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STRUCTURING FOR PRIVATE CLIENTS

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This talk will look at:

- History of trusts
- Trust laws of the ‘progressive’ jurisdictions
- Which structure for your clients?
- How to set up a trust and pitfalls to avoid
- Foundations – an alternative to trusts?

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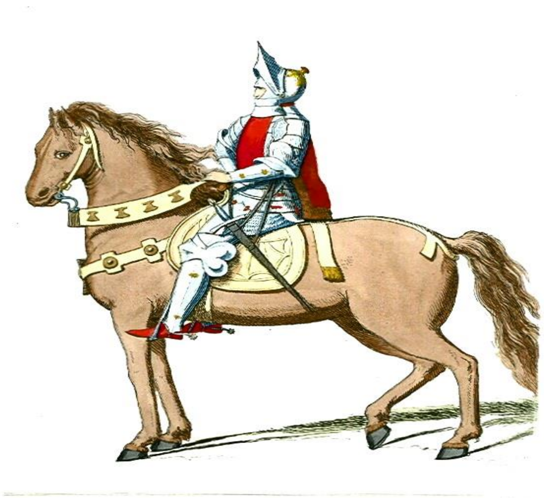
History of trusts



1. *origins over 1000 years ago when a man may go on a crusade – would transfer land and other assets to a trusted friend to look after his family with.*
2. *In 14th and 15th centuries, the family's rights became legally enforceable.*
3. *Trusts were also used for tax planning – in certain situations they could prevent tax payments being made to the king.*
4. *Trusts are in essence the same today – a settlor (the knight in the above) transfers assets to a trustee (the trusted friend) to look after for beneficiaries (the knight's family).*
5. *The beneficiaries have legally enforceable rights against the trustee.*

Why use a trust today?

- Succession planning – e.g. family businesses (avoid fragmentation)
- Avoidance of probate
- Tax planning
- Philanthropy
- Pre-IPO planning
- Asset protection

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Traditional trusts

- Key features of traditional trust:
  - trustee has power and duty to invest
  - may have duty to sell trust assets if not performing
  - may need to be involved in operation of companies
  - decides when to give capital/income to beneficiaries (discretionary trust)
  - beneficiaries have rights to challenge / information
  - trusts for non-charitable purposes generally not possible

- Potential limitations:
  - settlor wants control
  - ‘risky’ assets (e.g. family companies, real estate, art)
  - settlor wants to benefit non-charitable purposes, rather than beneficiaries
  - settlor doesn’t want beneficiaries to challenge / have rights to info

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Trust laws of progressive jurisdictions

May be traditional style, but other types / features:

- reserved powers
- VISTA and VISTA style trusts
- private trust companies
- Firewalls
- Non-charitable purpose trusts

Reserved powers

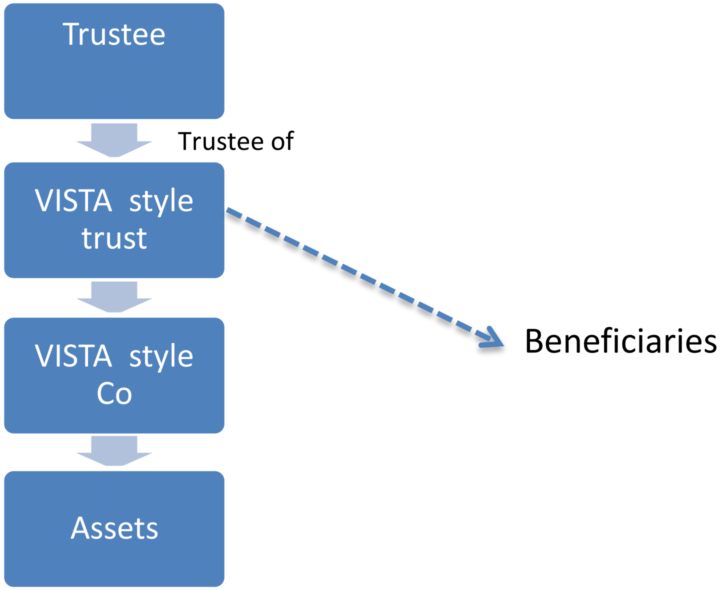
- Trust deed gives to settlor - or protector – certain powers the trustee would have in a traditional structure. Eg:
  - Power to invest
  - Power to appoint investment adviser
  - Power to direct payments of capital and/or income
  - Power to add / remove beneficiaries

- May also have:
  - Power to revoke
  - Power to replace trustee

- Powers may be passed on (e.g. after death of settlor)

- Possible in traditional jurisdictions but position less clear *(Concern that too many powers turns the trust into a nominee arrangement,. Generally thought that provided the trustee has to do something, even if it is just having a discretion in the event of incapacity of the settlor, then this would actually suffice However the matter has not been decided definitively in the courts, so the statutory certainty with the laws of the progressive jurisdictions is helpful.)*

VISTA style trusts

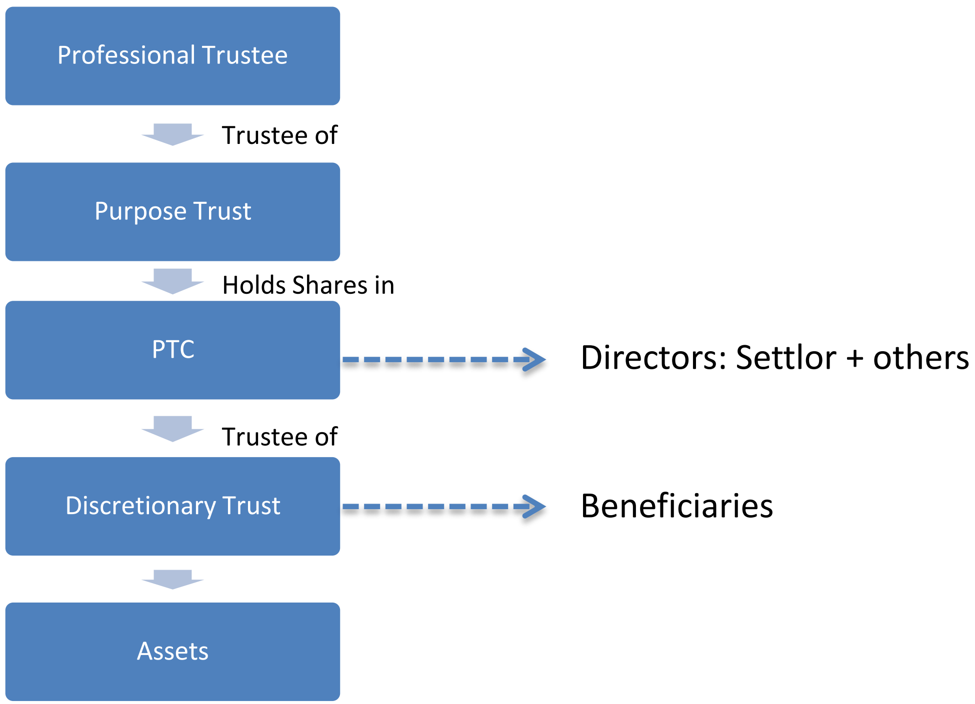


- Originated in BVI in 2003, now other jurisdictions have introduced
- Address an issue of traditional trusts – whereby the trustee needs to monitor the performance of a co owned as part of the trust fund, and intervene if necessary
- In VISTA style trust, the VISTA company directors run VISTA style co
- Trustee (shareholder) has no power to intervene in the affairs of the VISTA style co (except in extreme and limited situations set out in the trust deed).
- Trust deed – covers appointment and removal of VISTA style co directors
- Key uses – family companies, pre-IPO planning, risky assets, settlor wants investment control

Private trust companies (PTCs)
What are they?

- Trustees in many jurisdictions need a licence
- However, if trustee is a company which complies with certain requirements it will be exempt from licencing requirement
- Requirements vary, but general principle that the PTC provides trust services to related trusts (eg same family)
- Enables Settlor & family to retain some control by being on the board of directors
- Usually a PTC is a co ltd by shares. Who / What will own the shares?

Private trust companies
Typical Structure



Alternatively – can use a foundation to hold PTC shares.

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Firewalls
Laws of many progressive jurisdictions state:

- Assets transferred into a trust (governed by these laws) are not subject to forced inheritance rules of another jurisdiction

- Limits on enforcing judgements of a foreign court, including divorce judgements

- Key benefits:
  - Settlor from jurisdiction with forced inheritance rules
  - Asset protection

Non-charitable purpose trusts

- Traditional position – trusts for beneficiaries or charitable purposes
- Non-charitable purpose trusts generally not permitted
- Progressive jurisdictions – non-charitable purpose trusts
- Require enforcer as well as trustee
- Key uses – philanthropy, commercial, holding PTC shares

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Discuss:
What features does your client need?

1. Client wants to transfer portfolio of assets to a trust for his family (including himself). Wants to make investment decisions himself. *Reserved powers, PTC, VISTA style trust*

2. Client founded a private company. Wants to transfer company to a trust for his family. Planning IPO. *Reserved powers, VISTA style trust*

3. Client's son is getting married. Client wants to provide for son but is afraid future wife is gold-digger and marriage won't last. *Use progressive jurisdiction as governing law – get benefit of firewalls.*

4. Client is from Taiwan. Has fallen out with his daughter and wants to leave most of his estate to his son. *Use progressive jurisdiction as governing law - firewalls against forced inheritance rules*

- Reserved Powers
- VISTA
- PTC
- Firewalls
- Purpose trust

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Discuss:
What features does your client need?

5. Client has bought a small piece of land next to his block, wants to convert to a playground for the children of the block. *Purpose trust*

6. Corporate client – needs to keep asset of the books for a commercial transaction. *Purpose trust*

7. Client is adamant no beneficiaries should have rights to challenge, or rights to information. *Consider foundation*

- Reserved Powers
- VISTA
- PTC
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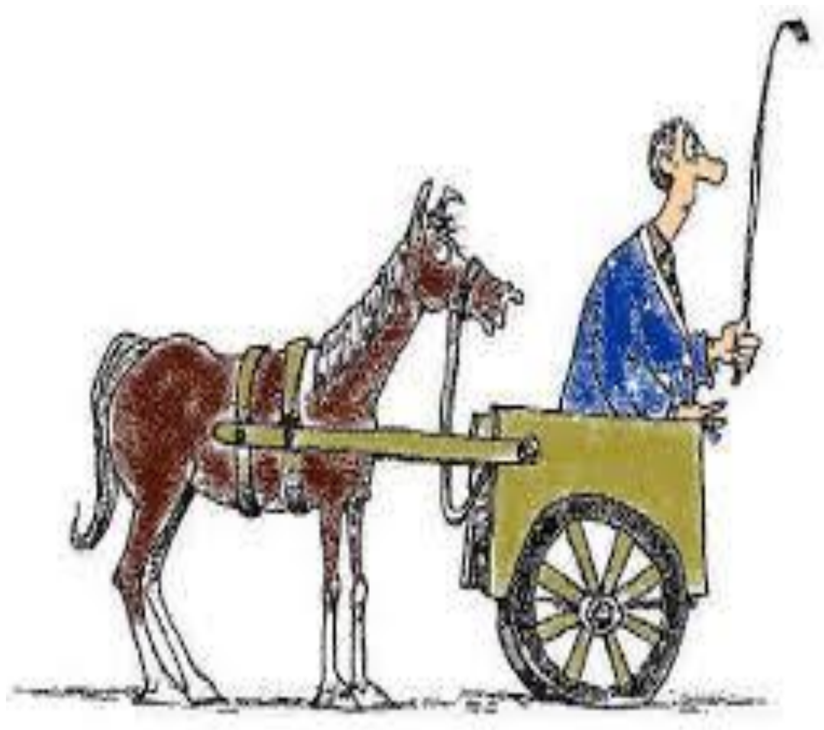
How to set up a trust (1)
Don’t put the cart before the horse!



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How to set up a trust(2)

- Discuss what client wants to achieve

- Discuss client's background – family, citizenships, tax residence, domicile, etc

- Trust lawyer / other structuring specialist should design or review structure – check it does what client wants, check for risks and pitfalls and amendments to be made

- Tax and disclosure advice on entire structure, in all relevant jurisdictions:
  - before establishment
  - on transfer to trust
  - on distributions
  - on any material changes in circumstances (adding beneficiaries, beneficiaries / trustee moving countries etc)

Potential pitfalls (1)
Too much control

- Settlor control may be express in trust deed through reserved powers
- Or may be through directorship of PTC / ownership of PTC shares
- May undermine some benefits of structure
- May also give rise to challenge that settlor did not intend to create a trust so trust was never created (3 certainties – beneficiaries, trust fund and intention)
- Who might challenge? *Creditor, divorcing spouse, tax authority, aggrieved relative*
- Solutions - consider changing some powers to consent powers, or use protector panel (which can include settlor)
- Avoid settlor being sole director of PTC

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Potential pitfalls (2):
Sham

- No formal powers in trust deed, but settlor directs trustee and they both understand that trustee will always do what settlor says.

- Sham?

- If settlor wants to reserve powers, it is better that these are included in the trust deed

Potential pitfalls (3)
Inappropriate use of PTC

- PTCs can be very valuable – particularly where very high value structure, family office etc, but ….
- Potential validity issues (e.g. if settlor is sole director, or PTC under his control some other way) – take care with structuring.
- Board of directors - need appropriate succession plan.
- A PTC is still a trustee. Powers and duties. Can be held to account by beneficiaries. Likely to need professional involvement / advice.
- Residence of directors may give rise to tax / compliance issues.
- Consider reserved powers instead?

Other potential pitfalls

- Unexpected tax consequences
- For advisers – non-compliant clients
- Trustees – unquestioningly following “instructions” from settlor, keeping inadequate records

Foundations:
An alternative to trusts?

- Corporate entity
- Beneficiaries / Purposes/ Both
- Offers avoidance of probate, avoidance of forced inheritance rules and many other benefits of a trust

Trusts and foundations: key differences

- Control – foundation controlled by council. Founder can be on council. A simpler alternative to a PTC structure.
- Enforcement: must or may be set up (depending on jurisdiction) so beneficiaries do not have right to enforce – a 'guardian' may have this right instead
- Beneficiary rights to information – similarly may be limited, along with enforcement right
- Statutory certainty - invalidity / sham – less of an issue?
- Trusts – long history. Foundations newer.

Foundations:
Uses

- Charitable or philanthropic purposes
- Succession planning
- Trustee
- Holding PTC shares
- Holding an asset to carry out a specific transaction

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Summary

- First step – discuss clients goals and background

- Consider using progressive jurisdiction as governing law particularly if client wants:
  - to retain control
  - to settle 'risky' assets
  - to benefit non-charitable purposes
  - regulated trustee
  - asset protection

- Foundations particularly useful where client wants:
  - to retain control in a simple structure
  - to benefit non-charitable purposes
  - to limit beneficiary rights to challenge / information

- Get appropriate legal advice if necessary – does the structure do what is intended? What are the risks and how might they be minimised?

- Tax and disclosure advice.

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