

Sham Trusts and Illegality Defence: Singapore High Court Clarifies Test for Illegality in Context of Trusts

In *Lau Sheng Jan Alistair v Lau Cheok Joo Richard and Sng Gek Hong Cynthia* [2023] SGHC 196, the sole beneficiary of an irrevocable trust sought to terminate the trust via the rule in *Saunders v Vautier* (1841) 4 Beav 115 (**Saunders v Vautier**) and have the trust property, a semi-detached landed property (**Property**), transferred to him from the trustees, who were his parents. His application was supported by his mother, the second respondent, but opposed by his father, the first respondent. The first respondent alleged that the trust was a sham instrument used by the respondents to avoid payment of Additional Buyers' Stamp Duty (**ABSD**). Finding in favour of the applicant and second respondent, the General Division of the High Court of Singapore (**High Court**) declined to follow the formal reliance test and clarified the legal test for the doctrine of illegality in the context of trusts.

Our Chan Yu Xin and Andrea Ang successfully represented the second respondent who, together with the applicant, stood in opposition to the first respondent before the High Court.

Our Comments

The High Court's decision is notable as it clarifies that the test for illegality in the context of trusts is a modified version of the test established by the Court of Appeal in *Ochroid Trading Ltd and another v Chua Siok Lui (trading as VIE Import & Export) and another* [2018] 1 SLR 363 (**Ochroid test**). The *Ochroid test* establishes the application of the illegality defence in the contractual context, as well as the principles governing restitution of benefits conferred under the impugned contract. However, it was not binding on the High Court because the Court of Appeal had expressly reserved its position on the applicability of the reliance principle for claims in torts or trusts. In this case, the High Court considered the *Ochroid test* strongly persuasive and took the view that the same framework, with some modifications, should apply in the context of trusts.

Background

The applicant was a 26-year-old Singaporean and the elder son of the respondents. The respondents also had a daughter who was not involved in the proceedings.

In July 2020, the respondents sought to purchase the Property and engaged an experienced and senior solicitor (**Solicitor**) to draft and execute a trust instrument (**Trust Deed**) under which the respondents, as trustees, would hold the Property or alternatively, the net proceeds from its sale, on trust for the applicant's sole benefit until he reached the age of 40. It was not disputed that the parties had received legal advice on the conveyancing process and the Trust Deed from the Solicitor.

The purchase of the Property was funded by the respondents through various loans which they eventually repaid through the sale of other properties and liquidation of some of their personal assets. Upon completion of the purchase of the Property, the family moved in and it became their sole place of residence. Shortly after the purchase of the Property, the respondents considered having the applicant sign a loan agreement, the stated purpose of which was to protect the capital sum of \$4.925 million which the respondents had used to purchase the Property (**Loan Agreement**). While the parties disputed whether the Loan Agreement was eventually signed, with the applicant and second respondent denying that it was, the parties agreed

that the purpose of the Loan Agreement was to protect the applicant from any future matrimonial claims from his future spouse and the capital sum of \$4.925 million.

In late 2021, the respondents' marital relationship broke down and the second respondent commenced divorce proceedings. The first respondent moved out of the Property while the second respondent, the applicant, and his sister continued living in the Property. In light of the ongoing divorce proceedings, the applicant brought the present application, stating that his intention was to prevent any more disputes between the respondents over the Property, and to ensure that the second respondent and his sister would still have a place to stay after the respondents' divorce proceedings were finalised.

In bringing the present application, the applicant relied on the rule in *Saunders v Vautier*, which stands for the principle that:

...the beneficiaries of a trust, if together entitled to the whole beneficial interest, can if sui juris put an end to the trust and direct the trustees to hand over the trust property as they direct ...

The parties' arguments

The first respondent argued that the Trust Deed was a sham and not meant by the respondents to truly benefit the applicant. Rather, he alleged that the purpose of the trust was for the parties to acquire the Property while avoiding payment of a hefty amount of ABSD which the respondents could not afford. According to him, the respondents were in a hurry to purchase the Property, which was priced attractively, and felt that the Trust Deed would buy them time to dispose of their other properties while avoiding ABSD. Hence, given that the Trust Deed was a sham created for an illegal purpose and therefore unenforceable, the court should not allow the applicant to rely on the rule in *Saunders v Vautier*.

In response, the applicant argued that: (a) the trust was not entered into for any illegal purpose of avoiding ABSD; (b) even if the court were to find that the trust was entered into for that illegal purpose, he did not need to rely on the illegality to terminate the trust; and (c) he had fulfilled the requirements of the rule in *Saunders v Vautier* and was entitled to terminate the trust and have the Property vest in him immediately.

The second respondent argued that the trust was not a sham and that the Trust Deed was entered into for *bona fide* purposes. She gave evidence that the respondents were already in their 50s and that the first respondent was retired when they acquired the Property. At that stage in their lives, they wanted to provide both their children with legacy properties while they were still alive. That the arrangement had the added benefit of allowing the family to move into a larger property while saving on ABSD was an incidental benefit which did not detract from the respondents' intention to gift the applicant, who was their elder child and only son, the Property. It was further not disputed that the Solicitor had advised the respondents that the Trust Deed could be "collapsed" before the applicant reached the age of 40, although each of the respondents interpreted the Solicitor's advice differently. The first respondent alleged that the Solicitor meant the respondents could collapse the trust after the seller's stamp duty period, while the second respondent understood the Solicitor to have meant the applicant could collapse the trust once he reached the age of majority (i.e., *via* the rule in *Saunders v Vautier*). In support of her position, the second respondent produced a meeting attendance note from the Solicitor showing that she had advised the respondents that it was the applicant who could collapse the Trust Deed before the age of 40. In addition, the Loan Agreement

prepared by the first respondent showed that the protection the respondents sought was for the capital sum of \$4.925 million, while the beneficial interest in the Property was to remain with the applicant.

The High Court's Decision

The High Court called for cross-examination of the parties in light of the significant factual disputes in the matter. After considering the evidence, the High Court found in favour of the applicant and the second respondent. The High Court found that the trust was a *bona fide* instrument meant to benefit the applicant, and not a tool for the respondents to avoid payment of ABSD.

The High Court further found that the applicant had satisfied the legal requirements of the rule in *Saunders v Vautier*, in that the applicant:

- (a) Was an adult of full age, being 26 years old;
- (b) Did not suffer from any mental disability, as proven by a psychiatrist's report he had obtained; and
- (c) Being the sole beneficiary, was absolutely entitled to the Property under the trust.

Given that the applicant had established a *prima facie* case for the termination of the trust pursuant to the rule in *Saunders v Vautier*, the High Court declared that the trust was to be terminated and that the Property was to be transferred from the respondents to the applicant.

Trust deed was not a sham instrument

In respect of the first respondent's argument that the trust deed was a sham, the High Court observed that:

- (a) A trust deed is a sham where it was never intended by the settlors to create an arrangement to divest themselves of the aspects of beneficial ownership in the manner that is provided for in the trust, while intending to give that false impression to third parties or to the court. The crux of a sham trust is a common intention to mislead, with the relevant common intention generally being that of the settlor and the trustee. In ascertaining this intention, a subjective test is used because the very purpose of a sham transaction is to mislead third parties.
- (b) In applying the subjective test to determine whether a trust deed in question is a sham:
 - (i) The person alleging that a document is a sham has the burden of proving that the parties intended the document to be a pretence; and
 - (ii) There is a very strong presumption that the parties intend to be bound by the provisions of the agreements they entered into.

Upon a holistic analysis of the evidence adduced, the High Court held that the respondents genuinely intended to benefit the applicant. It was eminently reasonable for them to undertake succession planning at this stage of their lives where they were in their mid-50s and financially stable. There was also no evidence to suggest that the respondents could not afford the ABSD and had to resort to using a sham document to evade it. This was supported by the fact that the respondents had various assets ranging from immovable properties to liquid assets.

Crucially, the High Court acknowledged that the respondents received legal advice on the effect of the Trust Deed and had been properly advised by an experienced and competent conveyancing lawyer. The first respondent's allegations that they had received erroneous advice was not corroborated by the objective evidence in the form of an attendance note penned by the conveyancing lawyer confirming the respondents' understanding of the legal advice received.

The High Court also noted that the respondents' contemporaneous conduct evinced a clear understanding of the effect of the Trust Deed insofar as it was meant to benefit the applicant. This was elucidated through a draft loan agreement prepared by the first respondent, which was premised on the applicant holding the beneficial interest in the Property. The High Court found that the first respondent's claim that the Loan Agreement was intended to protect the respondents for the four-year seller's stamp duty period before they could "buy back" the Property, was not credible given that the applicant was only aged 24 at the time of the Property's purchase; it was not believable that the first respondent thought the applicant could marry and divorce in following four years.

Overall, the High Court concluded that the fact that the trust arrangement additionally allowed the respondents to save on ABSD was an "incidental benefit" that did not detract from their overall intention to gift their elder child and only son a legacy property while they were still living.

Trust was not unenforceable for illegality

The High Court next considered whether the trust was unenforceable because it was constituted for an illegal purpose. The High Court held that it was not.

In reaching this conclusion, the court took the opportunity to set out the principles of the modified *Ochroid* test which apply where the illegality defence is raised against a claim to enforce a trust, as follows:

- (a) First, the court should consider whether the trust in question is illegal in itself and therefore void and unenforceable. A trust is illegal in itself when it is expressly or impliedly prohibited by statute or falls within an established category of situations that renders it void and unenforceable. Examples of such trusts would include trusts which are adverse to religion or morality and succession law.
- (b) Second, if the trust is not illegal in itself, the court should then consider whether the trust was created for an illegal purpose, or arose as an incidental consequence of the illegal purpose. If so, the proportionality analysis applies to determine a proportionate response to the illegality, and the factors to be considered include: (i) whether allowing the claim would undermine the purpose of the prohibiting rule; (ii) the nature and gravity of the illegality; (iii) the remoteness or centrality of the illegality to the trust; (iv) the object, intent, and conduct of the parties; and (v) the consequences of denying the claim.
- (c) Third, if the court decides that the trust was created for an illegal purpose and should not be enforceable, the court may consider whether the party seeking to enforce the trust can nonetheless establish an alternative basis for enforcing a proprietary interest by the operation of trusts law (such as by a resulting trust if his claim to enforce an express trust fails because the express trust is found to be unenforceable). In considering this, the court should apply the principle of stultification to determine whether, in allowing the claim, the fundamental policy that prohibited the trust in the first place would be undermined.

The High Court also considered, but declined to apply, the formal reliance principle in *Tinsley v Milligan* [1994] 1 AC 340, which states that a plaintiff who asserts a claim founded on an illegality will be refused the court's assistance if he must rely on the illegality to maintain his claim and, for that purpose, to "rely" on the illegality means that the plaintiff must plead the facts of the illegality. The High Court noted that the formal reliance principle has been the subject of strong judicial disapproval, both in the United Kingdom and in Australia. The Law Commission of England and Wales, after comprehensively reviewing the law of illegality in 1999, concluded that the formal reliance principle is "*far from easy to apply*" and its rationale difficult to locate. The High Court agreed that the application of the formal reliance principle could give rise to artificiality and possible arbitrariness as there seemed to be no justifiable reason why, if a trust is affected by illegality, an application should turn on whether the applicant needed to formally rely on the illegality in question.

Therefore, the High Court found that the use of the modified *Ochroid* test was preferred. Applying the framework set out above, the High Court found on the evidence before the court that the trust was not created for an illegal purpose (i.e., to avoid ABSD):

- (a) First, the Trust Deed was not illegal in and of itself. There is no express prohibition, statutorily or otherwise, of trusts created to avoid ABSD obligations.
- (b) Second, the trust was also not created for illegal purposes, as evinced by the High Court's findings of fact that the Trust Deed was not a sham.

In the circumstances, given that the Trust Deed was valid and the applicant had satisfied the rule in *Saunders v Vautier*, the High Court granted a declaration for the trust to be terminated and for the respondents to transfer the Property to the applicant.

If you would like information and/or assistance on the above or any other area of law, you may wish to contact the Partner at WongPartnership whom you normally work with or the following Partner:



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