The Possible Applications for Anglo-Saxon Trusts

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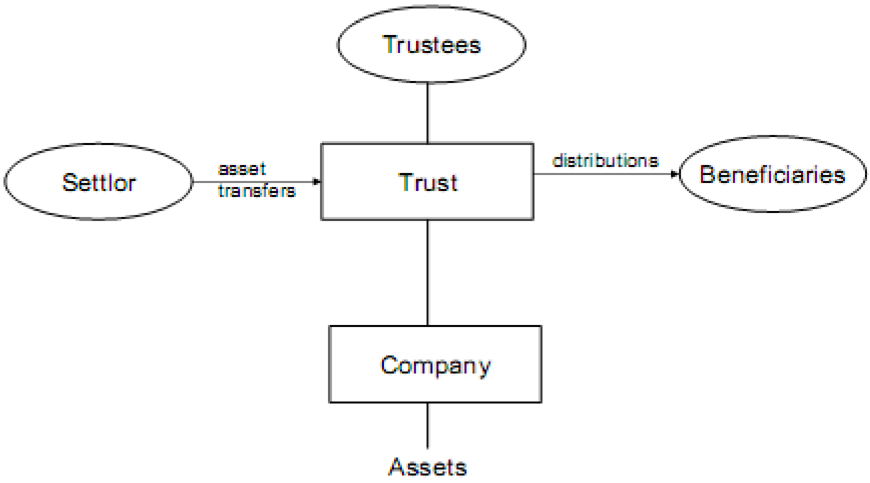
The Anglo-Saxon trust is a well-known vehicle in onshore and off-shore common law jurisdictions. Its essence is the division of legal and beneficial ownership derived from a concept of law, initially developed in England in the 16th century, known as equity. This looks through the legal form of the structure to ascertain the respective interests of the parties intended to benefit from the assets held in trust.

Revocable and irrevocable trusts

Trusts can take various forms. They can be revocable – where the party providing the assets (the settlor) to the party receiving the assets (the trustee) has the right to unwind the structure and repossess the assets – or irrevocable, where the assets cannot be reacquired. Although revocable trusts can be useful in certain circumstances, for example constituting grantor trusts for US tax purposes, the more general development of trusts has been in the irrevocable variant.

An irrevocable trust can state beneficiaries, either as absolute beneficiaries or with a lesser interest – say a right to income over the beneficiary's lifetime but no right to capital, or the trust can leave the identity of the beneficiaries and the extent to which they benefit to the discretion of the trustees. More recently, several jurisdictions have developed the concept of a purpose trust, where assets are held for a specified purpose rather than for individual beneficiaries. As such, the trust is an extraordinarily flexible structure which may provide highly effective solutions for individuals as well as for commerce. Let us look at each in turn.

Classic Trust Structure



Solutions for individuals

The traditional use for trusts was to protect assets. A trust cannot be an instrument of fraud, so English law (and therefore the law in most common law jurisdictions) does not permit transfer of assets into a trust to avoid settling existing debts or liabilities unless those debts or liabilities can be settled out of the remaining assets of the settlor. However, it is legitimate to take precautions to ensure that others are provided for, and that the assets are beyond the reach of later creditors or governments wishing to seize them either to pay judgment debts or, in less stable countries, as part of a policy of expropriation.

Today doctors, lawyers, company directors and other professionals know that they can be a target for litigation in the future. Transferring assets into trust before any specific claim manifests itself provides a level of protection for family wealth. Members of ethnic or political minorities may face political threats and again the trust, especially where the trust assets are outside the jurisdiction, can preclude a government taking legal title to such assets.

In turn, trusts have also become part of estate planning strategy. Moving assets into trust for members of a family can be done during the lifetime of the settlor, rather than at death, allowing the

settlor to supervise the process to some extent. It is therefore like a living will. Alternatively, trusts can be created by a will.

Flexibility

Just as important is that the trustees have the flexibility to react to unexpected circumstances as well as to decide where resources are needed in the next generations. This contrasts with the sometimes corrosive approach of just handing over significant funds to individuals, often at a relatively young age. Again, assets are protected for future generations through retention of assets in the trust rather than relying on the good sense of specific family members to retain, use and distribute the family assets wisely. In addition, when assets are held jointly for various family members, the trustee is respected as an independent disinterested party (trustees rarely benefit from the trusts they manage except for professional fees), hopefully defusing family disputes regarding the investment, use and distribution of family wealth.

The trustee thus becomes a type of independent arbitrator in relation to the operation of trust assets, listening to representations from various interested parties but making decisions based on the interests of the beneficiaries as a whole, while taking into account the settlor's wishes. Moreover, this is an excellent mechanism to keep the various interests together (for example holding shares in a family company).

Protection

By separating legal and beneficial ownership of assets, the general advantage of a trust is to protect beneficiaries from the burden of ownership of assets by leaving them in the hands of experienced administrators, whilst allowing them to benefit from the capital and profits. There are also specific Protective Trusts. Beneficiaries may be minors or suffer physical or mental disabilities. As a result, beneficiaries may not always be legally or mentally competent to manage assets. Again, trustees are tasked with preserving the resources and putting them to good use in compliance with the intentions of the settlor. Charities in common law jurisdictions are often created as trusts for charitable purposes.

Confidentiality

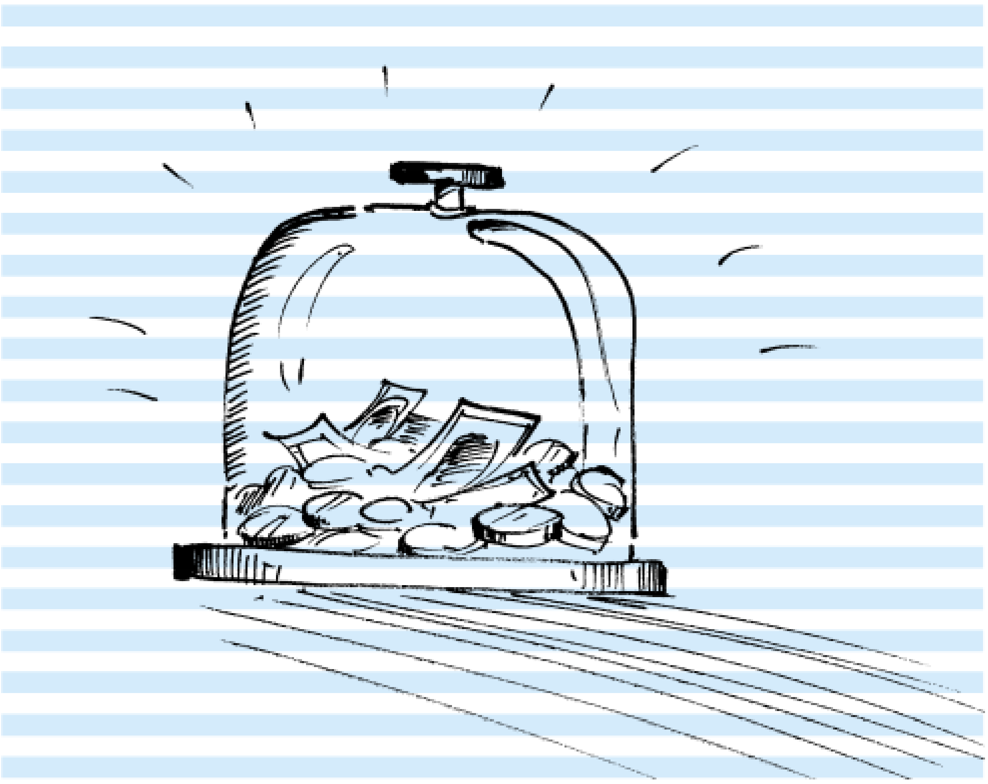
Placing assets into a trust creates a confidential structure. It is not necessary for the settlor to appear in the trust deed as the initiator of the vehicle and the contributor of the assets, and the objectives of the trust may be established by a confidential letter of wishes from the settlor. There may be many reasons why a settlor does not wish friends, family or governments to know what assets he has or what is he is doing with these. By creating a trust, assets can be invested and directed for particular purposes or beneficiaries without necessarily having a direct connection to the settlor, and in a way which is more discrete than a will, which may be in the public domain. The identity of the trustees and the existence of the trust can also be protected through the use of corporate vehicles under (i.e. owned by) a trust which corporation will hold assets.

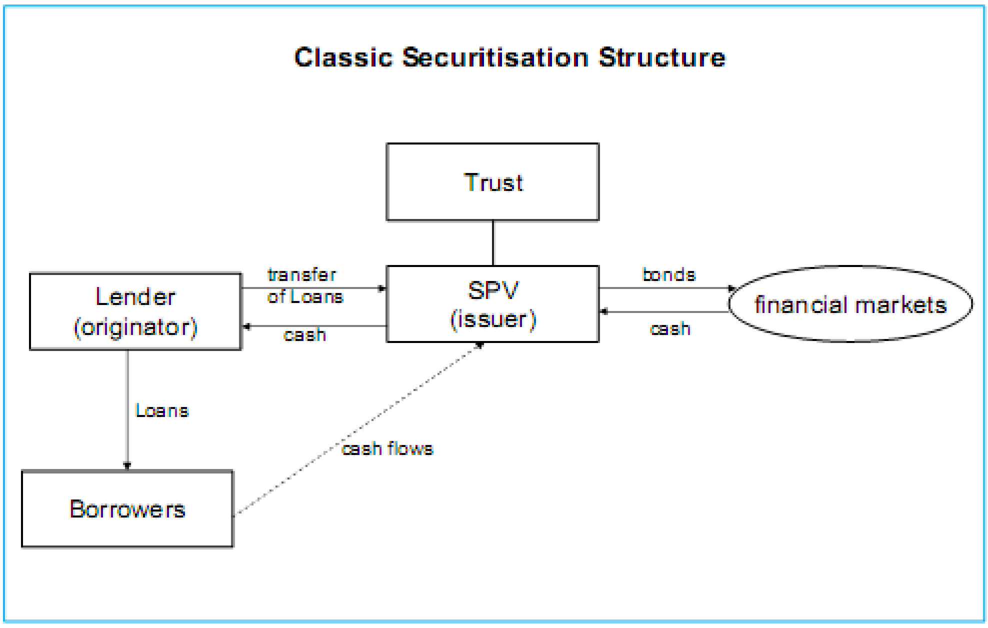
Tax planning

Trusts can present effective tax planning opportunities, always depending on the country the beneficiaries are resident in for tax purposes. For example, for UK tax residents who are not domiciled in the UK, trusts are a way of holding assets and then passing them to the next generation without UK inheritance tax applying to the gifts. Income and capital gains may be accumulated in these vehicles without being immediately liable to tax. Where beneficiaries are living in high tax jurisdictions, the holding of assets in offshore trusts and delaying payment of benefits can result in significant tax deferrals. Trusts also facilitate the holding of assets for subsequent generations, avoiding the successive inheritance taxes otherwise payable as the gift passes from the initial beneficiary to the next generation.

Solutions for entrepreneurs and businesses

Entrepreneurs may place business assets (e. g. shares in businesses) into trust, including shares of family companies. Nominee companies hold shares for named parties under bare trusts, effectively a type of agency relationship. But other business uses are now emerging for trusts. Sometimes this may be to protect the real business party from unwanted attention and attack. The Wilmington Trust Corporation in the United States often performs this role. Newspapers and other assets are often held by trustees to ensure independence. Pension and employee share schemes are also frequently held through trust structures.





Segregating assets

Today there are also new business models where trusts provide the answer to the problem of how to segregate assets when they are being financed. A classic securitisation structure will require that the issuing vehicle of the bonds secured by specific assets is «bankruptcy remote» from the originator – the company which originally concluded the transactions being financed. The rating agencies and the creditors will want to be sure that nothing can happen to the originator, such as it or its parent company becoming insolvent, which could «infect» or compromise the ability of the issuer to pay interest and capital on the issued bonds. The issuer therefore, is often a single purpose vehicle owned by a trust – either a purpose trust or a discretionary trust with charitable beneficiaries – but with the issuer contractually passing back the benefits to the originator at the commencement of the transaction. This protects the creditor from attack by other creditors of the originator, protects the originator from claims from the financial markets, and at the same time allows the originator's group to take the transaction off balance sheet.

Selection of trustees

In every case, the settlor has to choose his trustees carefully. It is called a trust for a reason. Legally the trustee's fiduciary duty of care is towards the beneficiaries, not the settlor, so there is a delicate balance. In the case of irrevocable trusts, the settlor is dependent on, and has to trust, that the trustees will exercise their duties not just in accordance with local law but also understanding and following the settlor's wishes when he established the vehicle.

Conclusion

The trust is a highly flexible structure able to protect both assets and their owners, which may also be used to plan for the future, and assign resources to the family, charities and third parties in a secure, confidential and tax effective way. It also has an increasing role in the commercial world as a method of holding assets independently as well as within creditor protection structures.