Trusts

February 2014

Introduction

The trust is an English concept and has been in existence for many centuries.

The early objects of trust were intended to regulate the succession of family wealth. This was achieved by the holding of assets by trusted and secured friends or other parties to protect the assets against spendthrift children or confiscation by third parties. They were used extensively at the time of Crusades by departing knights who placed the management of their English estates in the hands of trusted friends whilst they were away fighting in other parts of the world.

More recently, over the last 50 years or so, the concept of trust has been extended to include commercial transactions and is extensively used as a valuable instrument in international tax planning.

Whilst the concept of trust is essentially an Anglo-Saxon device, many western countries (with different legal codes, such as Napoleonic, Roman Dutch or Greek based legislation) have now formally recognised the trust instrument by way of an international agreement called the Hague convention.

Today the trust is used to deal with a wide range of international financial and legal problems.

1. The concept of trust in simple terms

The various types of trust vary in complexity, but they have one common fundamental feature. A "person" being either an individual or a company ("the trustee") agrees to hold certain assets ("the trust fund") in its name for the benefit of another person ("the beneficiary") on certain terms and with certain powers (which are usually set out in the trust Deed). The assets comprising the trust fund are legally held and registered as owned by the trustee and the trustee is under a duty, enforceable in the Courts, to hold those assets and the income arising from them for the benefit of the beneficiary(ies).

The above relationship can be summarised as follows: The trustee has legal title to the trust assets and the beneficiary has beneficial or equitable title (it is the beneficial title which is of value when one is considering asset ownership).

2. Elements of Trust

2.1 Settlor

This is the (legal or natural) person who establishes the trust by way of gift of property to be held by the trustee in accordance with the settlor's intentions.

2.2 Trust capital

The initial trust capital consists of property via receipt of gift (discretionary/fixed trust) or property held as per will (deceased estate).

2.3 Trustees

This is in effect the legal representative of the trust and administers the trust in accordance with the terms of the trust deed. The trustee could be a corporate entity or a natural person.

2.3.1 Corporate vs. individual trustee

The choice of a trustee is important and there are advantages and disadvantages for choosing one or another type of trustee.

The advantages for choosing a corporate trustee are:

- Potential immortality, as compared to individuals.
- A company may be the sole trustee, but the responsibility can be shared by a number of people via its directors.
- In case where there is an inability to satisfy trust creditors via the normal indemnity from the trust assets the corporate trustee has the advantage of limited liability.

The disadvantages are:

- Cost of establishing and administration of a company.
- The necessity to comply with the companies' legislation and filing/reporting obligations.

2.4 Objects

Beneficiaries

These are the persons benefiting from the creation of the Trust. For practical reasons they are construed as the beneficial owners of the trust fund to the degree and extent defined in the Trust Deed. They may be defined by name or by reference to a class of people (e.g. the settlor's children etc.).

Or

Purposes

Many Trusts do not have a Beneficiary, human or otherwise, at all. A Trust can instead be established to provide for payments towards the achievement of a purpose.

2.5 Protectors or Appointers or guardians

This is a person(s) (other than the Trustee) to whom powers are granted by the Trust Deed including powers to oversee and advise a Trustee in exercising hid powers or, if so required, to restrict key powers of a Trustee (by exercising a veto right) (such as add beneficiaries, etc.) so that they can only be exercised with the consent of a suitable person and includes the right of adding or removing a Trustee.

Care is required to examine (along with other things) the applicable regime in the country of residence of the Protector, not to restrict the powers of the Trustees in a manner that would allow for the protector to be construed as acting in a co-trustee capacity.

2.6 Enforcer (applicable in relation to non-charitable purpose trusts)

The Enforcer is the person with the statutory power to enforce the terms of a non-charitable purpose trust against the trustees.

3. Powers of Trustees

The powers of the trustee depend on the terms and provisions of the trust deed. If the deed is silent on a particular matter, then the applicable legislation will prevail. Therefore, it is necessary to ensure that the trustee has all the relevant power necessary to carry out the expected tasks and that the provisions of the Deed reflect the wishes of the settlor contributing his assets.

Some of the important powers are provided in the list below which is by no means exhaustive:

- to make capital distribution
- to borrow
- to guarantee
- to mortgage
- to employ
- to invest/lend money
- to be indemnified out of the assets of the trust
- to carry on business
- to make payments for and on behalf of the beneficiaries
- to advance money to other trusts for and on behalf of beneficiaries
- to amend the trust deed (either solely or otherwise)
- to accept “after acquired” property (e.g. gifts as part of the trust fund)

If the trustee is a company, it is important that the Memorandum of Association provides sufficient powers to enable the carrying out of the functions expected.

4. Type of Trusts

Today the trust concept is frequently used in a wide range of international financial and legal problems. The trusts could vary in form to satisfy the needs and objectives of the settlor thus the trusts although similar in the basic concept (i.e. the trustee holding assets for the benefit of the beneficiary/ies) could vary in the way they are structured and operated.

The following are some of the types of most commonly used trusts:

4.1 Protective Trusts

The purpose of protective trusts is to “protect” the beneficial interest of someone who is not able to manage his own affairs.

The beneficiary of a protective trust is given a life interest which may become discretionary on certain defined events, such as the bankruptcy of the beneficiary.

4.2 Discretionary Trusts

A discretionary trust is one created by way of a gift of property. The income and capital of the trust is held for the beneficiaries elected by the trustee at its discretion from a category of potential beneficiaries named in the trust deed. No one beneficiary has an indefeasible interest in either the trust capital or income before to the trustees’ determination. The most important features of a discretionary trust are the flexibility combined with the ability of the trustees to change the terms and objects of the trust by supplementary deeds or amendments to the memorandum of wishes when the circumstances of the individual beneficiaries change or when new trust property is introduced to the trust and existing trust property is paid away to the beneficiaries. A discretionary trust can be changed at any time as required and specified from time to time, in the relevant Deed.

4.3 Fixed Trusts

A fixed trust is one also created by way of gift of property, however the beneficiaries have certain specific entitlements in accordance with the trust deed. The intention of the settlers is to safeguard the interest of a person, or persons and the settlor specifically directs the trustee for the distribution of income and capital to a particular person(s).

4.4 Trading Trusts

Under a trading trust the trustee is usually a limited liability company which has power to carry on business and the trust has trading functions and employs staff to manage its business. Third parties may not be aware of the existence of the trust as all documentation used is in the name of the trustee company.

4.5 Charitable Trusts

Charitable Trusts are trusts established for purposes that would qualify as charitable as per the applicable laws of the jurisdiction of establishment of such trust.

4.6 Non-Charitable Purpose Trusts

A Purpose Trust is a Trust created to provide payments towards the achievement of particular purpose(s) with no ascertainable beneficiaries or class of beneficiaries (humans or otherwise).

5.0 Practical applications of trusts

5.1 Asset Protection – Mitigating Professional Liability

Wealthy and professional people are the targets of many lawsuits by creditors. Their assets could be protected by transferring them to a well-structured trust.

5.2 Exchange Control

Many trust jurisdictions provide for flexibility of the trust to move from one location to another. Thus, a trust could relocate from a jurisdiction that is no longer favourable for exchange control purposes (or other matters) to a more favourable jurisdiction.

5.3 Inheritance

The trust provides a tool for bequeathing assets to individuals who otherwise would have deprived themselves of the assets because of irresponsibility, incapacity or other reasons.

5.4 Estate Duty Planning

When an individual wants to retire in another country it is quite possible that in his new country of domicile his assets may be subject to heavy estate duty. This can be avoided by creating a trust to hold the assets in the original country of domicile.

5.5 Confidentiality

Trusts are used to provide confidentiality/anonymity of the owners of the assets. Shares and other investments can be held in trust for other people thus providing anonymity and at the same time the beneficial owner can exercise a degree of control over the trust property.

5.6 Tax Planning

Trusts are widely used for tax planning purposes. The main purpose is to retain profits in another country by accumulating profits in the trust. Also, in case of distribution of profit to the beneficiaries a discretionary trust will provide the option for the most tax advantageous distribution of profit.

Some countries tax their residents on their worldwide income. The trust will enable the resident to retain and accumulate overseas profits in a trust created in a more favourable trust jurisdiction.

5.7 Charitable Bequests

The donor of assets to a charitable institution can ensure that the donation is used for the purpose intended by creating a charitable trust and appoint the right people to administer such a trust.

5.8 Avoid Family Problems

The trust can be used to hold property (usually land) which is beneficially owned by several people but there is no divisible title thus avoiding possible problems and conflicts between the beneficial owners such as which part of the land belongs to each beneficiary.

5.9 Substitution of a Will

A trust is in effect a substitution of a will. Assets held in the trust will be administered properly rather than assets not settled. The trust is particularly important in case of sudden death.

5.10 Other Uses of Trusts

The uses of trust can be endless and it can be structured to benefit many individuals.

Some other examples are:

- Establishment and maintenance of provident and pension funds
- Cross border marriages involving the assets of foreign-born spouses especially in case where Muslim law is involved
- Settling the costs of education in other foreign countries
- Trading trust can be used to hold income producing assets (e.g. patents) to enable the most tax advantageous distribution of profit to the beneficiaries
- To benefit disabled or mentally handicapped people by making them beneficiaries but keeping or passing over the control to a suitable person.

NOTES:

The above is intended to provide a brief guide only. It is essential that appropriate professional advice is obtained. Our company will be glad to assist you in this respect. Please do not hesitate to contact us.