

# Five reasons for placing one's trust in - well, trusts

Insights - 27/09/2016

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*A version of this article first appeared in International Investment*

Many people are baffled by trusts, the purpose of which they don't fully comprehend. Some even regard them with suspicion, as tools of opaque tax evasion strategies of a type favoured by wealthy individuals.

This article presents five reasons they remain an essential tool in wealth managers' tool kits, none of which has to do with tax evasion.

For many the word "trust", when used to describe a type of asset-holding device, has recently become synonymous with "tax reduction", or even "avoidance." This perception, in fact, has driven changes to trust legislation around the world.

In some cases the changes have introduced taxes on trusts, their settlors and even their beneficiaries that can only be described as penal.

In 2011, for example, France introduced rules which treat a beneficiary of a discretionary trust - despite having no vested interest in the trust income or capital - as the "settlor" of that trust. And as a "deemed settlor", that beneficiary is liable to pay tax in France, calculated by reference to the value of the trust fund, even though that beneficiary may never receive anything from it.

Yet in spite of such changes, trusts continue to be used by many of the world's wealthiest families, because, in actual fact, trust planning is rarely all about tax planning.

Here, we look at five reasons why the trust is still alive and well, in spite of the usually well-intentioned but typically uninformed efforts of lawmakers to use it as a tool for going after wealthy tax evaders.

### 1. Probate avoidance

In most places, if someone dies while owning an asset, there is a formal process to follow. In the common law world, such as the UK and its overseas territories, this involves obtaining a Grant of Representation (called a Grant of Probate if the deceased left a valid will).

In some places this post-death process is very quick. In other places, it takes months to complete, and is an expensive and complicated process. Assets can be, and often are, frozen while the Grant of Representation is obtained; but this can be problematic where volatile investment assets are owned, as values can fall dramatically while those due to inherit are forced to wait for the Grant of Representation to be processed.

Trusts, though, allow these time-consuming post-death processes to be avoided.

If a person sets up a trust in their lifetime and puts their assets into that trust, when they die, the trustee of the trust is then seen to own those assets, and so a Grant of Representation is not required with respect to them. A Grant might still be required for any of the deceased's assets that weren't included in that, or any other, trust.

Interestingly, this strategy is much-used in the Cayman Islands, one of the world's most popular investment fund domiciles. Here, it's extremely common for investors to set up trusts to own their investments in funds, with the sole purpose of avoiding the need for a Grant of Representation upon their death.

## **2. Succession Planning**

Family businesses often struggle, and sometimes fail, after the head of the family which owns them dies, and the business passes to the next generation.

Although there are many reasons why this might happen, one that lawyers see fairly often is when the succession planning is not considered during the life of the matriarch or patriarch. Typically, it's only after the death of the first generation that the second generation begins to take a role in the running of the family enterprise, and the management of the family wealth.

And all too often, this second generation lacks the skills and experience to do so properly.

Trusts can provide a solution to this common problem, by enabling the second generation to begin getting involved in the family business while the family's matriarch or patriarch is still alive.

The nature of the role played by the second generation will depend on the level of control that the first generation are happy to cede. One arrangement that seems to work well is when the second generation is made part of an "advisory council" to the business. In this role they can be given specific roles and responsibilities, the nature of which can change as they settle into their new roles.

## **3. Ownership and Control**

Another use for trusts that also has to do with family businesses comes into play when the second generation wants an assurance that they, and not some outside party, will receive the family business when the first generation dies.

This matters because the second generation typically want to make sure that the time they devote to the business's development while the first generation is still on the scene - which can span decades, during which they might be building a career elsewhere - will not have been wasted.

At the same time, an elderly matriarch or patriarch may be reluctant to give up control of the business during their lifetime, as this comes with a (perceived or actual) loss of social and familial status.

Trusts, which allow for ownership and control to be separated, can be the perfect solution in such cases. The matriarch or patriarch can retain a significant degree of control over the family business, while allowing the second generation to benefit from the certainty of knowing that the business will be preserved for them.

#### **4. Privacy**

According to Privacy International, privacy is “a fundamental right...[to]...protect ourselves from unwarranted interference in our lives”.

It is not, contrary to much commentary in the wake of the Panama Papers revelations earlier this year, about avoiding tax, nor is it about committing crimes.

There are a growing number of international initiatives in place, or in an advanced stage of development, which address concerns that trust structures are being used to mask criminal activity and to avoid or evade tax payments. These include the American FATCA regulations, those of the UK and other countries which are modeled on them, the OECD's Common Reporting Standard, and (non-public) registers of beneficial ownership.

As some of the debate surrounding the creation of beneficial ownership registers has shown, privacy is widely regarded as a fundamental right, even though there are those who would see it take a back seat to the public's “need” to know who owns what.

For now, at least, trusts continue to be used by some individuals keen to preserve the privacy of their holdings. The way it works is that the Trustee is the owner of the assets held within the Trust; the deed or document establishing the trust is a private arrangement between the parties to it.

Many high net worth families transfer their assets to trusts for the simple reason that they don't want others to know what assets they own, or where those assets are.

Critics of this right to privacy would argue that those asserting the right are only trying to avoid tax, and while I'm not going to pretend that this has never happened (as it has with structures

throughout the onshore world, too), what we at Ogier see are ultra-high net worth families for whom kidnap and extortion are genuine and significant risks looking to reduce those risks. This is particularly true in certain parts of the world, such as Mexico and Latin America.

In other cases, UHNW families desire privacy because they, (commendably, many people would say), wish to shield their children from the reality of the family's true wealth until such time as the children are old enough to be able to understand and deal with the implications of that wealth.

While we live in an age in which people are accustomed to the idea that it's normal to share even the most minute details of their everyday lives on social media, it is important to remember that this is a fairly recent development, and not necessarily one that everyone wants applied to all aspects of their lives - as professional wrestler Hulk Hogan argued recently, and successfully, in court, against Gawker Media Group. (Hogan argued that his privacy had been invaded by the organisation's coverage of his private life.)

## 5. Organisation

Many of the world's biggest and most successful family businesses have operations in multiple jurisdictions, operate across multiple industries, and involve multiple generations of the founding family in key roles. They are very complicated operations.

Trusts are often used as the ultimate owning entities for these complicated structures. Under such arrangements, the Trustee has an oversight role, in respect of the activities of the underlying companies.

The Trustee can, for example, assist with the movement of capital around the structure, so that it reaches areas of the business where that capital is needed.

The Trustee can also ensure that family members are involved in the business or businesses in a way that best utilises their individual skills and helps them to develop new ones. He or she can also ensure that capital and income can be distributed from the structure, for the benefit of any family members who might need it.

Linked to this concept of organising family businesses through trusts is a growing trend towards families setting up "Family Funds". A Family Fund is the name given to an entity - usually a limited company - which is established to operate like a mutual/investment fund.

Multiple members of the same family come together to pool their assets within the fund structure; they appoint an investment manager; and then they seek to maximise their returns, reducing costs through the economies of scale that arise out of the pooling of their assets.

In many cases a trust holds the management (voting) shares in the Family Fund. This allows the Trustee to control the decision making within the Fund. The family members each own participating shares, which entitle them to share in any income distributions or capital gains.

## Summary

In short, then, for as long as trusts can be established in a manner that does not attract penal taxation, trusts will continue to be widely used in the planning arrangements of high-net-worth families around the world.

The many benefits of using trusts have long been known to the people who use them to hold their family wealth; and in many cases, there is no viable alternative to the trust in achieving a client's goals. Hopefully, lawmakers around the world will realise this, in the months and years ahead, as they continue to try to find ways to end tax evasion that actually work.

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