RDG Fiduciary Services

BASIC GUIDE: Introduction to trusts

A trust is a relationship. It is not a legal entity or a legal thing in the same way as, for example, a human being or a company. A trust cannot own assets nor be a plaintiff or defendant in court proceedings. A trust is simply a word used by lawyers to describe a particular type of relationship, more precisely, a set of responsibilities of one person to another in respect of certain assets.

A trust arises as soon as somebody agrees to hold some assets for the benefit of somebody else. For example, although most people do not think in these terms, if you and a business colleague are at the airport and you ask your business colleague to look after your luggage while you walk to the newsstand to buy a newspaper, your colleague is holding your luggage on trust for you.

This means that your colleague cannot treat your luggage in the same way as he/she can treat his/her own - notwithstanding that somebody looking at your colleague, standing with two suitcases beside him/her, might think that both suitcases belong to him/her. Your colleague can destroy his/her own suitcase, give it away, sell it, or do anything he/she likes with it. But he/she cannot do any of those things with your suitcase. This is because, when you return from the newsstand, you are entitled to ask him/her to hand your suitcase back to you in exactly the condition in which you put it under his/her control when you went to buy the newspaper.

A trust is therefore as simple as that. A trust arises whenever somebody agrees to hold some property for the benefit of somebody else and he/she, the trustee, owes certain responsibilities to the person for whom he/she is looking after the trust property.

Instead of the trustee holding the property for which he/she is responsible for the benefit of the person who gave it to him/her originally, it is possible, under trusts law, for the original owner to give the property to the trustee and to ask the trustee to hold it for the benefit of one or more other people, only one of whom might, but need not be, the original owner. The original owner can also ask the trustee to give the trust assets to the intended recipients at a specified day in the future or if a certain event happens. The triggering event can be an event that is certain to happen (for example, the death of the original owner) or may, but may not happen, (such as an intended recipient getting married or reaching a certain age or having one or more children).

Uses of trusts

Because, as described, a trustee can hold assets with instructions to deliver them either when an event occurs or if an event occurs, trusts can often be understood as "a device for delayed delivery". In other words, assets can move now out of the ownership of the original owner; into the hand of the trustee who will hold them until the triggering event occurs at which point the trustee will deliver the assets to whoever has become entitled to them depending on the nature of the triggering event that has occurred.

ln the context of private wealth planning and protecting assets within wealthy families, the trust offers many opportunities.

Assets that are currently in the hands of an individual are vulnerable to the death, mental incapacity, bankruptcy, divorce and indeed all the unexpected events that can happen to human beings because they are human beings. But recognising that assets are vulnerable just because they are owned by a human being does not necessarily mean that individual should give the assets away to other human beings because they, too, are just as vulnerable to the events that can befall human beings.

In wealthy families, it is generally best if no specific individual members of the family own the core assets of the family so that those assets are not disrupted or disturbed by any of the things that may happen to that individual as a member of that family.

Trusts are therefore, in this context, motivated by protecting the assets from the alternative, that is, of the asset being in the hands of private individuals. If the trustee is a company, the trustee cannot die, cannot become mentally incapable, cannot get divorced. A company, of course, can become insolvent. However, trusts law does not necessarily require an insolvent corporate trustee to cease to act as trustee. In most cases, an insolvent corporate sole trustee will not wish to continue to serve as trustee. The law recognises that trustees often need to cease to be trustee with a new trustee being appointed and so trust law provides a well-established mechanism for a trustee to retire and a new trustee to be appointed with seamless continuation of the trust and without disturbing the underlying asset or the entitlements of the potential beneficiaries.

Protecting family businesses

In the context of substantial shareholdings in private family businesses, trusts offer significant advantages in protecting that shareholding, and the business as a whole, from events that might befall either the founder or the next generation of the family.

For example, a business that has survived precisely because all, or at least a controlling majority, of its shares are in the hands of one person, might suffer badly if such a large block of shares became subject to the administration procedures on the event of the death of the majority shareholder or, worse still, the complications of law that can arise when an individual is suddenly reduced to mental incapacity- such as, after a car accident that leaves the individual in a coma. Weeks and most often months can elapse while the legal processes select the right individual with authority to continue to deal with the otherwise paralysed assets and the process of recognising that person's authority by Court Order.

Trust are therefore recognised as a useful tool in the context of business continuity. This applies not just to the founding shareholder, who may be concerned to protect his majority shareholding but also for external investors contemplating lending to or investing in the family business. They, too, will be adversely affected if the founder dies, becomes mentally incapable or becomes bankrupt. So it is in their interests as well as the interests of the founder to protect the founder's shareholding by using a trust.

Trusts do not protect only assets. They in fact protect human beings too. The newspapers often report the stories of wealthy families where inheritances received at an early age have destroyed the individual. An early inheritance can be a burden not a benefit. Where it is not yet clear that the next generation has the maturity or the skills to look after the shareholding that they might inherit or receive, a trust am not only protect the shares from the child but can also protect the child from itself and protect the child from those who might take advantage of the child to get access to the wealth that the shareholding represents.

For wealthy families where it is not yet clear where the next generation of children may choose to marry, live and bring up their own children, keeping inherited wealth out of the hands of the child and in the hands of an independent trustee can protect the wealth from the tax system, legal system, inheritance system, religious system and bankruptcy laws of whatever country the child may choose to live in eventually. The trust can contain enough flexibility that the questions of when and how much any beneficiary receives can be delayed until the answers to fundamental questions are clear.

Summary

In many families, therefore, where the wealth has been created and continues to be held in the hands of one individual, a trust offers the opportunity for that individual to give away so much of the ownership of the shares as is sufficient to protect those shares from the death or incapacity of that individual, at the same time as protecting the assets from the same events that may happen to the likely recipient . The founder, by remaining a beneficiary of the trust and by reserving certain management powers to himself under the trust, can largely continue to look after the trust assets and to manage them in the way that he did before he put them into the trust.

The trust allows a company that has benefited from a single individual being in charge to be able to continue to be run largely ln the same way, even after the death of the founder, while the next generation (or even the next two generations) can be required to show their skill and maturity in building and growing the family business before they receive any shares in the business in their own names. By continuing to hold the shares in the hands of a single trustee, the arguments that develop between children, particularly between children by different marriages, can be prevented from tearing the family business apart. While the trust cannot necessarily prevent those arguments from arising, it can prevent them from causing significant damage.

Where should a trust be established?

The trust relationship is a fundamental part of the legal systems of many territories. The principal jurisdictions with well- established trust law principles are those territories whose legal system is derived from English common law.

Consideration should be given as to where the trustee is located, which law governs the trust relationship and the location of the assets which are held on trust. There is a risk to a structure where any one or more of these is a territory in which the trust relationship is not recognised.

Who should be the trustee?

For the reasons set out above, the trustee should be a company and should be located in a territory with a strong trust pedigree. The main options are an institutional trust company (a company whose business is to act as trustee for many trusts in return for a fee) or a private trust company (a company set up to act as trustee for a small number of trusts which are usually for the same family). In many jurisdictions acting as a trustee is a regulated activity and trustees may need to be licensed or fall within certain specific exemptions.

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