Article

Trusts in divorce: an update on the English approach

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July brought the long-awaited conclusion to the latest high profile case in which offshore trusts came under attack from the Family Division in England and Wales. Mr and Mrs Akhmedova endured eight years of litigation before reaching their settlement, during which Mr Akhmedova placed assets in numerous offshore trusts and company structures and sought to benefit from the most robust firewall provisions available.

Mrs Akhmedova's battle for her share of the marital assets saw her launch proceedings in multiple jurisdictions and recently resulted in judgements being made against her son, a company owned by both of her sons and two Lichtenstein trust entities for their participation in Mr Akhmedova's schemes. Although proceedings were ultimately settled out of court, this case underlines how far the court was prepared to go in assisting Mrs Akhmedova. It also demonstrates, for both spouses and those who assist them, the lengths the court will go to frustrate schemes intended to defeat matrimonial claims.

General note on trusts in divorce

The extent of the family courts' powers can be surprising to those accustomed to using company and trust structures in a commercial setting. However, the court will generally be slow to interfere with trusts which were established for legitimate purposes and were not intended to be matrimonial in nature. This is particularly so where third party rights are involved. That said, discretionary trusts will always be vulnerable to the possibility of attack within divorce proceedings and an understanding of when an invasion is most likely, is vital to ensure wealth protection strategies are as effective as possible.

Nuptial Settlements

Perhaps the most significant risk to any trust, is a finding that it is a nuptial settlement capable of variation under the Matrimonial Causes Act 1973 (MCA). Whether a settlement is considered nuptial can be a fatal blow to a spouse's case (whether defending or attacking the trust) and poses the biggest risk to the interests of the other beneficiaries as the courts have essentially unfettered distributive powers under the MCA.

Despite the significance of a trust being considered nuptial, there remains an unfortunate lack of clarity of exactly when and how a settlement will be treated as nuptialised. In England and Wales there is no statutory definition and case law in this area is so inherently fact specific that it can be difficult to draw robust conclusions.

The most generous view is that a settlement will be nuptial whenever a benefit flows from it to a spouse (*DR v GR and Quan v Bray*). However, it is likely that in most cases the court will look for more compelling evidence than an isolated distribution to change the character of a settlement. It is impossible to provide an exhaustive list of acts which will be sufficient to nuptialise a trust. However, the court will commonly consider whether the settlement pre- or post-dates the marriage, whether the settlor or protector was one of the spouses, whether a spouse has a significant degree of control, the nature of distributions and whether the trust's holdings include traditionally matrimonial assets such as the family home. The court will also attach weight to the existence of independent beneficiaries whose existence will often provide compelling evidence that a trust is not nuptial in nature.

The recent case of *WX v HX* has provided some additional insight into what will be insufficient to change the character of a settlement. In that case both H and W came to the marriage with their own inherited wealth held in independent trusts. Crucially, H's trust assets were used for the benefit of the family. By contrast the capital assets within W's trust were untouched throughout the marriage and the income she derived was used for her own benefit and kept separate from family finances.

H sought to argue that W's trust assets had nonetheless been nuptialised as a result of his management of the trust over a number of years. The court rejected this argument concluding, in effect, that mere interaction with the assets, in the absence of drawing any benefit, is insufficient to change the character of the assets.

It should be noted that the court also found no evidence that H's management had led to an increase in W's wealth as he had suggested. Had H been able to demonstrate a substantial increase in wealth, there may well have been justification for a different division of assets in recognition of this contribution.

Whilst the risk of a settlement being treated as a marital asset is often a major concern, there is reassurance to be found in the realisation that the court's appetite to invade trust assets will be significantly dampened where genuinely independent third party rights exist. Decisions will not be taken without extending an invitation for their input (see the recent case of *JB v DB 2020 EWHC 2301* where a consent order which failed to account for the beneficial interests of children was set aside) and the courts are often prepared to hear from trustees in a manner which doesn't leave them exposed to a finding that they have submitted to the jurisdiction of the court.

Resources

Settlements are also at risk where a spouse has historically benefited from a trust, and can fairly anticipate that benefit to continue. In these circumstances the court can place reliance on the expectation that the trustees will step in to meet the beneficiary spouse's needs or even to satisfy a financial award made against him. Where there is little matrimonial wealth available on divorce, this approach could result in a significant request for support from the trust. This is perhaps the most surprising tool in the family courts' standard armoury as it places reliance on third party property to come to the aid of a spouse.

Whilst the court cannot compel a trust to make provision in these circumstances, nor make any direct order against the trust assets, these orders can be powerful given few would wish to see their family members in need.

It is important not to overstate the significance of this risk. The court is only able to rely on trust assets as resources where it considers it likely that trustees would accede to a request for distribution had it been made by the beneficiary himself (i.e. the Charman likelihood test). To avoid such a finding, it is important that trustees establish a history of giving beneficiary requests, and their impact on the trust, proper consideration and to be able to point to instances where requests were declined. It may also be useful to avoid outright distributions, favouring loans or lifetime interests instead.

The use of trust assets as a resource is most commonly seen in cases where the beneficiary is also the settlor, and are clearly easier to justify in these circumstances. When faced with a properly dynastic trust, the family courts will be mindful of third party rights and will not seek to encroach on these too dramatically.

Misuse of trusts to evade MCA

The family courts are understandably far more robust in their approach when faced with a spouse engaged in blatant and dishonest efforts to conceal assets. Here the courts will not only readily look beyond the façade of any company and/or trust structures employed, but will seek to be as creative as possible to give their powers maximum reach.

In Akhmedova, the highpoint of this robust approach was the use of orders against foreign trustees and companies. The Lichtenstein trustees were no doubt extremely surprised to find themselves on the receiving end of orders carrying the threat of committal, given the duties and obligations imposed upon them under domestic legislation and the firewall protections.

The trustees sought to challenge the validity of these orders on the grounds that they were not only in breach of international law, but in breach of the longstanding Hamlin principle that courts should not make orders which it knows are incapable of being enforced (which is almost certainly true in respect of Lichtenstein). The court firmly rejected the trustees' arguments against its order on two separate occasions, drawing a distinction between orders as against a person or entity who has submitted to the court's jurisdiction and those which purport to affect property in a foreign jurisdiction. The latter, it accepted, would not be permissible and would give rise to problems at the enforcement stage. However, the court was clear that this did not prevent adjudication against a person or entity in the first instance as it had done here.

One might have thought the Hamlin considerations would have posed a greater obstacle; being clear that Lichtenstein was amongst the countries least likely to give effect to an order of an English court. The court's willingness to make orders will likely be reserved for those cases where a spouse's misconduct is as clear as Mr Akhmedova's. However, it does highlight that the rule is a discretionary one which practitioners may wish to challenge more often in extreme cases.

Ultimately, the Akhmedovas reached a settlement without needing to test how the court would have responded to further attempts to frustrate its orders. There are several cases where pressure from the court did not produce a change in conduct. In those instances there may come a point where a spouse has to make the difficult decision not to pursue further remedy. However, the courts determination to assist Mrs Akhmedova, and to place pressure upon not only the spouse but family members and professionals, should help to discourage the frequency with which dishonest spouses, or at least their advisers, pursue such schemes.

Key considerations

Although discretionary trusts will always be vulnerable to interference by the English family courts, sensible advanced planning can significantly reduce this risk where trusts really are genuinely intended to protect generational wealth. Where settlors take care to set out their intentions and trustees refrain from acceding to every request its beneficiaries make, the likelihood of trust assets being looted

upon divorce are vastly reduced. Pre-nuptial agreements offer additional protection, provided a spouse isn't left in a position of real need.

By contrast, where courts observe a flurry of restructuring the moment a divorce is announced, it will be much harder to satisfy a court that a spouse is engaged in legitimate planning. Those who are found to be deliberately frustrating the intention of the court should be prepared for an unrelenting pursuit, even where they seek the protection of most resilient offshore jurisdictions.

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