

Trusts under threat: risks or opportunities?

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[ARTICLE](#)

Trusts have, in one form or another, been with us for generations. With roots to be found in the principles of Roman law, the concepts of equity and 'trust' as we know them have formed part of English common law since the 12th century. Trusts have, over the years, performed many and varied functions for both private individuals and families (succession and tax planning, asset protection, etc) and in a commercial context (for ownership of 'orphan' assets in refinancing structures or under Eurobond issues or in the creation of deductible Tier One capital, for example).

The use of trusts has, over time, gradually moved away from the protection of property rights of absent crusaders and become in recent times more tax-focussed, particularly for domestic clients. In response to this trend, high tax common law jurisdictions, such as the UK and the US, have reacted with, in some cases penal, legislation imposing taxation on both the creation of trusts and in respect of the income and gains of trusts. One of the most striking examples is the US rule that seeks to impose tax on beneficiaries at rates potentially in excess of 100% of the value of a distribution in certain circumstances.

UK domiciled (or deemed domiciled) individuals have suffered greatly of late with the changes to the UK inheritance tax regime introduced by the Finance Act 2006 severely limiting their opportunities to create a trust, whatever the motivation.

In response to this legislative change, high tax jurisdictions have looked to develop trust-like alternatives to recreate the non-tax benefits of trusts in a more tax neutral environment. The development of the 'family limited partnership' is an example of a contractually based arrangement used to replicate some of the benefits of trusts – the ability to pass economic benefits to the next generation without passing control of those assets as well – without the unpleasant tax side effects.

In the meantime, what has been happening in offshore, low tax and civilian jurisdictions? The civilians recognised the value of creating a solution that could offer trust-like benefits to their citizens in a way that was consistent with the tenets of a civil code. As a consequence, foundations were developed and introduced in a number of civil law countries, with Liechtenstein making the first move early in the 20th century. Much has been written about the similarities and differences between foundations and trusts, but, suffice to say, for the best part of a century they have enjoyed a polite co-existence, both providing useful functions for specific client types.

However, with the advent of the Hague Convention on the Recognition of Trusts, civil law jurisdictions, such as Italy, were able to sign up and so promote the use of trusts within their jurisdictions. Some civilian jurisdictions have gone further and pushed through trust legislation, rather than simply acknowledging the existence and enforcement of trusts. Have the civil law jurisdictions in fact stolen the edge as our client base becomes more international and so less inward looking and typically less tax focussed? As a consequence of the shrewd marketing of legal solutions, are the civil jurisdictions now better placed to serve the new clients that are emerging from regions such as Russia and the CIS, China and Latin America? All of these clients have access to great wealth, but little confidence in the nature of a trust and the benefits and flexibility that such a structure can offer.

The answer to this is a resounding no – common law jurisdictions are equally able to respond to market demand and have been seeking to match and better the opportunities offered by competitor jurisdictions. So, Liechtenstein and Singapore can offer a trust law? Well, now developed and reputable common law jurisdictions such as Jersey, the Bahamas and, very soon, Guernsey (amongst others) can offer foundations alongside trusts. This, together with the introduction of further alternative structures such as limited liability partnerships and protected cell companies, provides yet more solutions to the needs of an increasingly international client base.

These developments, together with the growth of wealth across the globe, means that there has never been more on offer to satisfy the objectives of our clients, whatever their background. Such developments can only be positive – the trust is alive and well, it is now operating amongst friends. The key to survival, as our clients know only too well, is adaptability and flexibility.