

INTERNATIONAL ESTATE PLANNING

Introduction to trusts

BACKGROUND

This note provides an introduction to discretionary trusts, and an overview of the control mechanisms that can be incorporated into a trust arrangement - including the appointment of protectors and the use of letters of wishes. What follows is intended as a general introduction only, and should not be relied upon without more specific advice. It is not intended to address tax questions arising from the use of a trust.

THE TRUST RELATIONSHIP

A trust (or “settlement” - they mean virtually the same thing) is a legal relationship created when a person (the settlor) places assets under the legal ownership of a trustee for the benefit of one or more beneficiaries. The division between ownership and control of assets and the ability to benefit from those assets lies at the heart of the trust relationship.

PARTIES TO THE TRUST RELATIONSHIP

Settlor

The settlor is the person who establishes the trust and determines all the checks and balances that are included in the trust documents. The settlor transfers assets to the trustee, who then holds them on the terms contained in the trust document.

Once the settlor has transferred assets to the trustees, he or she



is no longer the legal or beneficial owner of the trust property. He/she may, however, continue to benefit from the property as a beneficiary.

Trustee

The trustee is appointed by the settlor and is the legal owner of the trust assets. The trustee has day-to-day control of the trust property. In an offshore context, the trustee is usually a company in one of the offshore financial centres (such as Jersey or Guernsey) that specialises in trust business.

It is also possible to have a private trust company (PTC) as trustee. This is a private company, set up in an offshore financial centre, which has the sole purpose of acting as a trustee of a family’s trust or trusts. Typically, the directors of the PTC are a mix of family members and professionals.

The trust document sets out the trustee powers to manage the trust assets, in addition to those set out in the local Trust Law (each trust

jurisdiction has its own statutes relating to trusts). In managing the trust assets, a trustee is under a duty to act in the best interests of the beneficiaries.

Beneficiaries

The beneficiaries are the persons for whose benefit the trust is created. They may be named in the trust document or described by reference to a class of beneficiaries (such as “the settlor’s children”).

Depending on the terms of the trust, a beneficiary may have a right to benefit from the trust, or merely a right to be considered. A beneficiary’s interest can take many forms: it may (for example) include an immediate entitlement to trust income as it arises, a right to benefit from a proportion of the trust fund at a future date, or merely a potential right to benefit from the trust at the discretion of the trustee. It is possible to exclude certain persons from benefit.

INTRODUCTION TO TRUSTS

Protector

A trust does not need to have a protector but, in modern trusts, it is very common for there to be one. The role of the protector is specifically written into the trust document at the time that the trust is created. The powers of the protector could be quite limited, such as the power to hire and fire trustees or they could be more extensive, for example, the protector might need to consent to a distribution of income or capital from the trust to a beneficiary. It is also possible to make the protector's powers positive, for example, to compel the trustees to make a distribution or to invest in a particular asset or with a particular investment manager.

A protector is regularly appointed when the trustee is an offshore service provider (rather than a PTC). The settlor is often the first protector and then he/she can nominate a successor, often another family member, who would take over in the event of the settlor's death or incapacity. In this way, the settlor, through the protector, can moderate the actions of the trustee and hand this role to another family member or members on death or incapacity.

It is possible for more than one person to act as protector. Together they would form a "Protector Committee" and would be governed by a set of rules in the trust deed.

TYPES OF TRUSTS

Typically, trusts used in an international estate planning context are fully discretionary trusts. This means that the trustees have the discretion to decide which beneficiaries receive capital or income and when they do so. The trustees will be guided by a letter of wishes. The trustees also determine the way in which the assets of the trust are invested.

However, this leaves a lot of power in the trustees' hands and most settlors are not comfortable to do so. Some of the powers given to the trustees can therefore be more limited and can instead be retained by the settlor during his/her lifetime or the powers can be given to the protector as described above.

A power often retained by the settlor relates to investment. Under it, the settlor will be able to decide who the investment manager for the trust should be and may also be able to direct the trustees to enter into specific investments.

Transferring assets to a trust is a very significant step for most people and, therefore, settlors often choose to have a revocable trust. This means that at any time, the settlor can terminate the trust and the assets are returned to him/her. There are both tax and estate planning reasons why it is often advisable not to have a revocable trust and so one option is for the settlor to start the trust as revocable but once he/she becomes comfortable with the way it operates, the power to revoke can be released and the full tax/estate planning advantage can be gained.

Letter of wishes

The terms of the trust are usually widely drafted as the trust can continue for many generations and so flexibility is very important for the future. In order to guide the trustees, particularly after the settlor's demise, the settlor will prepare a letter of wishes. In this, the settlor will set out how he/she wishes the trustees to benefit the beneficiaries both now and for future generations. Whilst the letter of wishes is non-binding, it is an important document that the trustees will follow unless there are very good reasons at the time not to do so.

The settlor's death

One significant advantage of a trust for an individual with wealth in many jurisdictions is the fact that on the settlor's death, assets held in trust can continue to be held in trust and there is no need to take out a grant of probate or to deal with the other formalities usually associated with transferring assets from the deceased to his or her heirs. This allows the assets to continue to be administered throughout so there is not a hiatus normally associated with the delay between the death and the transfer to the heirs. Furthermore, where the law governing the settlor's estate on death gives family members fixed rights to a share of the estate, the assets held under the trust do not necessarily need to be subject to that division.

CREATING A TRUST

The trust is an incredibly flexible vehicle and so it is vital that the settlor takes independent advice to ensure that the trust is written in such a way that it meets his/her estate planning aims, but allows the settlor to be comfortable that he/she has sufficient powers to influence how the trust operates. These discussions should take place before the trust is drafted.

This note provides an overview of discretionary trusts. It is intended as an introduction to basic principles and must not be relied upon as a substitute for specific advice.

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