An overview of the types and uses of Guernsey law trusts

Briefing Summary: A trust is a legal and equitable relationship pursuant to which a person, called a trustee, is required to hold and manage property in the best interests of another person or other persons, called beneficiaries.

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A trust is created when the legal ownership of property is transferred to or vested in a trustee who thereafter is required by law to manage and administer the property for the benefit of beneficiaries, or for the furtherance of certain purposes.

The beneficiaries of the trust collectively hold beneficial title to the trust property. This permits the beneficiaries to enforce trust obligations through the courts if necessary. Where a trust is for purposes and thus has no ascertained beneficiaries it must have an "enforcer" who is a person empowered to enforce the trust obligations in through the courts if necessary.

The trust relationship is generally intended for the safekeeping, management and eventual disposal of property, but a trust can last indefinitely if required.

Guernsey is a leading jurisdiction for the establishment and management of trusts. The Island has a large and well qualified professional trust sector, modern trusts legislation and an effective judicial system. It is also recognised as being in the top division of international finance centres in the regulation and supervision of its financial services industry.

The Island offers fiscal neutrality for trusts established for non-Guernsey resident beneficiaries. This is discussed further below.

Trusts terminology

The settlor of the trust is the person who transfers assets into a trust and is usually the owner of those assets. The settlor creates the trust and may also benefit under its terms. Subject to certain conditions, a settlor may also act as a trustee of the trust (though this may cause certain tax consequences for the settlor).

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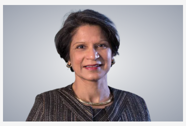

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The trustees are the individuals or company in which legal ownership of the trust property is transferred or vested and who are authorised to hold, administer and distribute such assets in accordance with the terms of the trust instrument and the Trusts (Guernsey) Law, 2007, as amended (the "Trusts Law"). Generally in Guernsey, trusts are administered by professional corporate trustees regulated by the Guernsey Financial Services Commission ("GFSC") under licence issued by the GFSC.

A trustee is a "fiduciary" and is bound by "fiduciary duties" which are rules of law and equity governing how a trustee is to act in the best interests of the beneficiaries of the trust or the furtherance of its purpose.

A trust instrument sets out the terms on which the settlor and the trustees have agreed that the trustees will hold and administer the trust fund. Some of the trustees' fiduciary duties or duties under the Trusts Law may be modified or eliminated by the trust instrument, but the duty of the trustees to perform the trusts honestly and in good faith for the benefit of the beneficiaries may not be excluded.

The trust instrument identifies the beneficiaries of the trust, that is, those persons intended to benefit from the trust fund or the purposes the trust was established to further. The trust instrument usually only refers to an initial nominal sum settled on the terms of the trust but its terms apply equally to subsequent property settled on the trust.

Guernsey trusts law

Guernsey's principal trusts legislation is the Trusts Law which is supported by a body of case law from the Island's courts.

Why choose a trust

There are many tools available for clients to manage their wealth, such as creating private holding or investment companies. Why choose a trust? As discussed above a trustee may not be released from the duty to act in the best interests of the beneficiaries of a trust or the furtherance of the purpose for which the trust was established, and this is a principal reason to choose the trust over other tools for wealth management. Indeed, it has been said that fiduciaries "must be worthy of being trusted to the ends of the earth, no matter what difficulties they may face." The trust relationship is held to some of the highest standards of professional care and skill known to the law.

This differs starkly from the directors of companies who must act in the best interests of the company itself, rather than the individual shareholders. A trustee looks only to the best interests of those named as beneficiaries or the furtherance of the purpose for which the trust was established.

There is something powerful in having a sophisticated professional or firm of professionals undertake to go to the ends of the earth; to promise to bring their formidable skill and expertise to bear in the best interests of the beneficiaries or for the furtherance of the purpose for which the trust was established. The trust relationship can offer a degree of personal service unlike any other, and is ideal for preserving and enhancing wealth for generations to come.

Common types of Guernsey trusts

Trust relationships are extremely flexible and may be tailored to suit the specific needs and goals of the settlor. The following are some examples of common Guernsey trust structures:

Discretionary trusts

A discretionary trust gives the trustees wide powers to administer the assets of the trust and to distribute them at their discretion. This provides the trustees with flexibility to adapt to the changing needs of beneficiaries over time. The settlor may guide the trustees' exercise of their discretions by providing a letter of wishes. The settlor may wish to update his letter of wishes over time. Whilst not legally binding, the letter of wishes sets out how the settlor would like the trustees to manage the trust property. It is normal for trustees to carefully consider the settlor's wishes in their administration of the trust and rare for the trustees to depart markedly there-from.

Fixed interest trusts

Trustees have little discretion as to how trust property is distributed in a fixed-interest trust. Rather, the settlor decides the proportions and timing of distributions to the beneficiaries. Such trusts are often used in inheritance planning that must accord with religious principles.

Purpose trusts

Unlike many common law jurisdictions, it is possible for Guernsey law trusts to be established partly or wholly for noncharitable purposes. Purpose trusts may be used in corporate transactions to create orphan structures or to hold assets which are otherwise difficult or undesirable for a company to hold. More commonly in a private wealth context such trusts can be used to protect family heirlooms or to hold assets such as shares in a family trading company. An enforcer is legally required to be appointed to enforce the terms of a trust in relation to its non-charitable purposes. The settlor may name the enforcer.

Settlor reserved power trust

Settlors may retain certain powers over the trust or trust property when they create a trust, such as the power to give binding directions to the trustees in relation to the investment of the trust fund, the power to vary or amend the terms of the trust, the power to remove a trustee and the power to change the proper law of the trust. Reserved power trusts are often used where a settlor is a successful business person and would like to remain actively involved in the management of a company following its settlement on trust. Powers may be reserved in any kind of trust, but care should be taken to ensure that no adverse tax consequences arise as a result.

Typical features of Guernsey trusts

Whilst it is not possible to cover the features of all trusts in this guidance note the points below are worth noting:

Revocability of trusts

A Guernsey trust may be revocable or irrevocable. If a trust is revocable, the settlor may terminate the trust and regain ownership of the trust fund held on trust on the date revocation takes effect. For this reason, tax authorities may argue that the settlor has always controlled the trust fund and careful advice is required if a trust is to be revocable in nature.

An irrevocable trust cannot be revoked by the settlor, though it may be terminated by the trustees according to its terms. Generally, this is the preferred form of trust settled under Guernsey law.

The use of protectors

The settlor of a discretionary trust may wish to ensure certain controls are placed around the key powers of the trustees. This can be achieved by requiring the trustees to obtain the consent of a third party before exercising such powers.

Such a third party is known as a protector of the trust. The rights and obligations of a protector vary from trust to trust and are normally set out in the trust instrument. Often, the protector is a close friend, relative or professional adviser of the settlor.

Common powers which are made subject to protector consent include the trustees' power to appoint new trustees, the addition and removal of beneficiaries and the distribution of capital from the trust fund.

Trust period

A Guernsey law trust may exist for a limited or unlimited period of time.

Practical uses of trusts

Guernsey trusts are generally used by individuals and companies for personal, business and investment purposes. It is important that any structure is properly established and professional advice is sought in each jurisdiction which affects the settlor, the beneficiaries and the trust fund. The following examples outline some of the practical ways in which trusts can be used:

Asset management and protection

Settlors capable of handling their own investments may be concerned about the ability of their heirs to do so after their death. A trust can be established reserving investment powers to the settlor during his lifetime. On the death of the settlor, either a person nominated by the settlor or the trustees may assume responsibility for the investment of the trust fund.

Settling assets onto trust can also serve important asset protection functions, so long as the trust is not established with the intention of defrauding creditors and the settlor does not reserve to himself unrestricted powers to revoke the trust or otherwise recover trust assets. Transferring assets to a trustee on the terms of a discretionary trust can serve to ensure that the assets are not available to creditors of the settlor or the beneficiaries and that the assets are protected in the event of family breakdown among members of the beneficial class.

Avoidance of probate formalities

Assets owned by an individual usually pass on death in accordance with the terms of a will. If the assets are held in a wide variety of countries it may be necessary to obtain a grant of probate to the will in each country where assets are located. This can be onerous, expensive and time-consuming. In addition, there may be estate duties and taxes payable before the estate can be settled and the assets distributed to the heirs of the deceased.

However, when assets are settled on trust they cease to be part of the estate of the settlor and so do not pass as part of the settlor's estate on death, eliminating the need to apply for probate or pay probate fees in respect of trust property. Trust property may be held for the benefit of succeeding generations in accordance with the terms of the trust instrument.

Forced heirship

Some jurisdictions' laws provide for the fixed distribution of a person's estate on death to their legal heirs (known as "forced heirship"). As discussed above property settled on trust does not form part of a settlor's estate at the time of death and so should not be subject to forced heirship rules. In addition, the Trusts Law provides protections in respect of Guernsey trusts and trustees against the claims of legal heirs pursuant to forced heirship regimes and thus settling a Guernsey law trust may offer a settlor who lives in a forced heirship jurisdiction but prefers to have freedom in the disposition of their property an elegant solution.

Privacy, confidentiality and anonymity

Trusts are generally created by a private document to which the settlor and the trustees are the only parties. The trust instrument does not have to be filed with any public body in Guernsey and information relating to the trust is not accessible by the general public. There are however certain exceptions to this, in particular, beneficiaries of a trust may be entitled to financial information relating to the trust. There are also ongoing developments in respect of international tax information exchange agreements and other treaties whereby certain information in respect of settlors, protectors and beneficiaries of Guernsey trusts may be required to be gathered and disclosed by the tax or other government or regulatory bodies in Guernsey to their counterparts in other countries with which Guernsey has entered into an exchange of information arrangement. Information exchange regimes such as the Common Reporting Standard ("CRS") reflect internationally accepted standards to which all reputable financial centres operate. However, such information is not accessible to the public or held in records which can be viewed by the public in Guernsey.

Prevention of division of assets

An individual who has built up a sizeable private company may have some children who are interested in the running of the business and some who are not. The individual may wish to benefit the children equally but would not want any of them to be able to dispose of their interest in the family company to non-family members. Such arrangements can be achieved through the use of a trust.

Family assets may also take the form of works of art or real estate which, by their nature, cannot be divided but from which a number of individuals could benefit. Such property can be held in trust for the beneficiaries without disturbing the underlying property.

Control of spending

In some cases, individuals may be unfit to manage their own affairs due to age, infirmity or profligacy. A trust structure can allow trustees to help in the management and preservation of wealth by controlling the manner in which trust funds are spent.

In some jurisdictions this will be critical to preserving the availability of government subsidised medical care or other sickness or disability benefits for disabled beneficiaries. Monies left to such beneficiaries by way of gift in a will or otherwise may form part of the beneficiary's estate and may cause them to fall foul of means tests associated with benefits regimes. Monies held on discretionary trust for a beneficiary do not form part of their estate save to the amount actually paid to or for the benefit of a beneficiary in a given year. This allows trustees the flexibility to enable a beneficiary to retain access to benefits systems (subject to applicable local rules) whilst preserving the trustees' ability to make large sums available for such a beneficiary's care when their eligibility for government subsidised care expires.

Commercial uses

There are also a range of uses to which trusts are put in the commercial sphere, including trusts established:

- for conferring benefits and incentives on employees (e.g. employee benefit trusts);
- as a vehicle for the administration of pension funds;
- as a platform for investment funds allowing investors to spread risk by acquiring limited stakes in a large portfolio of investments (e.g. a unit trust);
- to hold security over a borrower's assets for the benefit of lenders under syndicated loans; and
- as an 'orphaning' mechanism to hold assets 'off balance sheet', and in the creation of 'bankruptcy remote' structures.

Guernsey taxation of trusts

In Guernsey, the taxation rules for trusts are relatively straightforward provided the beneficiaries of the trust are not resident in Guernsey. In general terms the position is as follows:

- where the settlor of the trust is liable to Guernsey income tax and they and/or their spouse may benefit under the trust or in any circumstance control trust property the settlor will be liable to pay income tax on all income arising in the trust;
- trusts with no Guernsey resident beneficiaries are only liable to tax on Guernsey source income;
- Guernsey bank deposit interest is not treated as Guernsey source income when received by the trustees of a trust with no Guernsey resident beneficiaries; and
- if a beneficiary of a trust with no Guernsey resident beneficiaries becomes resident in the Island, steps can be taken to vary the trust, for example by restricting that individual to benefit from an isolated fund in the trust, if the trust's entire income is not to become subject to Guernsey income tax.

Conclusion

A trust is a flexible arrangement which can be structured to meet the objectives of a settlor. Tax advice should be obtained by the settlor and in some cases the beneficiaries, in each case in the jurisdiction in which they are tax resident, before a trust is established, to ensure the terms of a trust are tailored appropriately.