

The Utility of Flexible Private Trusts and Foundations within CARICOM

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Trusts and Foundations Contrasted

Trusts

A trust is an obligation affecting specific assets and binding a person, who is an office-holder called a trustee and who owns those assets, to deal with them for the benefit of any number of persons (of whom he may be one), who are called beneficiaries or for the furtherance of charitable or other purposes permitted by the law governing the trust. Exceptionally, non-charitable purpose trusts with a designated enforcer can be validly created by settlors under the law of some jurisdictions eg Antigua, Belize, The Bahamas, Bermuda, BVI, Cayman Islands, Liechtenstein, Isle of Man, Jersey and Guernsey. These trusts are particularly useful in structuring financial transactions involving corporate special purpose vehicles and in restricting enforcement rights to enforcers to the exclusion of beneficiaries interested in benefiting under the purpose trust.

In the traditional common law *proprietary* trust the beneficiaries or the persons having the right to enforce a purpose trust have more than mere personal rights to sue the trustee for losses occasioned by a breach of trust or for profits made for the trustee for himself or his associates. They also have equitable proprietary interests in the trust property. These interests enable the beneficiaries or trustees for them or an enforcer of a purpose trust to recover

specific trust assets or their traceable product, not just from a wrongdoing trustee but from any third party transferee, unless the transferee is a bona fide purchaser from the trustee for valuable consideration without notice of the trust or is protected by special legislation eg upon paying the purchase price for a house to two trustees.

In the case of civil law jurisdictions or jurisdictions that are a mixture of civil law and English common law, ring-fenced funds or “*obligational* trusts” exist. The beneficiaries do not have proprietary interests capable of binding third party transferees. Instead, they have the benefit of a specially preferred obligation that binds the trustee, the trustee’s creditors upon his insolvency and the persons taking over the trustee’s property on liquidation or death. The trustee has a fiduciary patrimony separate from his private patrimony, and the fiduciary patrimony can only be used for the benefit of the beneficiaries interested in it or the purposes to which it is dedicated. In Guyana it seems that, although there can be proprietary trusts of movables, there can only be obligational trusts of immovables.

Both the property model and the obligation model of a trust rank as trusts for the purposes of The Hague Convention on the Recognition of Trusts and, in both types of trust, the beneficiaries have extensive rights to information in order to enable them to hold the trustees to account in carrying out their obligations to the beneficiaries.

A trust has no legal personality. It is the trustees who own and manage the trust assets and who themselves sue or are sued by third parties for breaches of contract or for torts (delicts). A trust is an inherently mobile structure in that the trust instrument can authorise

replacement of the trustees by trustees in another jurisdiction and, indeed, change of the governing law to that of another jurisdiction.

Foundations

A foundation does have legal personality and is the full and absolute owner of its property and can sue or be sued in contract or tort (delict). Unlike a company, it does not have shareholder members or other owners, but it will be run by a council or board of directors whose duties are owed to the foundation. Some European countries require much formality to create foundations and restrict their use only to charitable purposes or purposes that are not trading or commercial in nature. Moreover, the foundation is immobile, so that it has to be dissolved if its assets are to be transferred to a foundation in another jurisdiction.

Other countries are happy to permit private foundations to be created easily, by registering the foundation with a simple charter, and to operate with little state interference except as to anti-money-laundering and anti-terrorist-funding obligations. They even allow the foundation to be transferred as a continuing entity to another jurisdiction, the laws of which will accept the foundation. The foundation's confidential regulations or by-laws can provide for benefiting purposes or a founder's relatives and persons to be designated by the founder and can even confer rights on a protector (or "curator"), as in the case of offshore discretionary family trusts. The regulations or by-laws in some jurisdictions can ensure that discretionary beneficiaries' rights to information are virtually non-existent (especially if provision is made for an audit of accounts by an independent third party) unlike the position for beneficiaries under trusts. Moreover, provision can be made under some laws for disputes to be resolved by

arbitration or mediation, without the insuperable problems faced in trust disputes where there are unborn or, as yet, unascertained beneficiaries, so that court proceedings are necessary. The founder can, of course, be a member of the council or board and reserve substantial rights, enabling him or her to appoint and replace members of councils or boards or protector committees or to add or subtract beneficiaries as he or she sees fit.

Flexible foundation legislation is found in Liechtenstein, Panama, Anguilla, St Kitts and The Bahamas.

A foundation, unlike a trust, can never be a sham, a sham trust being one where the settlor and the trustees intend from the outset to hold trust property to the order of the settlor and not for the beneficiaries described in the trust instrument. Regularly consulting the settlor and deciding to do what he or she suggests does not make the trustee a trustee of a sham trust, even where the settlor is one of the beneficiaries to whom the trustee decides to make a payment, so long as the trustee understands that the decision is the trustee's own decision to make or not to make. However, if the settlor-beneficiary is being divorced, the trust assets will be taken into account as his or her available resources where it is shown to be likely that the trustee will make payments to him or her if so requested.

While a foundation cannot be a sham, it can be treated as the alter ego of the founder (the real founder as opposed to a nominee used as a founder), just like a company can be regarded as the alter ego of an individual.

Governing laws

Obviously, the law of the relevant jurisdiction must govern the foundation created by registration within that jurisdiction. In the case of trusts there is much flexibility in choosing the law to govern a trust so as to achieve a situation not possible under staid English or Trinidadian trust law, especially if a local trust is set up in a jurisdiction having a flexible trust law (like Cayman, Bermuda or The Bahamas) before engrafting onto it substantial foreign factors e.g. as to assets and beneficiaries. However, either The Hague Convention on Recognition of Trusts, that has been incorporated into many jurisdictions' laws, or a jurisdiction's own law will prevent enforcement of provisions that are manifestly incompatible with public policy, and will afford a local court the opportunity to refuse to recognise a trust which is wholly local except for the governing law of the trust and, perhaps, a trustee. This may create some anxieties if a perpetual trust is created or a pure non-charitable purpose trust is established.

Use of a private trust company owned by a trust or foundation

A private trust company ("PTC") is one that does not need to be licensed by a jurisdiction's financial authority because it does not provide services to the public but only acts as a trustee of one or more trusts for the benefit of the same family or of employees of a particular company.

To comply with anti-money-laundering and anti-terrorist-funding regulations the PTC will need to employ a licensed financial or corporate services provider to act as secretary or director or records keeper e.g. for knowing your client/customer/beneficiaries purposes.

The PTC's shares will be held either by a private foundation or by a purpose trust. This is a trust formed for the purpose of holding the PTC shares, exercising the rights attached thereto and promoting the transactional functions of the PTC, and in which the settlor designates a particular individual or specially formed company to act as enforcer of the purpose trust. In my view, it is preferable to have the PTC shares held by a foundation. There can then be no question of the underlying beneficial (or equitable) interest in the shares remaining with the transferor: this can arise if a court considers that a purpose trust deals only with the investment holding and management side of things, not with the beneficial (or equitable) interest in the trust fund.

The PTC can then be the trustee of, say, Family Trust 1, owning a Bahamian International Business Company ("IBC") with a family investment portfolio and Bahamian real estate, and of Family Trust 2, owning, say, a BVI IBC owning shares in a family trading company and owning a family yacht.

Use of a PTC owned by a purpose trust or a private foundation affords scope for obscuring the settlor's involvement and provides a fair amount of secrecy, while the PTC can own assets of a trading or risky nature that a professional trust corporation would not be prepared to own or manage.

If things go wrong it can, however, be very difficult for beneficiaries to acquire adequate recompense where PTCs are used, unlike where professional trust corporations are used, the latter having "deep pockets". Where professional trust corporations are not appointed as

trustees their services are commonly utilised for administrative book-keeping purposes and for executing investment transactions, these tasks exposing them to little risk of liability.

Settlor input where major financial institutional is the trustee

(i) *The distributive function re income and capital*

While the settlor is alive and of full capacity, he can reserve to himself the exercise of powers of appointment over income and capital in respect of his issue and their spouses or civil partners – or his consent can be made requisite to the trustee exercising such powers to make payments of over a specified amount in each year to a beneficiary.

After the settlor's death, the trustee's exercise of distributive functions can be kept in check by the need for the consent of the settlor's wife if surviving him, or, otherwise of the majority of a committee of protectors (eg comprising the heads of each branch of the settlor's family) with such consent being dispensed with in the case of any deadlock. The protector could, instead, be a company, the shares in which are owned by family members.

(ii) *The management function*

A settlor can confer power on a trustee not just to invest but to speculate as if he were a billionaire speculator who could afford to lose the value of the whole trust fund without it affecting his standard of living at all; and oust the trustee from any liability for

any losses occasioned by it or its fund manager investing or speculating as if such a billionaire speculator.

By having the trustee owning an underlying company, so that liberal rules apply as to what amounts to capital and income of a company, one can by-pass illiberal inflexible trust law rules as to what amounts to income and capital. More significantly, the settlor or his nominee can play a key role as managing director of the company with special protection for the trustee against liability for the managing director's conduct, whether provided in the trust deed or special trust legislation as in the case of BVI VISTA trusts. It is possible for the company's articles to confer wide gift-making or loan-making powers and for the law governing the company to enable the managing director to be entrenched as irremovable unless certified as mentally incapable; but this may lead to allegations that the trust structure is a sham.

It is better for the trust deed to provide for the settlor or the settlor's nominee to be entrenched as the fund manager (except that the settlor can replace the nominee from time to time), while the trustee keeps the accounts, performs the distributive functions and monitors the manager's exercise of the powers to invest or speculate so as to prevent or reverse any exercise that is prohibited as amounting to a direct or indirect distribution to a beneficiary or a non-beneficiary.

Protection against creditors and heirs

It helps that once property has been transferred to a trustee or a foundation it will become immune from claims by the settlor's creditors after expiry of a period of time, which is often three years - or fewer under some governing laws.

A settlor may also be worried if his or her *lex successionis* is that of a jurisdiction conferring forced heirship rights upon heirs. Such rights commonly provide that if the deceased dies survived by eg three children, three quarters of the value of the notional estate at death, comprising the actual estate plus gifts made in a preceding period, which varies in different jurisdictions between five or thirty years, must pass absolutely to those children. As a result, the children can bring actions against the earlier donees to obtain money to make up the value of their entitlements. This is worrying for wealthy settlors who do not want their children to get their hands on too much money, worried by the three generational "rags to riches to rags" scenario, and so wanting to create a dynastic trust. If the settlor is worth 72 million pounds or US dollars he or she will not want 54 million to pass to his or her three children equally: it will be preferable to create a dynastic trust of say, 60 million, to benefit successive generations of the family.

At first sight, the settlor is protected by the general common law rule that the *lex situs* governs the validity of a transferor's lifetime transfers of property, so that property transferred in a common law State cannot be part of the transferor's estate at death to be governed by the *lex successionis* (even if the foreign *lex successionis* treats such property as subject to the *lex successionis*). Legislation in many offshore common law States expressly spells out the common law rule, so as to encourage foreign settlors

preferring this to that of a lawyer's written opinion, while also making clear that foreign judgments in favour of forced heirs will not be recognised and enforced. However, this is subject to the territorial impact of civil law *lex successionis* rules if such property is movable property found at the transferor's death in the jurisdiction of the *lex successionis* or a sympathetic jurisdiction having its own forced heirship regime. Moreover, if local "Civilopian" movable or immovable assets are transferred to a "Trustopian" company whose shares are then transferred to a Trustopian foundation or trustee, despite the validity of this Trustopian transfer by the Trustopian *lex situs*, any underlying assets owned by the company but located in Civilopia will be affected by the Civilopian *lex successionis*. Territorial might prevails.

Conclusions

Trusts and foundations have such inherent flexibility within their structures that they are exceptionally versatile vehicles for the preservation and development of family or corporate wealth, especially if offshore tax advantages may be exploited. While there has been a major crackdown on such exploitation – and common law tax authorities may have scope to treat a foundation like a trust or a company - non-tax advantages more than justify the use of flexible family trusts or foundations.

If a CARICOM jurisdiction is to become a successful international financial centre it needs to have up-to-date flexible trust and foundation laws.