

## In Practice

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# The super power of the revocable discretionary trust

### KEY POINTS

- Officeholders and their lawyers should always carefully check the terms of any trust to see if it contains a power to revoke the trust.
- If the trust does contain a power of revocation, such power vests in the officeholder and can be exercised by him/her so as to reclaim for the insolvent estate the assets held on trust.

### INTRODUCTION

When an officeholder is seeking to realise property in an insolvent estate it is not uncommon for an argument to be advanced that the property is held on trust, be it by a creditor wanting to claim an entire asset for himself (rather than rank as an unsecured creditor) or by a bankrupt wanting to keep substantial property out of the bankrupt estate for his family. A trustee in bankruptcy is all too frequently presented with a written declaration of trust stating that the family home is in fact held on trust for the spouse and/or children, thus giving the trustee in bankruptcy no interest.

When presented with a declaration of trust, the next steps for the officeholder will invariably be to review carefully the terms of the trust document and all the available evidence and consider:

- (a) Is it a sham?
- (b) Is it a transaction at an undervalue?
- (c) Is it a preference?
- (d) Is it a transaction defrauding creditors?

It is, however, also important to consider:

- (a) Are the terms of the trust sufficiently certain even to constitute a trust?
- (b) If they are, is there a power given to the settlor of the trust to revoke the trust?

The power of revocation is very powerful for an officeholder but it is easy to miss if one is not consciously looking for it. The power is more commonly encountered in foreign trusts or in trusts purportedly executed within England and Wales but based upon foreign precedents. A bankrupt with property in multiple jurisdictions is arguably more likely to execute a revocable discretionary trust if such trusts are common in other jurisdictions where he has property. The power of revocation is important because the power is capable of vesting in the trustee in bankruptcy and can therefore be exercised by him so as to realise property for the insolvent estate. In other words, the trustee in bankruptcy can essentially reclaim what is held on trust.

### WHAT DOES A POWER OF REVOCATION LOOK LIKE?

A power of revocation does not have to be expressed in any specific form of words, and in each case the trust terms will have to be scrutinised carefully. Examples of possible wording include:

- (a) 'The settlor may vary this deed at any time, even to the extent of revoking all the trusts it establishes.'
- (b) 'The trustee may revoke this trust at any time.'
- (c) 'The settlor may revoke all the trusts hereby established without the consent of any of the trustees.'

It is conceivable that in some cases it will not be entirely clear whether a power of revocation can be established or not but, even if it is only arguable, the trustee in bankruptcy will have the ability to negotiate a settlement for part of an asset, rather than possibly receiving nothing at all.

### THE VESTING OF THE POWER OF REVOCATION

If the bankrupt settlor is given a power of revocation under a trust then that power (subject to certain exceptions considered below) vests in the trustee in bankruptcy pursuant to s 283(4) of the Insolvency Act 1986 (IA 1986). This also appears to be the case given the Privy Council decision of *Tasarruf Mevduati Sigorta Fonu v Merrill Lynch Bank and Trust Co (Cayman) Ltd* [2011] UKPC 17. The debtor was made bankrupt in Turkey. He had established two discretionary trusts in the Cayman Islands. He and his wife were the beneficiaries of these trusts, and the debtor (settlor) had a power of revocation. A creditor commenced proceedings in the Cayman Islands seeking the appointment of a receiver by way of equitable execution over the power of revocation. The Privy Council found that the power of revocation was 'tantamount to ownership' and that the creditor was therefore entitled to seek the appointment of a receiver by way of equitable execution over the power. In the Court of Appeal of the Cayman Islands it had been queried whether a sole creditor should be entitled to seek the appointment of a receiver when there was a trustee in bankruptcy in whom the power might vest. By the time the case reached the Privy Council it had become apparent that the power of revocation did not vest under Turkish law in the trustee in bankruptcy, and therefore the creditor could not have relied upon him to obtain the property by revocation.

The provisions of IA 1986 relevant to powers of revocation are ss 283, 306, and 436.

Section 306 provides that the bankrupt's estate vests in the trustee immediately on his appointment taking effect.

Section 436 states that property includes 'every description of property wherever situated and also obligations and every description

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### Biog box

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of interest, whether present or future or vested or contingent, arising out of, or incidental to, property.'

Section 283(1) provides that a bankrupt's estate comprises (a) all property belonging to or vested in the bankrupt at the commencement of the bankruptcy and (b) 'any property which by virtue of any of the following provisions... is comprised in that estate or is treated as falling within [(a)]'. Section 283(4) states that references to property 'include references to any power exercisable... over or in respect of property except in so far as the power is exercisable over or in respect of property not for the time being comprised in the bankrupt's estate and – (a) is so exercisable at a time after either the official receiver has had his release... or the trustee of that estate has vacated office... or (b) cannot be so exercised for the benefit of the bankrupt; and a power exercisable over or in respect of property is deemed... to vest in the person entitled to exercise it at the time of the transaction or event by virtue of which it is exercisable by that person...'

Accordingly, when reviewing a trust one must consider whether the trustee in bankruptcy has a power of revocation that falls within s 283(4) and that no exceptions apply. The wording of s 283(4) is not as clear as it could be, but it is evident from *Tasarruf* that the Privy Council considered that it applied in the context of a power of revocation.

The phrase in s 283(4) 'except in so far as the power is exercisable over or in respect of property not for the time being comprised in the bankrupt's estate' arguably does not apply to a power of revocation because such a power is 'tantamount to ownership' in light of *Tasarruf* and therefore the relevant property is effectively comprised in the bankrupt estate. This is because the power exists uniquely for the sole benefit of the settlor.

Even if the above analysis were wrong, the trustee in bankruptcy should succeed provided:

- (a) The power has been exercisable throughout the duration of the bankruptcy and remains exercisable, and the bankruptcy administration has not yet come to an end. This section does not appear to be worded with powers of revocation specifically in mind, but it is the most practical interpretation available.
- (b) The power is exercisable for the benefit of the bankrupt alone. If the power is exercisable for anyone else's benefit as well, then it does not apply. It is therefore important in each case carefully to consider the trust wording.

The relevant power has to be a power vested in the bankrupt otherwise than in his capacity as a trustee. A power to remove or appoint new trustees of the trust, even when the bankrupt is himself a discretionary beneficiary, would not constitute a relevant power since such powers are fiduciary. The test is whether the power can be exercised for the benefit of the bankrupt alone.

There is no need to try to upset a settlement (by arguing, for example, that it is a sham or a transaction defrauding creditors, a transaction at an undervalue or a preference) if the settlor has reserved to himself an exclusive power to recover the trust property for himself by way of a power of revocation. If the settlor is bankrupt these powers

will have vested in his trustee in bankruptcy so as to enable the trustee to recover the property for the settlor's creditors.

### PRACTICAL CONSIDERATIONS

A trustee in bankruptcy in whom a power of revocation vests is likely to want to exercise that power, having initially considered what the effect of revocation would be, including the tax implications of revocation. To exercise the power the trustee is likely to have to execute a deed revoking the trust, taking into account the terms of the trust and s 283(4). The trustee is also likely to want to obtain a declaration that the relevant property vests in him, and to seek an order for possession and sale. It may also be necessary to obtain a without notice injunction to prevent a bankrupt settlor from exercising any powers under the trust pending revocation in case such powers could affect the exercise of revocation. Any exercise of such powers by a bankrupt would likely be liable to set aside in any event, for example as a transaction defrauding creditors, but an injunction may well be the safest means to protect the property.

Once proceedings are afoot it is also likely to be necessary to consider whether the pleadings concerning the power of revocation (such as whether the trust does in fact contain one, whether it has been revoked effectively, and what the effect of revocation is) should be determined as preliminary issues. This may well be preferable if the trustee in bankruptcy would alternatively be seeking to argue that the trust is a sham, a transaction defrauding creditors, a transaction at an undervalue or a preference, as such issues would likely take up considerably more court time.

It is also important to consider powers of revocation when valuing assets for IVA purposes. Where there are discretionary trusts that are revocable, it is likely in view of *Tasarruf* that property held on such trusts should be treated as assets of the debtor. This can have a profound influence on the success of an IVA. It will be especially important to search for such powers when one is dealing with properties around the world where revocable trusts are more common.

Powers of revocation can also be of great importance to creditors even before, or without, a bankruptcy order having been made. A creditor may wish to appoint a receiver by way of equitable execution over a power of revocation, as in *Tasarruf*. This will likely be appropriate where:

- (a) the settlor is not bankrupt but has not paid a judgment debt; or
- (b) the settlor is bankrupt, but the applicable law does not recognise the vesting of the power of revocation in the trustee (as was the case of Turkish law in *Tasarruf*).

Whilst revocable discretionary trusts may not be encountered all that often, they are incredibly powerful for creditors when they are. It is therefore critical that they are not overlooked. It is all too easy to attempt, not necessarily successfully, to unravel a trust as a sham or a transaction defrauding creditors, but it is important carefully to consider the terms of a trust to see if it contains a power of revocation. The trustee in bankruptcy can then exercise the power of revocation vested in him and revoke the trust, thereby reclaiming valuable assets for creditors. ■