

What is a trust?

A trust is a legal obligation that comes into existence when an individual or other legal entity (known as the settlor) transfers the legal ownership of assets – which may be of almost any type – to another person or persons (known as the trustee) to hold not for their own benefit but for the benefit of the beneficiaries who can be individuals or otherwise. It is essential that the transfer is gratuitous otherwise the transaction takes on the characteristics of some other legal entity.

A trust may therefore be defined as an equitable obligation which binds the trustee to hold and deal with the trust assets for the benefit of the beneficiaries in accordance with the terms of the trust.

How is a trust created?

Most trusts are established by a written document executed by both the settlor and trustee in which is set out the duties and powers of the trustee.

Trusts created by written document will generally take one of two forms:

A settlement: this form of document will be entered into and signed by both the settlor and the trustee and so provide clear evidence of the intentions of both parties and of the agreed obligations assumed by the trustee.

A declaration of trust: this form of document is entered into and executed by the trustee only, and records that the trustee has received certain property, specified in the document, to hold upon the terms set out in the document.

It is sometimes more convenient to create a trust by declaration of trust rather than by settlement, for example, the settlor may not be available to sign the document, when it is prepared. Moreover, a declaration of trust preserves confidentiality as to the source of the trust assets.

A trust can also arise on death under the terms of a will. It is also possible, subject to certain exceptions, to create a trust orally, with no written evidence of its existence.

In Jersey, there is no requirement to register the creation of a trust, nor is a copy of the trust instrument available for public inspection; a trust remains a private agreement between the settlor, the trustees and the named beneficiaries. Moreover, there are no stamp duties or other fiscal charges payable on establishing a trust.

The main characteristics of a trust

'The settlor'

This is the person who establishes the trust by transferring assets to the trustees. The settlor must completely constitute the trust and must do everything in his power to transfer the assets to the trustees.

'The trustee'

The trustee is an individual or company who receives assets from the settlor and who has the responsibility of administering them for the benefit of the beneficiaries. The trustee becomes the legal owner of the assets but cannot use them for his own benefit. The trustee is obliged to perform certain duties as laid down in the trust document and in accordance with the law. Most countries which recognise trusts have laws which determine the powers and duties of trustees.

'The trust deed'

The terms and conditions on which the trustee is to hold the assets will generally be set out in a written document commonly known as a trust deed. In many instances they are lengthy documents with extensive provisions to ensure that the trustee has the power to carry out the wishes of the settlor and to safeguard the interests of the beneficiaries.

'The beneficiaries'

The beneficiaries of a trust may be individuals (including the settlor), classes of persons or corporate bodies who will or may become entitled to the income and capital of the trust. They need not be named but they must be identifiable or ascertainable. It is not necessary to make a list of all beneficiaries but certainty as to what the settlor intended is essential. Where the trustee has discretion as to which of a group of persons is to benefit, no one beneficiary has a right to any of the trust assets

The Jersey law on trusts

Unlike England, there has never been a dual system of law and equity in Jersey and for a long time the validity and enforceability of trusts in Jersey was clouded in some obscurity, especially as regards trusts relating to immovable property. There was a limited amount of case law on the subject of trusts dealing with the creation, subsistence and termination of trusts and on the rights and obligations of the parties to such trusts.

Where the local case law was lacking the Court turned to English authorities for guidance and generally applied the principles of English Trust Law to such matters. It is not surprising therefore that Jersey Trust Law developed on very similar lines to its English counterpart and this similarity is evident from the codification of Jersey Trust Law in March 1984.

The Trusts (Jersey) Law 1984 removed many of the doubts and uncertainties which previously existed in relation to the establishment and administration of Jersey trusts; the law is not, however, entirely exhaustive and the courts of Jersey continue to accept judgements of the courts of England as being persuasive in relation to certain trust matters.

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The Trusts (Jersey) Law 1984 provides a modern legal framework for the establishment of trusts in Jersey and for the protection of beneficiaries.

The duties of trustees

The duties of a trustee are onerous. The law provides that a trustee:

- Must act impartially in the interests of all the beneficiaries.
- Must keep trust accounts and accurate records of distributions and administrative decisions.
- Must act jointly where there are several trustees.
- Must preserve and enhance the Trust Fund so far as is reasonable.
- Must not make speculative investments.
- Must administer the trust with due diligence as would a prudent person to the best of his ability and skill and observe the utmost good faith.

Whilst various trustee duties are expressed to be subject to the terms of the trust instrument it is not open to the settlor of a trust to be able, if he wishes, to relax these basic duties which underline the essential nature of trusteeship.

The powers of trustees

During the lifetime of a trust and as long as he is a trustee, a trustee must exercise the powers set out in the trust deed. These generally will include the following:

Wide investment powers which allow the trustee to invest in almost any kind of investment:

- Power to employ agents, investment advisors, nominees and custodian.
- Power to appoint new or additional trustees.
- Power to move the trust to another jurisdiction.
- Power to transfer the whole or part of the trust assets to a new trust provided the beneficiaries of the new trust include beneficiaries who were intended to benefit from the original trust assets.
- Power to establish companies and to transfer any part of the trust assets to those companies. The use of a dual structure can provide taxation benefits.
- Powers to borrow, to make loans with or without interest, to pay fees and expenses, to pay taxes, to carry on trade and to insure the trust assets.

The main types of trust

Trusts may be classified in several ways, but most commonly they are classified according to the nature of the interest of the beneficiaries in the trust assets. This classification falls into two broad categories: those where the disposal of capital and the income has been pre-determined by the settlor and those where the disposal of capital and income requires the exercise by the trustee of discretion. The former are normally referred to as fixed interest trusts while the latter are commonly known as discretionary trusts. In practice many trusts combine the characteristics of these two main types of trust.

Discretionary trusts

Without doubt, the discretionary trust is the most widely used type of trust, especially in Jersey. It has been developed into a most powerful tax planning tool and can be an ideal asset holding vehicle for an individual who is neither domiciled nor resident or ordinarily resident in the UK and whose activities span several countries.

The discretionary trust is commonly used when, at the time the trust is established, no decision has been taken as to what proportion of the trust's income and capital should be reserved for each beneficiary, and where it is desirable to maintain flexibility in this respect. Under the provisions of a discretionary trust, the trustee are given the power to select which person or persons are to receive a benefit from the trust and the extent of such a benefit. They may also have the power to decide whether to distribute income or accumulate it. The trustee very often have the power to add or remove beneficiaries and this gives considerable flexibility to the trust.

Whilst the trustee of a discretionary trust will usually have the power to determine the beneficiaries of both the income and the capital of the trust, and the amounts which they are to receive, it is normal to find that the settlor will have given the trustee some guidance as to how they should administer the trust, both during the settlor's lifetime and after his death; the guidance will be set out in a 'letter of wishes' or letter of intent.

For tax reasons, these letters are usually expressed not to be legally binding. In practice, it is most unusual for the trustee to disregard the settlor's wishes. Such letters may be varied by the settlor at any time during his lifetime, to meet changing circumstances, and they can be completed without formality. The trust therefore becomes an ideal substitute for a Will.

It is also normal for a discretionary trust to include extensive investment powers to meet the requirements of international clients and it can hold all manner of assets both esoteric or otherwise. As this type of trust is very often used in combination with a company or companies, there will be power for the trustee to establish wholly-owned companies, notwithstanding this, the terms of the trust may provide that the trustees do not need to interfere in the management of such companies.

Fixed interest trusts

In contrast to a discretionary trust, the respective rights of the beneficiaries of a fixed interest trust to share in the capital and income of the trust are fixed and clearly defined by the terms of the trust, from the moment it is established. The trustee is not given any discretion in how to distribute the trust income and capital to the beneficiaries.

There are a number of particular forms of fixed interest trust, of which the best known is the so-called 'interest in possession' trust: this is a trust whose terms provide that the trustee must distribute all of the income of the trust fund to a particular individual – often the settlor – during that person's lifetime, following which the trustee is required to distribute the capital of the trust to the capital beneficiaries in accordance with their respective rights.

Protective, or asset protection, trusts

These are trusts where the beneficiary has a fixed interest which, however, ceases if certain events occur, for example, upon the bankruptcy of the beneficiary or on his attempted alienation or sale of his interests. In such event, the fixed interest ceases and the principal beneficiary together with his family become members of a discretionary trust.

This type of trust would often be used for non-tax reasons. In recent years, the trend towards speculative litigation against professional persons, particularly medical practitioners, lawyers and accountants, and most noticeably in the USA, has led to many such persons establishing offshore asset protection trusts as a means of protecting assets from future judgement creditors.

Practical uses of Jersey trusts: general

Jersey trusts are used principally to provide for the protection of the trust assets and to minimise or defer the tax payable on the income the capital and the capital gains of the trust assets and on the transfer of those assets.

It is most important that, at the time of creating the trust, the settlor should consider the taxation, exchange control and other legal consequences flowing from the creation of the trust, both in his country of residence and nationality and in the country or countries of residence of the beneficiaries, where necessary, the settlor should obtain appropriate professional advice as to the consequences of establishing the trust.

Trusts established in Jersey can be used for a variety of purposes, some of which are listed below:

For estate planning

To avoid probate formalities and harsh succession laws in the settlor's country of residence. In regards to avoiding foreign rules of forced heirship Jersey law offers particular assistance to those seeking to establish a Jersey trust for such purposes in that the Trusts (Jersey) Law 1984 provides that a non-Jersey domiciliary transferring property to a Jersey trust during his lifetime is deemed to have had capacity to make that transfer as long as at that time he was of full age and sound mind under the law of his domicile.

Thus, no rule of inheritance or succession law of his own domicile has any effect on the validity of the transfer (or of the trust).

For asset protection

Trusts to protect the assets of professional persons against speculative litigation have already been referred to in the previous section. Protective trusts may also be used to provide security for assets which might be open to expropriation or confiscation by a politically unstable or hostile regime.

To minimise or defer taxes on the assets and on the income and gains arising from them

Many countries, for example the United Kingdom and the United States of America, have sophisticated anti-avoidance provisions in their tax legislation, intended to reduce the opportunities for persons resident in them to reduce or avoid taxes through offshore trusts, nevertheless, opportunities still exist for significant tax benefits to be gained through the use of Jersey trusts by persons resident in those countries. For example, a person resident but not domiciled in the UK can significantly reduce his tax burden – income taxes, capital gains tax and inheritance tax – by transferring assets to a Jersey trust. Many other countries have much less sophisticated anti-avoidance provisions, leading to many more opportunities to use Jersey trusts for tax planning.

Frequently, the opportunity to establish an offshore trust to minimise tax will arise when the settlor and his family moves from one country to another, so changing their country of tax residence and sometimes, their nationality.

For exchange control planning

If the settlor is resident in a country with exchange control regulations and has a pool of assets outside such regulations, it may be desirable to transfer the ownership of such assets to non-resident trustee.

For confidentiality

It can be useful to transfer the shares of private companies, and also shares held in public companies, to non-resident trustee, to preserve confidentiality as to the ultimate beneficial ownership of those shares.

There are many other ways in which Jersey trusts can be used for protection of assets and in international and cross border tax planning.

Trusts and companies

It is often necessary or appropriate for the trustee of a trust to hold all or a part of the trust assets through an underlying limited liability company. Such a company might be established offshore, in Jersey or in another low tax area, or it might be established onshore, in England or elsewhere. The trustee might own all of the shares of an underlying company or there might be other shareholders.

The reasons for establishing an underlying company, are likely, to fall into two areas: they will be either fiscal reasons or non-fiscal reasons. There can be a number of ways in which an underlying company may have fiscal, or taxation, advantages: for example, in order to change the effective situs of trust property, to make it excluded property for UK inheritance Tax purposes, or to reduce taxation on royalty payments received on patent rights owned by the trustee.

Similarly it might be desirable for the trustee to establish a wholly owned company for non-fiscal reasons, for example, if it is proposed that the trustee should undertake a certain trade or business, the trustee may wish to undertake that through a limited liability company and so avoid any personal liability arising from that trade or business.

Though the trustee would often be involved in the management of an underlying company this need not always be the case: the terms of the trust might provide that they need not interfere in the management of an underlying company.

Further information on establishing and managing companies in Jersey and other low tax areas is available on request.

The use of a protector

It is possible to add another party to the trust arrangement, known as a protector. A protector does not normally have any positive powers over the trustee, but he has the power to veto certain decisions of the trustee, if he feels that the trustee is using their powers in an undesirable fashion.

For example, the trust deed may provide that the protector's approval must first be obtained by the trustee, before the trustee exercises its discretion to appoint another person to the class of beneficiaries, or to distribute any part of the trust assets to the beneficiaries. The trust deed will set out in detail those occasions when the protector's approval will first be required, before exercise by the trustee of any of their discretions.

It must be noted that there are some drawbacks to the appointment of a protector. For example, the appointment of the protector may cause delays for the trustee in administering the trust, because of the need to obtain the protector's consent.

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Jersey as a haven for trust assets

Jersey provides a secure haven for the tax-free administration of offshore trusts. Jersey has a long history of political stability, based upon a democratically elected government but without any political parties. This combined with a strong economy and full employment inspires confidence for the future of the Island.

Though it is a dependency of the English crown, Jersey is independent of the United Kingdom. Special arrangements were negotiated at the time of the United Kingdom's entry to the European Community; under these Jersey does not have to adopt EC directives on taxation, the movement of capital and other matters which might otherwise affect the Island's finance centre activities.

Jersey trustees are not subject to income tax on income received by them as trustees, provided that the beneficiaries of the trust are not residents for tax purposes in Jersey and the trust is not in receipt of income from any source within the island other than bank deposit interest.

Jersey does not levy tax on capital gains or on capital. No stamp duties or other fixed charges are payable either on the creation of, or during the administration of, a Jersey trust.

This note is intended to provide a brief rather than a comprehensive guide to the subject under consideration. It does not purport to give legal or financial advice that may be acted or relied upon. Specific professional advice should always be taken in respect of any individual matter.