



FOUNDATIONS AND TRUSTS COMPARED

TRUST

Background

Trust law developed in common law jurisdictions, principally England. The law derives from judicial decisions from as far back as the time of the crusades in the 12th century. The law has then been improved by statute.

Most jurisdictions which derive their law in whole or in part from English law recognise trusts in their legal and tax systems. These jurisdictions include for example those which were former British colonies.

Certain other jurisdictions (such as Switzerland) also recognize the law of trusts having ratified the Hague Convention on the Law Applicable to Trusts and on their Recognition.

Legal Structure

A trust is not a legal entity. It is a private arrangement which comes into existence when a person (known as “the settlor”) transfers property to another (“the trustee”) to deal with that property for the benefit of certain persons (“the beneficiaries”) or purposes.

As a trust is not a legal entity, the trust assets are legally owned by the trustees who hold it as a separate “trust fund”.

The terms of the trust are set out in the trust deed. Typically the settlor will also write a “letter of wishes” to the trustees which provides guidance as to how the trust should be administered. The letter of wishes is non-binding and is confidential to the trustees.

A trust may be revocable or irrevocable. The duration of is sometimes limited by the governing law, although some trust jurisdictions, including the Bahamas, have abolished their rules regarding maximum duration (perpetuity).

PRIVATE FOUNDATIONS

Foundations are a civil law concept which are governed by the statutory laws of the relevant jurisdiction. They can only be created in jurisdictions which have adopted specific foundation law.

Although foundations are a civil law concept, more recently some common law jurisdictions have introduced a domestic law of foundations, such as the Bahamas in 2004. The foundation laws of these jurisdictions tend to be more straightforward and flexible than those civil law jurisdictions which rely on older statutes.

A foundation has its own separate legal personality. It will usually come into existence once the charter is registered in the public registry of the relevant jurisdiction.

As a foundation is a distinct legal entity, it can own assets in its own name.

The foundation documents comprise the foundation charter and separate confidential regulations or by-laws, both of which bind the foundation council.

It is common that the foundation documents will reserve certain powers and privileges to the individual who created the foundation (known as “the founder”).

A foundation may be revocable or irrevocable and may be established for an unlimited duration.

Control and Administration

The control and administration of the trust is exercised by the trustees.

After the trust has been created the settlor does not in principle have any further rights or powers in respect of the trust unless the rights are expressly set out in the trust deed. The settlor must take care not to reserve too many powers. Taking “too much control” over a trust can render it ineffective for the settlor’s tax or asset protection objectives.

Often the trust deed will provide for a “protector” whose role is to supervise the trustee and to exercise certain controls over the trust. The protector is often a close family member or advisor. The settlor could be the protector during their lifetime if that is acceptable bearing in mind the settlor’s personal tax and legal circumstances.

Unless provided for otherwise in the trust deed, the trustee and any power holder (such as a protector) are subject to “fiduciary duties”. This means that they must act in the best interests of the beneficiaries. If the beneficiaries consider that the trust is not being administered in their best interests they can apply to court.

Assets and Purposes

Bankable and non-bankable assets can be held in trust. There is no minimum value provided by statute.

Trusts are mainly used as a vehicle to hold business and personal assets for estate and tax planning purposes as well as asset protection (in case of divorce, incapacity etc). Trusts are also commonly used for charitable and philanthropic purposes.

Furthermore, a trust may be used to facilitate commercial transactions and the entering into of international agreements.

The day-to-day control and administration of a foundation is exercised by a council.

It is common for the founder to have significant controls over the foundation, for example power to instruct the foundation council and to change the foundation terms. In certain jurisdictions the founder is given these wide controls by default as a matter of statute (even if the powers are not provided for in the foundation charter).

Similar to a trust, taking “too much control” over a foundation can render it ineffective for the founder’s tax or asset protection objectives.

A foundation may have a protector or advisor with similar powers to those used in a trust context. However in civil law jurisdictions there is less of a tradition of power holders acting as “fiduciaries”. Unless provided otherwise the powers are generally “personal”, meaning that the power holder has discretion to exercise the powers at his or her absolute discretion.

Bankable and non-bankable assets can be held by the foundation (although see below concerning commercial assets). There is a minimum value required which, in Switzerland, is CHF 50,000.

Foundations are created for succession purposes but less frequently used for tax planning. Foundations may also be used for philanthropic or charitable purposes. Some jurisdictions (e.g. Panama and Liechtenstein) consider that a private foundation is not suitable for the pursuit of commercial purposes though the foundation can own an underlying company that may carry out commercial activities.

Beneficiaries

Beneficiaries are defined in the trust deed. Beneficiaries can be legal persons, individuals or charities and may include the settlor.

The most common type of trust is “discretionary”, meaning that the trustee has wide discretion to decide how and when the beneficiaries can benefit. Trustees may be guided by the settlor or protector.

The beneficiaries have power to enforce the proper administration of the trust. In order to enable them to do so, beneficiaries are entitled to information regarding their interest in the trust. For example, a beneficiary with a reasonable expectation of benefiting from a trust may ask to see the trust deed and accounts.

Confidentiality

A trust is a private arrangement between the trustees and the settlor. Trustees are subject to a general duty to keep the affairs of the trust confidential (the extent of this duty will depend on the laws of the jurisdiction concerned). There is no requirement to register the trust in a public registry.

Most trusts will qualify as “Financial Institutions” for FATCA and CRS purposes. Depending on the facts, reporting may be required on the settlor, protector (if any) and beneficiaries.

Re-Domiciliation

Trusts can easily be transferred between common law jurisdictions. The governing law of the trust can usually be changed from one jurisdiction to another without too much difficulty. Changing the place of administration does not require any formal legal procedure.

Beneficiaries are usually designated by the founder in the by-laws. Beneficiaries can be legal persons, individuals or charities and may include the founder.

Distributions are made in accordance with the by-laws, which typically provide for them to be made in accordance with the founder’s instructions.

The laws of most jurisdictions permit the foundation by-laws to extensively limit the rights of beneficiaries to information in respect of the foundation.

The foundation charter or a registration document containing a minimum amount of information must be filed at a public registry. The by-laws (which identify the beneficiaries) is a private and confidential document which is not registered.

Most foundations will qualify as “Financial Institutions” for FATCA and CRS purposes. Depending on the facts, reporting may be required on the founder, protector (if any) and beneficiaries.

Foundations are less easily transferred since they are tied to one civil law jurisdiction as a consequence of being entered in the relevant public registry. In some cases (for example, Panama to Bahamas) it is possible to transfer a foundation to another jurisdiction by virtue of special legislation.

Disclaimer

The information and comments contained herein are for the general information of the reader and are not intended as advice or opinions to be relied upon in relation to any particular circumstances. For particular application of the law to specific situations, the reader should seek professional advice.

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