

## Thought Leadership

# The role of trusts for families

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When to use a trust and why it is not always the right solution. These are just some of the topics we spoke about recently with Alexis Hille, Counsel at Farrer & Co, an award-winning independent law firm headquartered in London.

We thought it would be interesting to share with you Alexis' insights on trusts and their place for families organising long-term estate planning. We have included a 'jargon buster' at the end to help with terms and technicalities particular to trusts.

### **Why use a trust?**

The answer to this probably depends a little on the jurisdiction involved, but broadly speaking clients use trusts for succession planning, asset protection, and tax planning.

It can be as simple as wanting to ensure children don't receive too much wealth at too young an age, or as complex as needing to manage significant multi-generational family wealth.

The tax rules for trusts keep getting more and more complex, and the reporting can be onerous. But with the right planning, and the right choice of trustee, trusts can be a very useful tool.

There are so many complicated tax rules around trusts in English law now that they tend not to be that useful for UK resident and domiciled clients unless they operate a private trading business or have very substantial surplus taxable income. That said, for non-domiciled clients, or clients with no UK footprint (other than perhaps UK resident children), trusts can still offer a number of tax benefits, particularly for inheritance tax.

Clients who are planning to move to the UK, or who have only been UK resident for a few years, often consider setting up a trust before they become deemed domiciled for tax purposes (which happens, very broadly speaking, after 15 years of tax residence). As long as the trust is settled while the client is non-domiciled, with non-UK assets, the assets will remain outside the inheritance tax net even after the settlor becomes deemed domiciled.

### **What is the role of the trustee?**

Most clients who set up trusts during their lifetimes choose a discretionary trust, which will have potential beneficiaries, either named (e.g., Jane Smith) or as a class (e.g., the children and remoter issue of the settlor), but no beneficiary will be entitled to anything from the trust. The trustee decides

whether to make a distribution, which beneficiary to benefit, and the quantum of the distribution. The trustee is the core power-holder and decision-maker; that's why the choice of trustee is so important.

### **What is the role of the protector?**

A trust doesn't need to have a protector, but it can be a useful role to include. The protector's role is supervisory, offering a 'safety valve' to ensure that the trustee carries out its fiduciary duties properly. The protector's role is usually fiduciary too, meaning that the protector needs to consider the best interests of all discretionary beneficiaries.

The protector could be the settlor (subject to ensuring that doesn't create any tax issues), a trusted individual, or group of individuals, or a corporate entity like a PTC (a privately owned company).

The most important power given to a protector is usually the power to hire and fire the trustee. Other typical protector powers include power to consent to important trustee decisions, such as the exercise of the trustee's power to make distributions.

### **How does the common law approach to trusts differ from the civil law approach?**

Although trusts may be recognised by many civil law jurisdictions, those jurisdictions tend to favour other structures, like foundations (which have their own legal personality, unlike a trust).

We have clients with existing foundations who need advice on how those foundations are likely to be treated from a UK tax perspective. It's not just a question of what the documents say, although that is important; we also need to review how the foundation has been run in practice.

It can be tricky to translate between common law and civil law jurisdictions, especially where the tax authorities in the civil law jurisdiction may misunderstand or even be suspicious of the idea of a trust altogether. For instance, in Switzerland if a tax authority thinks a beneficiary has too much influence over the trustee or protector, there is a risk that the trust will be viewed as transparent and taxed as though the underlying assets belong to the beneficiary.

Where we can help is to bridge the gap by explaining how discretionary trusts work, i.e. that no beneficiary has an entitlement and the trustee is the ultimate decision-maker, and by advising on how best to arrange the trust governance to show that it is robust. It's really important that everyone involved – trustees, protectors, beneficiaries, and their advisers, as well as the directors of any underlying companies – have a clear understanding of the proper chains of communication.

### **The US and England both have common law trusts, but they seem to use trusts quite differently. What's been your experience of that?**

You're right, the two jurisdictions do tend to look at trusts differently, which can create problems for US/UK clients if their advisers don't take both jurisdictions into account when planning. In the US trusts are often used as a way to avoid probate.

It's possible to create a US revocable lifetime trust which in practice allows the grantor to retain a significant amount of control over the assets, while building in succession provisions that dictate how the assets will pass after the grantor's death, effectively like a Will substitute. Although this works well in the US, for UK clients it can create UK tax issues if the clients put UK assets into the trust or if the clients are UK domiciled. We're often asked to advise on how US trusts might be drafted to reduce the risk of them being treated as taxable 'settlements' by HMRC.

In England, settlors tend to have much less control over trust assets, mostly because having control can trigger UK tax complications. Trusts are used very frequently in Wills even where there isn't a great deal of money involved, but for lifetime planning the use of a trust tends to be most appropriate where the sums are significant, and the settlor is non-domiciled or entirely outside the UK.

### **What is the most suitable location for a trust?**

Without wanting to sound like a cop out, it really does depend in each case. If all the beneficiaries are US persons, for instance, it may make sense for the trust to be based in a US jurisdiction like Nevada, South Dakota, or Wyoming.

There are a number of well-respected trust jurisdictions 'offshore'. I'd say the majority of my recent clients have looked to Jersey, Guernsey, or Bermuda (or the US, if appropriate). It is also possible to have a trustee resident in one jurisdiction (like Switzerland) with a different trust governing law (like Cayman). Some important factors in the choice of jurisdiction are

- (i) how long trusts are allowed to last (the so-called perpetuity period),
- (ii) how robust the 'firewall' provisions are for asset protection,
- (iii) how developed and extensive the professional infrastructure is and
- (iv) how far away the jurisdiction is from the settlor/beneficiaries, in terms of distance and time zones.

As can be seen from all of the answers above, this is a complex area and requires thought, consideration, and above all the right advisors. If you are thinking of setting up a trust, or considering which structure would be right for you, please do get in touch.



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### Jargon Buster

- **Domiciled** - the country you treat as your permanent home, or live in, and have a substantial connection with
- **Non-Domiciled** - you consider (and have declared) your permanent home to be outside of the country you are currently in, even if you live in that secondary country all year round.
- **Settlor** - is the entity that establishes a trust. The settlor goes by several other names: donor, grantor, trustor, and trustmaker. Regardless of what this entity is called, its role is to legally transfer control of an asset to a trustee, who manages it for one or more beneficiaries.
- **Discretionary Trust** - a trust in which the number of shares of each beneficiary are not fixed by the settlor in the trust deed, but at the discretion of the trustees.
- **Remoter issue** - refers not just to the children of the grandchildren but includes further generations among the possible beneficiaries. 'Issue' generally means descendants and is not limited to children.
- **Probate** - the process completed when a decedent leaves assets to distribute, such as bank accounts, real estate, and financial investments as defined by the Will.