Can human rights trump offshore asset protection trusts?

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Aggressive asset protection planning may be used to avoid tax and other obligations. Whatever one's opinion may be about the moral implications of such activity, the reality is that the clever use of devices such as offshore asset protection trusts can effectively shield assets from national treasuries, victims of fraud and other creditors. While the settlor's personal liability remains, the separation of ownership that a trust entails means that any judgment against a settlor is worthless if he has successfully divested himself of assets that would otherwise have been available to satisfy such a judgment. That, it seems, is the end of the matter. Or is it? Much will depend on the nature of the right sought to be asserted against assets that have been placed into trust. When we speak about attempts to avoid a pre-existing obligation, we refer to just that – an obligation. An obligation is defined in the Oxford Dictionary as:

> *"An act or course of action to which a person is morally or legally bound; a duty or commitment; the condition of being morally or legally bound to do something, it is a state that attaches to a person but not to property as such."*

The question is, if the property transferred into trust is subject to a proprietary claim (i.e., what lawyers call a claim *in rem)*, can that transfer be successfully attacked despite the use of offshore asset protection laws?

A glance at some of the more aggressive trust legislation available to protect assets would suggest that attacking any transfer is nigh impossible. In Cyprus for example, no transfer of property to a Cyprus International Trust can be set aside simply because the laws of any jurisdiction prohibit such a transfer, or do not recognise the concept of a trust. This would hold even where a gift to a trustee adversely affected the rights conferred by the law of any jurisdiction on any person by reason of a "personal relationship" to a settlor. In Nevis, similar protection is provided. As in Cyprus, foreign judgments against a Nevisian trust are not enforceable. Burdens of proof are enhanced against creditors; and limitation is shortened. Any civil action to recover assets from a Nevis or Cyprus trust must be brought anew in the Courts of the Federation of St Kitts & Nevis or the Republic of Cyprus respectively. That, it would seem, settles the matter (excuse the pun). Or does it?

Many jurisdictions offering similar models to Cyprus or Nevis have enacted legislation that provides that all matters concerning the validity of transfers of assets into a trust must be determined in accordance with the laws of the *situs* of the trust, thus conferring exclusive jurisdiction on the home courts. Those home courts however are obliged to take into account not just the laws of the State in question, but also any supra-national laws, such as international conventions to which a state may be a party. In the member states of the European Union (the EU), the law of the EU must prevail over national law in instances of inconsistency. Restated, state law must be interpreted in such a way as to ensure that it does not conflict with supra-national laws.

While Nevis is not a party to any international human rights treaty, Cyprus has ratified the European Convention on Human Rights (ECHR) (1950). Human rights in Cyprus are protected through the Constitution (which was amended in 2006 to give precedence to EU Law) and various International Conventions. Pursuant to the 5th Amendment of the Cyprus Constitution, EU Law and

International Conventions, to which Cyprus is a party, have superior force to national law. The relevance of this is that individuals can rely on their human rights and protections deriving from international law to protect themselves from encroachments on those rights and freedoms by the State. Where an individual raises a valid claim based on an internationally protected right, the Court is obliged to protect that right. Therefore, if any national law threatens such a protected right, it must either be declared invalid or construed in such a way so as to avoid any encroachment upon that right.

The use of trusts to protect property that has been taken from someone else gives rise to a human rights question. While commentators may argue about the hierarchy of human rights and the status of the right to property within that hierarchy, the fact remains that the right is guaranteed in varying forms in a variety of international and regional human rights instruments.[1] If a vested property right exists in property – and if such a right is itself protected under an international human rights treaty, how can a domestic asset protection statute be employed in such a way so as to undermine that right? Admittedly, in the majority of cases where property is placed into trust, that transfer takes place to protect the property rights of the Settlor and thus avoids a scenario in which one can claim an infringement of that right. What is the position however where that property is one in which another also has a protected right? Can a transfer into a trust simply deprive that right of any meaning? The writer contends that the answer must be a clear 'no'. Take for example the case of a wife whose husband has established a trust for the benefit of the couple's children. The wife is not named personally as a beneficiary; and thereafter the couple separate. That trust has been settled with marital property. Depending on which system of law applies, either the wife is entitled to (a) an equitable distribution on dissolution of the marriage, or (b) a defined percentage share of assets acquired during the course of the marriage. Either way, the trust has been settled with property in which the wife has an interest. The nature of that interest is all important, as not all rights to property are protected by international covenants guaranteeing the right to private property as a fundamental human right.

Let us return to the case of Cyprus. As noted, it is a party to the ECHR. Article 1 of Protocol No. 1 of the Convention protects the human right to peaceful enjoyment of possessions. This has been interpreted as protecting vested rights to property. The Permanent Court of International Justice accepts the broad definition used in public international law in which "possessions" are equated with "vested rights":

> *"The Court, though not failing to recognise the change that had come over Mr Chinn's financial position [...] is unable to see in his original position – which was characterised by the possession of customers and the possibility of making a profit – anything in the nature of a genuine vested right".*[2]

The European Court of Human Rights also subscribes to this view, declaring in the case of *Marckx v Belgium:*

> *"the right of everyone to the peaceful enjoyment of his possessions [...] applies only to a person's existing possessions."*[3]

This is why the Court refused, in this case, to guarantee Alexandra Marckx's right to acquire possessions on the basis of a prospective intestacy, since nothing had, in practice, been passed on. It did, however, consider that property already acquired by inheritance constituted possessions.

Marital property is recognised as a vested right and as such enjoys protection under the ECHR. Marital property rights are governed by the time and laws of the place of acquisition. Thus, the laws of the place of marriage in force at the time of marriage will govern how property acquired during a marriage, and indeed other property of the spouses, will be divided upon dissolution. In our example let us say that the wife is entitled to a 50% share of assets acquired during the marriage. Thus any transfer of part of (and by definition all of) that property into a trust that deprives the wife of her right runs afoul of the protection afforded by Article 1 of Protocol No. 1 of the ECHR.

To use the protection offered by Article 1 of Protocol No. 1, an aggrieved spouse must show that her right to use or dispose of her property has been interfered with. Interference triggering a right to relief under Article 1 of Protocol No. 1 is usually the direct consequence of action taken by a public body (such as where an executive authority expropriates land to build a public road in exchange for compensation to the owner thereof). It may also arise from a court decision or from legislation. Article 1 however may still apply, even if the public body was not directly responsible for the interference with the property, such as for example when a third party – a private individual or body corporate – provokes the interference. In our example the husband has provoked the interference by settling a Cypriot asset protection trust. However, the law that enables him to do that and to deprive the wife of a vested right is also potentially in breach, unless it can be interpreted in such a way as to avoid any interference with the vested property rights of the wife.

In the *Bramelid and Malmstrom* decision, the European Commission of Human Rights stated:

> *"The division of inherited property, especially agricultural, the division of matrimonial estates, and in particular the seizure and sale of property in the course of execution" are examples of rules which may compel a person to surrender a possession to another. "The Commission must nevertheless make sure that in determining the effects on property of legal relationships between individuals, the law does not create such inequality that one person could be arbitrarily and unjustifiably deprived of property in favour of another."*[4]

To apply legislation so as to diminish or destroy the dominion and control of the wife over her stake in community property deprives the wife of a vested right. Only the police power of a state can operate to impair vested rights – and then only when necessary for the public welfare, coupled with just compensation for a taking. In our example, the legislation of Cyprus potentially impairs the vested right of the wife.

Apart from the supra-national laws applicable, the right of property in Cyprus is guaranteed by Article 23 of the Constitution, paragraph 1 of which states:

> *"Every person alone or jointly with others has the right to acquire, possess, enjoy or dispose of any movable or immovable property and has the right to respect for such right. The right of the Republic to underground water, minerals and antiquities is reserved."*

The Supreme Constitutional Court in *Evlogimenos v. The Republic*[5] noted that:

> *"The right to property safeguarded by an Article such as this is not a right in abstracto but a right as defined and regulated by the law relating to civil law rights to property and the word "property" in paragraph 1 of Article 23 has to be understood and interpreted in this sense."*

What is interesting about the protection of property afforded by the Cypriot Constitution is that it provides that any deprivation or restriction or limitation of any such right shall only be made as provided in Article 23, the remainder of Article 23 only refers to deprivation for the public good in general terms, although there is an allowance for the protection of the rights of others in the midst of paragraph 3, to wit:

> *"Restrictions or limitations which are absolutely necessary in the interest of public safety or public health or the public morals or the town and country planning or the development and utilisation of any property to the*

promotion of the public benefit or for the protection of the rights of others may be imposed by law on the exercise of such right."

It is questionable whether these six words in the context in which they appear would be considered sufficient to justify the enabling of the creation of trusts that potentially deny the vested rights of others. In any event, as noted above, the Constitution gives precedence to EU Law, and must by definition itself be construed in such a way as to give effect to and not contradict the provisions of such supra-national law.

Although the author has not reviewed the majority of national Constitutions, it is fair to say that from a sample reviewed, the protection of property in some form or another is present in the majority. It is also fair to say that freedom from unlawful deprivation appears to be the lowest common denominator in terms of levels of protection offered. If we look to a sample of some regional human rights instruments it can be seen that there are varying degrees of protection.

Article 17 of the Universal Declaration of Human Rights provides that:

"(1) Everyone has the right to own property alone as well as in association with others.

(2) No one shall be deprived of his property."

Article 21 of the American Convention on Human Rights provides that:

"(1) Everyone has the right to the use and enjoyment of his property. The law may subordinate such use and enjoyment to the interest of society.

(2) No one shall be deprived of his property except upon payment of just compensation, for reasons of public utility or social interest, and in the cases and according to the forms established by law."

Article 14 of the African Charter on Human and Peoples' Rights provides that:

"The right to property shall be guaranteed. It may only be encroached upon in the interest of public need or in the general interest of the community and in accordance with the provisions of appropriate laws."

Again the lowest common denominator is the right not to be deprived of property unlawfully. Where there is deprivation it must serve some higher good and depending on the circumstances should be accompanied by just compensation. Returning to our example of the Cypriot trust settled with marital property, it can hardly be argued that such interference is somehow justified in the public or other overriding social interest. So how does one go about asserting a right to compensation if indeed there is a deprivation, or perhaps more aptly, how does one seek relief in respect of the wrong in question? As alluded to above, the term deprivation bears connotations of state action. While the legislation – promulgated by the State – enables the interference, it does not cause it as such. The author argues that in order for there to be an actionable interference (such that the wronged party could ultimately lodge a complaint with the European Court of Human Rights),[6] the vested right itself must actually be interfered with, by for example the settling of marital property into a trust in respect of which the wife is neither a beneficiary nor a protector. In the example of a Nevisian or Cypriot trust, that transfer cannot be set aside absent compliance with stringent requirements that do not envisage or include the vested right of the spouse as providing justification.

In the case of Cyprus, Article 1 of Protocol No. 1 of the ECHR is arguably applicable to the above fact scenario. The purpose of Article 1 was first referred to in the *Marckx* judgment, where the Court pointed out that in recognising that everyone has the right to the peaceful enjoyment of his possessions, Article 1 in substance guarantees the right to property.[7]

This dicta points to an important distinction between the content of the right enshrined in Article 1 of Protocol No. 1 and that enshrined in many national constitutions and other instruments – that is, the right to be free from arbitrary deprivation of property. Some might argue that this is a distinction without a difference. However, the case law of the European Court of Human Rights has highlighted the possibility of there being an interference with the right to peaceful enjoyment in circumstances where no deprivation has taken place.

The European Court of Human Rights has held in *Beyeler v. Italy*[8] that:

"Article 1 of Protocol No. 1 comprises three distinct rules: "the first rule, set out in the first sentence of the first paragraph, is of a general nature and enunciates the principle of the peaceful enjoyment of property; the second rule, contained in the second sentence of the first paragraph, covers deprivation of possessions and subjects it to certain conditions; the third rule, stated in the second paragraph, recognises that the Contracting States are entitled, amongst other things, to control the use of property in accordance with the general interest ... The three rules are not, however, 'distinct' in the sense of being unconnected. The second and third rules are concerned with particular instances of interference with the right to peaceful enjoyment of property and should therefore be construed in the light of the general principle enunciated in the first rule" (reproducing in part the analysis in *Sporrong and Lönnroth v. Sweden*).

In *Beyeler v Italy,* the European Court of Human Rights emphasised that the second sentence of Article 1 was only a particular instance of interference with the right guaranteed in the first sentence, again suggesting that the right to peaceful enjoyment encompasses more than simply a guarantee against unlawful deprivation.

In Nevis, the only arguable protection of property rights is to be found in the 1983 Constitution of St. Kitts and Nevis. That protection is expressed as the right not to be deprived of property without compensation. It is also clear from the specific article in question (it is mentioned in Article 3 as a fundamental freedom in the same sentence as protection for personal privacy and the privacy of the home and other property), that the deprivation in question refers to the compulsory taking of possession of, or the compulsory acquisition of, property. Thus, a "taking" involving an act of state is regulated. Unlike Cyprus, Nevis has not ratified any international or regional convention or instrument that otherwise guarantees the right to property. While the right to freedom from unlawful deprivation of property is arguably an international standard, it is not at all clear that a disgruntled ex-spouse whose rights in marital property have effectively been wiped out through the settlement of an international trust in Nevis would have any recourse under the Nevis Constitution.

There are of course other offshore locales where the available asset protection structures are similar if not for all intents and purposes practically identical to those on offer in Nevis and Cyprus. The protection of property provisions provided in the Cook Islands, is referred to below by way of example. However, Nevis and Cyprus have been singled out to highlight the potentially wide reaching and divergent impacts that human rights might have in respect of questions of the infringement of vested property rights. In one jurisdiction, Cyprus, a supra-national body of law, (and arguably its own Constitution), has the potential – the author argues – to declare unlawful the settlement of assets

into a trust in exactly the same set of circumstances that in the other jurisdiction, in Nevis (in the absence of recognition of a similarly protected right to property), gives rise to no repercussions.[9]

The Cook Islands protects the right of the individual to own property and the right not to be deprived thereof except in accordance with law in Article 64 of its Constitution. The Cook Islands has not ratified seven of the nine core human rights treaties. Prior to 1988, the International Covenant on Civil and Political Rights and its first Optional Protocol, the International Covenant on Economic, Social and Cultural Rights and the Convention on the Elimination of All Forms of Racial Discrimination were extended to the Cook Islands by New Zealand treaty action. A right to property is not recognised in any of these instruments. The Cook Islands is seen as, and promotes itself as, a world leader in the formation of asset protection trusts. Cook Islands courts will not recognise or give effect to certain judgments of foreign courts in relation to international trusts. In order to bring a claim for fraudulent transfer, the claim must be instituted in the Cook Islands within one year (at most two) and proven beyond a reasonable doubt – the criminal standard. One might say that a Nevis or Cook Islands trust offers extra protection by virtue of their shameful record in ratifying international human rights instruments, or recognising their standards. In contrast, any trust domiciled in a jurisdiction that is a party to the European Convention on Human Rights, (and in particular Article 1 of Protocol No. 1 thereof) is arguably open to attack on the grounds identified above.

The European Convention on Human Rights and its Protocols form a living instrument, capable of interpretation to meet the requirements of the time. At a time when offshore asset protection structures are receiving bad press and offshore locales are coming under increased scrutiny, there is surely room for the development of a body of jurisprudence that recognises the potential for widely recognised human rights to trump the cards played by those who seek to undermine vested rights by availing of questionable legislative measures such as those discussed above. Certainly legislation that does not provide an avenue for challenging an action that divests a person of vested property rights, or only provides an avenue in limited circumstances and subject to an unreasonably short limitation period, must be seen as falling afoul of the Article 1, Protocol 1 protections. In *Thomas v. Bridgend County Borough Council*, claimants seeking compensation for the noise and nuisance arising from a newly built road successfully argued that a three year limitation on bringing their claim under section 19(3) of the Compensation Act 1973 operated unfairly and in breach of the Protocol.[10]

This article has focused on the example of the divested ex-spouse. However, the argument raised is equally applicable in respect of any scenario where a vested property right is infringed. An example of this is where an agent misappropriates a principal's funds in breach of trust and seeks to 'protect' them by use of a Cypriot trust. How can Cyprus's trust law be used to defeat a proprietary tracing claim into the trust's assets in the light of the ECHR? While a contingent claim is not a protected property right, the term 'right to property' or 'possessions' in Article 1 of Protocol No. 1, as translated from the broader French terms of 'biens' or 'propriété', has been applied to a wide range of economic interests, including the protection of contractual rights.[11] In *Slivenko v. Latvia* the ECHR stated that: "[p]ossessions" can be "existing possessions" or assets, including claims by virtue of which the applicant can argue that he or she has at least a "legitimate expectation" of acquiring effective enjoyment of a property right."[12] However, where a claim is subject to some condition precedent that has not been fulfilled, then protection will not be afforded under Article 1 of Protocol No. 1. It follows that proprietary claims are protectable property rights under Article 1 of Protocol No. 1, in any case where property is misappropriated and transferred to a trust within a jurisdiction party to the ECHR.[13]

END NOTES:

1. *See for example Article 17 of the Universal Declaration of Human Rights; Article 21 of the American Convention on Human Rights; and Article 14 of the African Charter on Human and Peoples' Rights .*
2. *See the Oscar Chinn Case, PCIJ, 12 December 1934, Series A/B No. 63, p. 88.*
3. *See Marckx v Belgium, European Court of Human Rights, 3 June 1979, App. no. 6833/74 ECHR 2 (Marckx judgment), para. 50.*
4. *European Commission of Human Rights, decision of 12 October 1982, Bramelid and Malmstrom v. Sweden, Nos. 8588/79 and 8589/79, DR 29, p. 64.*
5. *2 RSCC p. 142.*
6. *The wronged party must first have exhausted all remedies in the national courts of the State where the alleged violation has taken place. In our example, the ex-spouse would be obliged to apply to the domestic court seeking for example declaratory and other appropriate relief implicating infringement of the rights protected under Article 1, Protocol 1.*
7. *European Court of Human Rights, 3 June 1979, App. no. 6833/74 ECHR 2 para. 63.*
8. *European Court of Human Rights, 5th January 2000, App. no 33202/96, ECHR 2000-I 57.*
9. *Although Nevis presents a real challenge to creditors and proprietary claim claimants, it does seem that if a settlor does not own the beneficial title to an asset which he gifts to a trustee, the true beneficial owner thereof may still pursue a challenge against the trustee on property title bases.*
10. *Thomas and others v. Bridgend County Borough Council [2011] W.L.R (D) 254. While this case revolved around the operation of a provision designed to provide for compensation to property owners for depreciation of value as a result of noise and other nuisance arising from a newly built road, the principles addressed can arguably be applied to other legislation touching on property interests. Thus in our example one could argue that what we might call the balancing provisions in the Cypriot trust legislation – those enabling challenge of a transfer to a trust – have the effect of excluding a class of potential claimants. In Thomas and others v. Bridgend County Borough Council the claimants submitted that use of the road had interfered with the peaceful enjoyment of their homes, and that the provisions designed by Parliament for their protection, and necessary to achieve the fair balance which article 1 of the First Protocol required, failed to do so because they could be defeated by the unilateral action (or inaction) of those responsible for payment. Carnwath LJ noted that the operation of section 19(3) in circumstances such as the present was truly bizarre. The diligent road-builder who completed his project on time was penalised by liability for compensation; the inefficient road-builder was rewarded by evading liability altogether. He pointed out that Member States had a significant margin of discretion in deciding how to give effect to the rights safeguarded by Article 1, and in setting the boundaries of any mitigation measures. However, that worked both ways. In deciding whether the proportionality test was satisfied, the court was entitled to treat the compensation rights created by the 1973 Act as part of the "fair balance" thought necessary by Parliament. Where a class of potential claimants was excluded from those rights, the court was entitled to inquire into the reasons for the exclusion, and ask whether it served any legitimate purpose, or led to results "so anomalous as to render the legislation unacceptable" quoting J A Pye (Oxford) Ltd v United Kingdom (2007) 46 EHRR 1083, para 83.*
11. *See Association of General Practitioners v Denmark (1989) 62 DR 226 and Gasus Dosier und Fordertechnik GmbH v The Netherlands (1995) 20 EHRR 403.*
12. *European Court of Human Rights, App no. 48321/99 (GC) ECHR 2002-II, para. 121.*
13. *Protocol 1 has been ratified by every member of the Council of Europe except Monaco and Switzerland.*