responsibility.

**Vista Trust Legislation Highlights**

- Authorising the removal of a trustee's monitoring and intervention obligations.
- Permitting the settlor to confer on a trustee a duty to intervene to resolve specific problems (for example, a deadlocked board).
- Allowing trust instruments to lay down rules for the appointment and removal of directors (thereby reducing the trustee's ability to intervene in management by appointing directors of their own choice).
- Giving both beneficiaries and directors the right to apply to court if trustees fail to comply with the requirements for non-intervention or the requirements for director appointments and removal.
- Prohibiting the sale of shares without directors' approval.
- Preventing a trustee, except in certain specified circumstances, from exercising its voting or other powers so as to interfere in the management or conduct of any business of the company.
- Leaving to the discretion of the company's directors the management of the company's business whose fiduciary duties to the company will remain intact.
- Permitting the trustee to dispose of the shares in the company only with the consent of the directors of the company (or such other persons as are specified in the trust deed).

The Act also provides that the trust deed may include an "office of director rules" in terms of which the trustee will be directed how to exercise its voting powers in relation to the appointment, removal and remuneration of directors and the trustee will generally be required to follow these rules.

The trustee will only be able to intervene in the affairs of the company in specified circumstances; namely, when required to do so by an "intervention call" by a beneficiary, a class of persons who may be the beneficiaries of a discretionary power of appointment, a parent or guardian of either of them, the Attorney General (in relation to charitable trusts), the enforcer (in relation to purpose trusts) or other specified persons.

The VISTA legislation can be applied to existing trusts subject to the trust instrument containing sufficiently broad powers of amendment. Foreign trusts can elect to be governed by the VISTA legislation by changing their proper law to that of the BVI provided, as in the case of existing BVI trusts, that the trust instrument contains appropriate powers of amendment.

Note: The legislation applies only to BVI trusts and only where there is an express provision in the trust instrument directing the Act to apply. The legislation also requires that the shares held by the trust must be shares in a BVI company, such as a BVI International Business Company. In addition, the trustee of a VISTA trust must be a company, such as Trident Trust Company (BVI) Limited, which is a licensed trustee under the BVI Banks and Trust Companies Act, 1990.

### **Trustees' Obligations to Lenders and other Third Parties**

Under English law a trust is not a separate legal person. As such a trust cannot itself undertake liabilities. It is only the trustee that accepts such liabilities. The remedy of anyone dealing with a trust is to seek redress against the trustee. For this reason trusts have traditionally been an unattractive vehicle for commercial transactions.

Because the primary remedy of the party to whom a liability is owed is against the trustee personally, the courts have only allowed that party recourse to the trust fund by way of subrogation to the trustee's right of reimbursement (so that the third party stands in the shoes of the trustee). Such a right of subrogation may be viewed by third parties, particularly lenders, as an inadequate protection of their rights. This has been of particular concern to banks and other lenders. From a trustee's perspective, the situation is unsatisfactory because they are at personal risk if the assets of the trust fund are insufficient to meet the liability.

#### **Summary of Changes Affecting Trustees and Lenders**

- Banks and other third parties dealing with trustees will be able to have recourse to the trust fund where, when entering into a transaction, they have made reasonable inquiry that the trustee has the express power to enter into such a transaction and has complied with any express requirements (such as requirements for consent) contained in the trust instrument.
- A trustee of the trust which by its terms adopts the relevant provisions of the statute, will not be personally liable under any contract which the trustee has entered into with another if the trustee has disclosed (or the other party was aware) that it was contracting as trustee (unless the contract provides otherwise). A claim based on such a contract may be satisfied out of the trust fund.
- If the trust deed does not elect to be governed by the relevant provisions of the statute (and if the trust instrument does not provide otherwise), where a trustee has entered into a contract having disclosed its fiduciary capacity, it will be liable under the contract to the third party only to the extent of the value of the trust fund when the payment falls due (including the amount of any distributions made after the contract was entered into).
- A trustee will only be liable for a tort committed in the course of administering the trust if the trustee is personally at fault.
- Where requested by a lender a trustee may restrict its future powers of investment and distribution (and the powers of appointment and removal of trustees) in order to protect the lender – the purpose of this provision is to address the legitimate concerns of those dealing with trustees who might be concerned that their rights will be diluted as a result of the manner in which the trust is administered after a liability has been incurred by the trustees.
- Trustees will be able to create various forms of charges over trust assets in favour of creditors.

**Note:** In order for the trustees and lenders to be able to rely on the new statutory protections, the trust deed itself must include express reference to the legislation.

### **Anti-Forced Heirship Rules Strengthened**

Since 1993 BVI trust legislation has included a provision (Section 83) which prevents the enforcement of forced heirship provisions found in civil and Islamic law. To improve the acceptance in other jurisdictions of the anti-forced heirship provisions, the Trustee Ordinance has been amended to include additional provisions which are significantly more robust in their defense of potential forced heirship claims. The

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Trustee Ordinance now includes rules that clarify which law will apply to both the actual transfer and to the property that is being transferred to a BVI trust.

Importantly, the Act states that all questions arising with regard to the validity, construction, effect or administration of a trust, including powers, obligations, duties, liabilities and rights of trustees, and the existence and extent of powers, will be determined by the proper law of the trust. The Act also expressly states that foreign judgments based on forced heirship claims will not be recognised or enforced in the BVI.

**Note:** The new provisions of the Ordinance, contained in Section 83A, only apply to trusts created after March 1, 2004. Existing Section 83 will continue to apply to trusts created before that date.

#### **Amendment to the Rule in Saunders v. Vautier**

It has been a long held principle of trust law that trust beneficiaries over the age of 21 can, subject to their unanimous approval, terminate a trust. This rule has always troubled settlors who seek to preserve a trust beyond their death for a period of time. The VISTA legislation now makes it possible for the rule in Saunders v. Vautier to be postponed for a maximum of 20 years where the rule has been expressly excluded by the trust instrument.

#### **Purpose Trusts Legislation Expanded**

Purpose trusts have become a common feature of trust legislation of many offshore jurisdictions. Purpose trusts are particularly useful in the commercial context (in order to take advantage of one of the features of such trusts which is that there is no beneficial owner of the trust's assets). Examples of the commercial use of purpose trusts include taking transactions off balance sheets, isolating assets and financial deals, separating voting from economic control and providing ownership structures for private trust companies.

Section 84 was added to the Trustee Ordinance in 1993 to include provisions allowing for the establishment of purpose trusts subject to BVI law. Since that date developments have occurred in the jurisprudence surrounding purpose trusts and the new amendments to the Ordinance have as their purpose the inclusion of provisions that reflect these new concepts. These include:

- The definition of a purpose trust has been changed so that it is stated merely to be a "purpose trust" rather than a "trust for any purpose".
- Every purpose trust must have an "enforcer"; previously the appointment of an enforcer was optional.
- An enforcer cannot be or become one of the trustees of the purpose trust.
- The enforcer is given express statutory power and duty to enforce the provisions of the trust.
- The court has been given a discretionary power to make an award in relation to the enforcer's costs in enforcing the trust.
- Purpose trusts will be exempt from the rule against perpetual trusts.
- The trust instrument does not have to specify a terminating event as a perpetual purpose trust can be established. The trust instrument will have the option of specifying a terminating date or event, of providing for the disposition of trust assets on the trust termination and of providing that the trustees will owe no duty to any person entitled on such termination.

**Note:** The trustee of a purpose trust must be a "designated person" such as a licensed BVI trustee like Trident Trust Company (BVI) Limited. In addition, the designated trustee of a purpose trust is required to retain certain essential trust records in the BVI.

**Other Changes**

Among the other changes introduced by the new legislation are:

- **Variation of Trusts.** The new legislation states that where a trust instrument includes a straightforward power to amend a trust, in the absence of any contrary provisions in the trust instrument, this will be construed widely as a power to vary all or any of the terms of the trust. The purpose of this change is to circumvent difficulties of construction which in practice arise in interpreting expressed powers of variation.
- **Third Party Approval for Trust Changes.** The new legislation includes provisions which allow a trust deed to provide for the appointment of a person, such as a protector, to approve variations on behalf of those parties (e.g. minors) who are incapable of giving their consent. This provision will avoid the cost and delay of making an application to court to approve a variation of a trust deed. However, this provision will not apply unless there is an express direction to this effect in the trust deed.
- **Flee Clauses.** The ability for a trust to move to another jurisdiction will be restricted to avoid potential abuse of such “flee clauses”. The ordinance now provides that a flee clause will not be capable of being activated by (a) a court order, (b) the institution of criminal proceedings or (c) investigations by the Financial Services Commission in relation to the settlor, the trustees, the beneficiaries or the trust property.
- **Increase in Trust Duty.** The applicable duty has been increased to US\$100 from US\$50.

Trident Trust Company (BVI) Limited acts as trustee for international families and businesses that use trusts as part of their international planning. Our services include fiduciary and corporate administration, liaison with legal and financial advisors and institutions, accounting and reporting to settlors and beneficiaries. Please contact any Trident Trust office or Mr. Kenneth Hodge in the BVI at [khodge@tridenttrust.com](mailto:khodge@tridenttrust.com) for more information on the new legislation and our fiduciary services.

Trident Trust wishes to thank Mr. Chris McKenzie of Harneys for his permission to include in this Client Memorandum extracts from his various presentations on the new legislation.

The explanations provided in this Client Memorandum should not be regarded as the giving of legal advice. Clients are recommended to consult qualified legal counsel with regard to the interpretation and application of the VISTA legislation and the other changes to the Trustee Ordinance which are discussed in this memorandum.

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