

Controlling your assets through a trust structure – Options to “have your cake and eat it too”!

Originating in England as early as the Middle Ages, trusts are a popular form of legal structure for succession planning, tax planning, and protection against external business and family threats. But as trusts develop into non-traditional markets and to unique uses, the issue of how a client can keep some hand in controlling their assets after passing their legal title to a trustee remains a prevalent issue.



Why is control such an issue?

The early trusts (prior to, say, the birth of the trust industry in the mid-1970's) were largely fixed interests – akin to the beneficial interests in a Will whereby a Settlor (person who sets up the trust) transferred his assets on irrevocable terms to a trustee and then simply step away from the control of the assets, except for providing the trustee with a non-binding letter of wishes - a letter which set out how the Settlor would like the trustee to invest the assets and, to the extent there were discretionary decisions to make, distribute the assets the beneficiaries. These trusts were best used for succession planning of assets to one's heirs.

The modern trust, however, is a complex collection of discretionary beneficial interests which requires a Settlor to transfer the legal ownership of his asset to a trustee in exchange for a mere discretionary beneficial rights – that is, that the trustee may

consider the beneficiaries (which may include the Settlor) for distributions without an absolute right to it. Add to that the trustee is likely to be a professional trustee company that the Settlor has no prior dealings with, in a foreign country, it is no wonder then that those unsure of trusts focus on the absence of control once they transfer their assets to a trustee.

Compare this to the Settlor establishing a company instead – whereby although he has transferred legal title of his asset to a newly set up company, he can be on the board of directors but also be the shareholder – thus retaining significant control and indirect ownership of the asset.

The emergence of 'control'

Since the 1980's, and particularly the birth of the 'offshore trust industry' the early form of trust has undergone radical change. Driven primarily by tax planning and creditor/litigation risk, client's favour establishing trusts during their lifetime but retaining control of the trust assets: in essence,

transfer legal ownership of the asset in order to take advantage of tax and creditor laws, but retain legal control of the asset.

The ability to permit the Settlor to retain control over certain aspects of the trust is also important for the trustee. There is a considerable body of case law on the strict obligations a court imposes on a trustee to invest the trust fund prudently and in the best interests of the beneficiaries. It is therefore to the trustee's benefit that they take decisions whether the consent of, or direction from, their Settlor.

Indeed, this issue is so important in current trust business, that it is fair to say that mechanisms to let a Settlor 'have their cake and eat it too' have become a feature of the modern trust.

What controls can the modern trust contain

The offshore trust industry has gone to great lengths to ensure control of various key features of a trust may be retained by a

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Settlor. The following are the most common types of controls. They fall into two broad headings; (i) those reserved under statute (by law) and (ii) those contained in the trust deed.

Controls reserved by statute	Controls agreed in the trust deed
<p><i>Power of Investment</i></p> <p>The Settlor can direct the trustee how to invest the trust fund, including whether to buy or sell any asset in the Trust.</p> <p>It should be noted that this reserved power of investment is available in most trust jurisdictions but many, such as Jersey, Cayman Islands and Bahamas also have much wider powers that may be reserved to a Settlor.</p>	<p><i>Consent</i></p> <p>All trustee powers can be <i>by consent</i> (eg: the Trustee must obtain the consent of a named person(s), including the Settlor before taking an action.</p> <p>Trustee powers which can be subject to consent include:</p> <ul style="list-style-type: none"> • Investment of the Trust Fund; • Distribution of Trust assets to beneficiaries; • Right to appoint (hire and fire) the Trustee; • Right to change the law governing the Trust <p><i>Revocable Trust</i></p> <p>The Settlor can establish the trust as revocable or irrevocable. If it is revocable, then if he does not want to continue with the Trust he can simply send the trustee a letter terminating (revoking) the Trust immediately.</p> <p><i>Private Trust Company</i></p> <p>For certain clients, often those with considerable wealth or family businesses held in trust, it is not enough to simply use an independent trust company as a trustee – they prefer to set their own trust company. This was a very expensive proposition in most trust jurisdictions because of the cost of a trust licence. The answer lay in permitting a private company to act as a trustee of a trust for a particular Settlor – called a Private Trust Company.</p>

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The effect of these controls is that the Settlor has enormous power to restrict the ability of the trustee to act without his direction or without his consent if he wishes. This gives the Settlor considerable peace of mind.

The problem of too much control

Discretionary trusts are effective to preserve and protect. They work effectively for two main reasons: like a company, assets are transferred out of an individual's name thus creating distance, or remoteness – in this way they can be held on the Settlor's behalf for asset preservation (succession planning) or asset protection – remoteness from creditors and other threats.

However, the Settlor undermines this remoteness if he assumes, or reserves on himself, too much control. There are plenty of examples of this in practice: take, for example, a Settlor interested in tax planning. If he reserves decision making powers the 'centre of control and management' of the trust may well be considered to be where he is resident, often completely negating the tax planning benefit. In the case of creditor protection, if the Settlor has powers of distribution, cases have held that if the Settlor were to be adjudicated bankrupt, that power of distribution is assignable to the

Official Assignee in Bankruptcy, thus opening the Trust up to access to the creditor.

In the case of a divorce, if the Settlor has controls, indeed, even if he is a beneficiary who regularly receives trust assets, those assets may well be seen as his or her resource, to be taken into account on divorce (despite legal title being vested in a trustee of a discretionary trust).

In practice – the right to appoint/remove the Trustee and the right to direct investments

In practice, often the most important control a Settlor can have is the right to appoint and remove the trustee. The commercial reality is that the professional trustee wants the Settlor's business and wants to ensure that they act in accordance with his wishes to retain him as their client. Although this often revolves around the right fee and level of service, this ultimate ability to replace the current trustee is a most important vanguard.

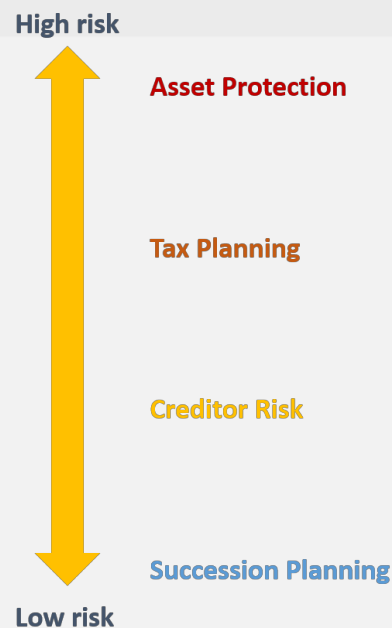
Many jurisdictions have wide powers of 'Settlor reserved Powers'. Jersey law, for example, permits almost every trustee power to be reserved in the Settlor. Other countries, like Hong Kong and Settlor, have settled on the power to direct the investment of the trust fund as the single most important Settlor control. As a

consequence, most discretionary trusts in Singapore and Hong Kong will have reserved the Settlor's right to direct investments.

Given the fragility of individuals (being subject to external and internal risk), it is preferable to control wealth rather than to own wealth.

Control in context

It is best to consider control with reference to the objectives that the Settlor wishes to derive from having the trust in the first place. Below are the most common reasons for establishing a trust.



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From this simple diagram, a Settlor can determine how much control he may retain in his structure. If he is simply wanting to ensure that assets preserved for future generations he can retain enormous controls.

However if he is desirous of protecting his assets from external risk, such as divorce, creditor risk, threats from confiscation of assets by the Government etc, he needs to take far more care to ensure remoteness.

Other control issues

Protection from the Fraud of the Trustee

It is a critical that the Settlor feels that giving his assets to a trustee is not a risk in itself. The professional trust industry is built on the solid foundations of rigorous licensing, strict industry standards and a law that holds the trustee to a high standard to safeguard trust assets.

In most ‘trust jurisdictions’, trust companies are licensed by the Government. In Singapore, for example, the Monetary Authority of Singapore regulates and supervises trust businesses. There is a constant communication with individual trust companies to ensure that they are well capitalised, insured and are meeting the highest standards of consumer protection.

It is for this reason that professional trust companies are

preferred to individual trustees, who are held to a lesser standard, are not covered by any licence regime and are not subject to oversight. It is generally inadvisable to use individual trustees.

There are very few cases indeed of outright fraud from regulated trust companies although it is important to consider the reputation and heritage of each trust company service provider. This may include reviewing the internal procedures for detecting and monitoring fraud – typically larger trust business will have ‘four eyes’ policies as well as checks and balances to ensure that procedures are followed.

Protection from the Liquidation or Bankruptcy of the Trustee

It is a basic rule of trusts that any assets being held in trust do not form part of the trustee’s personal assets. Therefore the trust fund will be unaffected by the trustee’s own financial position. If a corporate trustee was to be into liquidation or an individual trustee was to be declared bankrupt, the Court will ensure that the trust assets remain undisturbed and will assist to find a new trustee. Most likely, the trust deed will contain provisions for the Settlor or his proxy to remove/appoint trustees so he will probably exercise this power long before these termination events occur.

If any individual trustee were to become incapacitated, or

otherwise incapable of performing his functions as trustee, the trust will effectively be frozen until the issue is resolved – which may require a court application. Alternatively, if the individual trustee were to die, the trust assets will be subject to the probate of the individual, albeit not forming part of the trustee’s estate, and it is the role of the executor of that individual, who may not know the Settlor of the Trust, to appoint a new trustee.

Conclusion

The desire for those setting up trusts to “have their cake and eat it too”, that is, obtaining the preservation and protection advantages of trusts by being arms-length to their assets, but also controlling the asset and the trustee holding the asset has become the most pressing need for most clients in the trust industry. It had to be so, in order for the common law concept of Trust to be marketed in civil law countries not used to the trust concept.

It has been resolved over the last 20 years by unique laws, drafting practices and supported by case law such that the modern trust deed can invariably resolve the issue for a nervous Settlor by adopting one or more of the myriad of control techniques available.

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Talk to us

If you would like to find out more about Hawksford and our specialist services, please do not hesitate to contact us.

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Marcus is responsible for the overall management and development of the Private Client business in Asia for Hawksford. Marcus has extensive leadership and strategic management skills. Having worked at some of the top private client law firms in New Zealand, the BVI, Cayman Islands, Guernsey and Singapore, his broad experience gives him a unique perspective on the private client environment not only jurisdictionally but also to a high level of sophistication. He will drive intermediary and client relationships.

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Darren leads the management and growth of our Private Client services and proposition. He is responsible for our team of specialist administrators who are discreet, professional and focused on the long term and individual needs of our clients. He expects our team to deliver nothing but the best service. Darren has spent 13 years of his fiduciary services career in management and/or leadership positions. Prior to Hawksford, Darren held senior leadership position at Intertrust (formerly Elian) where he was responsible for their Private Wealth team in Jersey and held key client relationships across the Private Wealth, Fund Administration and Real Estate Administration service lines.

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About us

We help clients to make the most of their business decisions and wealth.

We take on the burden of regulatory, financial and tax compliance, and corporate governance to enable our clients to focus on managing their business interests and creating wealth.

We've helped families to take care of their wealth, entrepreneurs to succeed, multinational companies to transact and operate, and funds to maximise their returns.

Further information

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