

AN INTRODUCTION TO TRUSTS

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A trust is a legal arrangement which exists in many jurisdictions where typically one person (a settlor) transfers assets to a trustee, who accepts ownership of the assets not for his or her own use and benefit but for the benefit of others (the beneficiaries). Usually a trust is constituted in writing in the form of a trust deed which will set out the manner in which the beneficiaries can benefit from the trust, as well as the powers and duties which the trustees will have in administering the trust and its assets.

It is the separation of the legal ownership of the trust assets (which lies with the trustee), from the right to benefit from those assets (which lies with the beneficiaries) which is the crucial factor to an understanding of trusts. The settlor loses all title and control over those assets, including control over how they are managed, unless they reserve specific powers in the trust deed. The nature and scope of such powers can often require careful specialist advice if the trust is to achieve its intended purpose.

Types of Trust

Not all trusts are constituted in the same way. Some of the more common types of trust are described below:

Discretionary trust: this is a form of trust where the interests of the beneficiaries are not fixed, but depend upon the exercise by the trustee of some discretion or power in their favour. As such, it is the most flexible of all trusts and the most common form of trust. An advantage is that the individual circumstances and needs of each beneficiary can be considered at any time. A trust where the interests of beneficiaries are fixed is a "fixed" or "strict" trust.

Life interest / Interest in possession trust: these terms both indicate a trust where a particular beneficiary (the life tenant) has a right to receive all the income arising from the trust fund during his or her lifetime. The trustee will usually also have a power to apply capital to the life tenant. Often, ocorian.com

there are successive life interests, in favour of an individual and their spouse. After the end of the life interest(s), the trust fund will usually be held upon fixed or discretionary trusts for other beneficiaries, perhaps the children of the life tenant. In such circumstances, the trustee must, in investing the trust fund, balance the competing interests of life tenants and capital beneficiaries.

Purpose trust: many jurisdictions allow the formation of trusts for a specific purpose (e.g. to hold shares in a company) but which may or may not have any beneficiaries. These are commonly referred to as purpose trusts (or STAR trusts in Cayman). These trusts can be particularly useful where a client wishes to create a trust for good causes which are not strictly charitable or as special purpose vehicles in commercial transactions.

Charitable trust: this form of trust is used when the settlor wishes the assets of the trust fund to be used for charitable or philanthropic purposes.

Parties to a Trust

Settlor: this is the person who causes the trust to be established by transferring the initial assets of the trust fund to the trustee. The settlor, or others, may subsequently transfer further assets. Usually, but not necessarily, the transfer is by way of absolute gift. Unless the trust deed reserves powers to the settlor, they have no subsequent right to interfere in the running of the trust or to enforce the terms of the trust - these rights are vested solely in the

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beneficiaries and the courts. A settlor may, however, be a beneficiary of a trust.

Trustee: this is the person or professional organisation who accepts ownership of assets not for their own use and benefit but for the benefit of others, i.e. the beneficiaries.

Beneficiaries: the nature of the beneficiaries' interest will depend upon the type of trust and its terms. The beneficiaries are, however, entitled to expect the trustee to administer the trust for their benefit in accordance with the terms of the trust and the duties of trustees laid down by the governing law of the trust. For this reason, beneficiaries are usually entitled (if they so request) to copies of certain trust documents (including the trust deed) and to the accounts of the trust.

Protector: this is a person who can act as a fetter upon the way in which the trustees exercise certain powers. Most commonly, a protector is given a power of veto over the exercise of particular powers contained in the trust deed. A protector could also be given specific powers, such as the power to appoint trustees. As such, the protector is not a trustee but may have duties of a fiduciary nature. A protector is often a trusted personal adviser of the settlor, and this is one means by which a settlor may retain some assurance that a trust will be administered as intended.

Private Trust Companies

Available in certain jurisdictions, this is a useful vehicle to consider in the planning and establishment of trust structures for ultra-high net worth families. Rather than transferring assets to a service provider's professional trustee company, certain families may prefer to establish their own private trust company to be the trustee of the trusts which they plan to create.

Reasons for a Trust

By transferring assets to trustees, for the benefit of chosen beneficiaries, a settlor gives up control and ownership over those assets, and therefore these assets may cease to form part of the settlor's estate. A company cannot fulfil this purpose: although title to assets can be transferred to a company, the shares in the company will remain part of the settlor's estate for all purposes.

Some of the reasons for establishing a trust are as follows:

- **Continuity of ownership:** Often a settlor will wish to ensure that a particular asset will remain in the same ownership for the foreseeable future. Examples include shares in a family company or a valued heirloom.
- **Protection against profligacy:** Similarly, settlors may be concerned that assets should not be released to their children until they have demonstrated a responsible and mature attitude. A trust can achieve this.
- **Philanthropy:** a charitable trust can be used to benefit certain defined causes on a discreet and professional basis.
- **Forced heirship requirements:** Many systems of law impose upon individuals a requirement that, on their death, they must leave a proportion of their assets to certain heirs. A trust can often protect against this. For example, in the case of a Jersey trust, the Jersey courts will not entertain a claim to set aside any trust which is based upon forced heirship rights of a foreign jurisdiction.
- **Protection against high taxation:** A trust may be a legitimate tool in limiting or postponing the incidence of taxation upon the assets placed in trust. For example, a Jersey trust, if it has no Jersey resident beneficiaries and no Jersey source income (other than bank interest), will not be subject to any taxation in Jersey.
- **Protection against exchange control or sequestration:** Many settlors resident in politically sensitive jurisdictions find that a trust, by removing assets from their ownership, can protect against the risk of assets being seized by political means or against restrictions imposed upon the transferability of assets.
- **Estate duties and probate formalities:** Assets transferred into trust during a settlor's lifetime will not generally form part of the settlor's estate upon death.

Formation of a Trust

The formation of a trust is generally uncomplicated and in most cases simply requires the execution of a trust deed by the parties and the receipt by the trustees of some property, which is often for convenience a nominal cash sum, upon which the trust can operate. Before this occurs, however, there will be additional matters to consider.

First, settlors will wish to discuss the form of trust most suited to their requirements and the identity of the likely trustee. These discussions will usually involve the settlors and their professional advisers. Often, the trustee will be chosen by reputation or by

recommendation. The form of trust required will be discussed with the settlors and their advisers.

The potential trustee will also want to satisfy themselves that they understand the settlor's reasons for establishing the trust and that those reasons are bona fide. A settlor can therefore expect that a trustee will require satisfactory evidence to establish the identity of the settlor and all beneficiaries, confirmations as to the source of the assets to be transferred into trust and satisfactory evidence that the settlor has taken appropriate tax advice.

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KEY CONTACTS

JERSEY



PAUL BUTEL
Managing Director
 T +44 (0)1534 507341
 E paul.butel@ocorian.com

LONDON



PAULINE GALE
Managing Director
 T +44 (0)20 7367 8347
 E pauline.gale@ocorian.com

MAURITIUS



KEVIN ALLAGAPEN
Managing Director
 T +230 (0) 464 8916
 E kevin.allagapen@ocorian.com

SINGAPORE



RUDY TAN
Managing Director
 T +65 6438 4307
 E rudy.tan@ocorian.com

LUXEMBOURG



CATHERINE KOCH
Executive Director
 T +352 28 26 11 62 30
 E catherine.koch@ocorian.com

DUBLIN



NIGEL WOODS
Executive Director
 T +353 1 633 6032
 E nigel.woods@ocorian.com

CAYMAN



GRANT BARBOUR
Managing Director
 T +44 (0)1534 507343
 E grant.barbour@ocorian.com

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