

**STUART SMALLEY & Co LLC**  
**SOLICITORS**

**and**

**DOUGLAS TRUSTEES LIMITED**  
**(a Trust Corporation licensed by the Isle of Man Financial Supervision**  
**Commission as a Corporate and Trust Service Provider)**  
a wholly owned subsidiary of Stuart Smalley & Co LLC

**OFFSHORE TRUSTS**

*briefing*

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# OFFSHORE TRUSTS

*This note is in two parts. Part 1 outlines the nature and purpose of trusts generally and Part 2 discusses offshore trusts and explains the administration services offered by Douglas Trustees Limited in the Isle of Man. Douglas Trustees Limited is a Trust Corporation licensed by the Isle of Man Financial Supervision Commission as a Corporate and Trust Service Provider.*

## **PART 1 THE NATURE AND PURPOSE OF TRUSTS**

### **Introduction**

Trusts originated in England several centuries ago and are now established or recognised in numerous other countries. Even so, in some parts of the world the concept of the trust is still largely unfamiliar and, even where it is recognised (for example in parts of Europe), the local law regulating trusts may be rudimentary.

Trusts are frequently established in "offshore tax havens", ie places which impose little or no tax on income or capital gains.

A trust is, typically, an arrangement under which an individual ("the settlor") transfers assets owned by him ("the trust fund") to one or more persons ("the trustees") with directions, which are legally binding on the trustees, that the trustees should hold those assets upon prescribed terms ("the trusts") for the benefit of specified persons ("the beneficiaries"). The document in which the settlor's directions are contained ("the trust instrument") governs all future dealings with the trust fund.

For example, someone owning company shares might transfer them to trustees and direct the trustees:

- to pay the income from the shares to himself during his life and, after his death,
- to pay the income to his wife and, after her death,
- to transfer the shares to his children.

The expression "settlement", which is often heard in connection with trusts, means the act of creating a trust but it can also refer to the trust itself or to the document containing the terms of the trust ("the trust instrument").

### **Some Uses of Trusts**

We set out below some of the reasons for establishing a trust. The list is not exhaustive.

- Regulating the ownership of assets, for example providing for children or other dependants.
- Tax planning: this may for example involve a trust in an offshore tax haven in combination with a company or companies owned by the trust.
- Protecting assets, for example from government interference.
- Acting as a substitute for a will and so avoiding formalities on death, estate administration problems, inflexible inheritance laws and publicity about the transfer of assets on death.
- Preventing property from being used unwisely by particular individuals because it is the trustees who own and manage the assets for the benefit of those individuals.
- Providing flexibility in distributing assets or income amongst beneficiaries.

## **Family Trusts**

The example given earlier above is a typical "family" trust: the main purpose is to provide for the settlor and his family both during his lifetime and after his death. People outside the family, charities and others can also be included as beneficiaries where appropriate. The precise terms of the trust will depend on individual family circumstances.

Here are some examples.

- A "fixed interest" trust. As in the example already given, the rights of the beneficiaries are established at the outset and cannot be altered later. This has the merit of giving the beneficiaries fixed entitlements but it lacks flexibility.
- A trust with an overriding "power of appointment". This is the same as the paragraph above except that the trust deed contains a power to alter the entitlements. The power can be given to anyone including the settlor, the trustees and any beneficiary. The nature and extent of the power can be varied to suit individual requirements.
- A "discretionary" trust. This is an even more flexible trust; it is different from the paragraph above because;
- There are usually no fixed entitlements at the outset and
- The trustees are given a wide discretion to apply capital and income to or for the benefit of any one or more of a specified class of beneficiaries, for example the settlor and his family.

A discretionary trust is particularly suitable when there is uncertainty about the future requirements of the beneficiaries.

## **Non-Family Trusts**

This category includes charitable trusts and trusts created by companies, for example for employees.

## **The Trust Instrument**

The terms of a trust are normally set out in writing in a "trust instrument". This is commonly signed or sealed by both the settlor and the trustees. However, if the settlor prefers not to be named in the trust instrument, it can take the form of a "declaration of trust" which is signed or sealed by the trustees alone. In this case the trustees must be satisfied that they have adequate instructions from the settlor to enter into the declaration.

## **Duties of Trustees**

Trustees have a strict legal responsibility to carry out the terms of the trust. Any beneficiary of the trust may apply to the Court to stop a trustee from dealing with trust assets in an unauthorised manner. If beneficiaries suffer loss as a result of unauthorised conduct by the trustees, the trustees are personally responsible for making good the loss. Trustees should understand their trust, they should be familiar with trust law, they should be able to keep proper accounts and to manage the funds and, if anything goes wrong, they should be able to put it right or to make good any loss. The choice of trustees is therefore very important.

## **Choosing Trustees**

Trustees can be individuals or companies or a combination of the two. Most banks and many professional firms of lawyers and accountants offer trustee services.

Where clients of Stuart Smalley & Co LLC and Douglas Trustees Limited need the services of offshore trustees, these can be provided in the Isle of Man. A trust company for which Douglas Trustees Limited is fully responsible is normally appointed as trustee.

## **The Trust Fund**

The trust fund can be made up of assets of almost any description, for example company shares, businesses, investment properties, private houses, cash, insurance policies or interests under other trusts.

## **Trust Administration**

Trustees are usually given wide powers to manage the trust fund, for example to invest, to sell and to exercise voting rights. These powers tend to be lengthy because it is hard to forecast, when the trust is first established, exactly what powers may be needed later.

## **The Rights of the Settlor**

Once a trust is created, the terms of the trust instrument will govern future dealings with the trust fund. The settlor will have transferred management and control to the trustees. Accordingly the settlor will cease to have any rights over the trust fund unless the settlement keeps particular rights for him, for example:

- including the settlor as a beneficiary,
- giving him a power to revoke the settlement or a power of appointment,
- giving him power to appoint new trustees or
- requiring his consent to certain transactions, such as distributions of capital to beneficiaries.

In practice trustees will normally pay regard to the wishes of a settlor even where he has not reserved any legal rights over the trust fund. It is not uncommon for the settlor to set out his objectives in creating the trust in a "letter of wishes" to the trustees. This is not legally binding but it is helpful as guidance.

Settlors should bear in mind that in some cases the reservation of powers over or interests in a trust may have adverse tax consequences, for example making the settlor liable to tax on the trust income in his country of residence. Please also note the comments made in the next paragraph on the question of insolvency.

## **Insolvency of the Settlor**

The effect on the trust fund if the settlor becomes insolvent depends on the circumstances and perhaps also on the possible application of foreign systems of law. However, as a general proposition, the more completely the settlor gives up all powers over and interests in the trust fund, the smaller the risk is of the fund being held liable for payment of his debts in the event of his bankruptcy.

## **The Residence of the Trust**

By "residence" we mean the country where the trustees are resident and where they manage the trust. This is discussed more fully in Part 2.

## **Taxation**

The taxation consequences of a trust depend on a variety of factors, for example:

- the residence of trust,
- the residence and domicile of the settlor,
- the residence and domicile of the beneficiaries and
- the location of the trust assets.

Each case should be considered carefully on its own facts and, where necessary, legal advice on foreign taxation should be obtained. In Part 2 we discuss the position in the Isle of Man.

## **Death of a Settlor**

The terms of the trust instrument continue to govern the trust after the settlor's death. A settlor does not need to make a will in respect of property which he has put into a trust, unless he has reserved to himself a "power of appointment" exercisable by will.

## **Protectors**

In the case of a discretionary trust, a "protector" can be appointed with a power of veto over certain acts of the trustees so as to keep an eye on their wide powers, such as excluding beneficiaries or moving the trust to another country. The protector is usually intended to pay special regard to the wishes of the settlor and, for this reason, is often a professional adviser or a close friend of the settlor. A protector is sometimes given power to remove trustees and appoint substitutes. The protector is not a trustee unless the powers given to him are extensive, so the protector is not usually given many positive powers as opposed to the right to restrain the trustees from taking steps beyond the wishes of the settlor. The protector must exercise his discretion properly, because he owes a fiduciary responsibility to the beneficiaries, but he is not involved in the management of the trust itself and so is not an extra trustee as such.

## ***PART 2 OFFSHORE TRUSTS***

### **Tax Havens**

Trusts can be based in a number of offshore tax havens. The Isle of Man is particularly well established as a location for offshore trusts, not least because of its proximity to and strong links with the United Kingdom. It offers the advantages of well established trust laws and practices, high standards of professional and financial services, excellent communications and political and economic stability.

There are many possible offshore trust locations; the choice often depends on the personal preference of the client rather than only on legal or tax issues. However, in our view and having regard to various factors, the Isle of Man compares favourably with all other locations as a base for the administration of trusts.

### **Trust Law**

The Isle of Man is independent of the United Kingdom in relation to taxation matters and it has its own separate trust law, though it is very similar to English law.

### **Taxation**

The Isle of Man does not charge tax on the income of a trust provided the settlor and the beneficiaries are not resident in the Island, and the trust income, other than bank interest and certain investment income, comes from outside the Island. There are no capital gains taxes, estate duties, inheritance taxes or wealth taxes. Offshore trusts can provide significant tax advantages for beneficiaries living in high tax countries but each case must, of course, be considered within its own specific circumstances with the assistance of local tax advice, where appropriate.

### **Formal Requirements**

The trust instrument is a private document and is not subject to compulsory registration in the Isle of Man. There are no statutory accounting or auditing requirements and there is no need to file tax returns. In the Isle of Man it is possible to obtain an advance clearance based on a draft trust deed so that the identity of the settlor and the beneficiaries can be kept totally confidential.

### **Other Systems of Law**

It may sometimes happen that a trust established under one system of law conflicts with the requirements of some other system of law which applies to the settlor, for example by reason of his domicile, residence or nationality. In other cases conflicts can arise between the law of the trust itself and the law of the country where trust assets are located. Situations may arise where the trustees have to seek advice from local lawyers. Before the trust is set up, the settlor must take appropriate professional advice and satisfy himself that the assets he puts

into the trust are at his free disposal and that the creation of the trust does not have adverse tax or other implications.

### **Forced Heirship**

A particular problem arising from conflicts between two systems of law is in the area of succession law. Many countries have laws allowing a surviving spouse, children and perhaps other relatives to claim specified proportions of the estate on death. This is usually described as "forced heirship".

The Isle of Man does not have any legislation concerning forced heirship at present but a trust will not normally be open to challenge under Isle of Man law even though the terms of the trust conflict with another country's forced heirship laws. Exceptions would be those cases which the Isle of Man regards as being in breach of public policy, although it is thought to be unlikely that the mere disinheriting of a relative will be regarded as contrary to public policy in the Isle of Man.

However, it should be noted that a wife, husband, child or other relative of the settlor may be able to apply to the courts in a country other than the Isle of Man for compensation if he or she has been disinherited by the trust. The claim may succeed if, for example, there are assets of the trust in that country or if a trustee or beneficiary of the trust lives there.

In cases where the forced heirship issue is important, we recommend settlors to consider the possible implications carefully with their advisers.

### **Costs**

There are no government or other fees charged on trusts in the Isle of Man. The cost of making the settlement will consist of the fees for preparing the settlement and related professional advice, the cost of transferring assets to the trust and sometimes an acceptance fee where trustees charge it. Annual administration costs will consist of the trustee's fees (which in the case of banks and other institutions are often scale fees based on the value of the trust assets) and, where applicable, stockbrokers and other professional fees for management and advice. The current fee basis of Douglas Trustees Limited is attached.

The current charges apply from 1<sup>st</sup> September 2002. Fees are normally reviewed annually. The legal fees for preparing the settlement will depend upon the amount of advice required in discussing the terms of the trust and other related matters as well as upon the amount of drafting and the complexity of the required trusts. As a guideline, the approximate fee for establishing a trust in a simple case using one of our normal precedents would be £1,500 to £1,800. This covers the basic preparation of the trust deed, acceptance of the trusteeship by one of our trust companies and preparation of related trust minutes etc. The exact cost will depend upon the amount of advice required in discussing the terms of the trust and other related matters as well as upon the complexity of any drafting to be undertaken.

The normal basic annual fee for the provision of our trustee services is a minimum of £1050 payable in advance.

VAT will be added if applicable.

## Charging Structure for Trustee Companies<sup>1</sup>

### 1. Trust Documentation

Preparation of trust document using standard form discretionary trusts £1,500 to £1,800

Preparation of other documents Minimum fee £250.00, plus legal costs

### 2. Trust Acceptance

On acceptance of trust 1% of assets in trust fund, plus legal fees.

### 3. Trust Management

Each year of acting as trustee 1% of trust fund<sup>2</sup>, plus legal fees.

### 4. Trust Distribution

On distribution of capital<sup>3</sup> 1% of amount distributed, plus legal fees.

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<sup>1</sup> All fees where appropriate exclude value added tax at the current rate at the time of the invoice

<sup>2</sup> Charged quarterly

<sup>3</sup> Including any accumulated income

# QUESTIONNAIRE

The information requested is intended only as a preliminary guide. Detailed discussion will usually be necessary before trust documents can be prepared. Please use a separate piece of paper if space is insufficient here.

1.	Your full names.
2.	Address.
3.	Usual country of residence.
4.	Nationality.
5.	Your date of birth.
6.	To the best of your belief, are the assets which you intend to put into the trust at your free disposal?
7.	Please describe briefly the assets to be put into trust; we will ask for further details when we know the nature of the assets.
8.	Do you wish to retain any interest in or control over the trust? If so, please state what you have in mind. See "The Rights of the Settlor" on pages 3 & 4 of the note.
9.	Do you wish to appoint a protector? See "Protector" on page 5 of the note. If you have anyone in mind, please give full name and address.
10.	Please state, in broad terms, whom you wish to benefit under the trust (giving full names and dates of birth where possible) and how (eg income only or shares of capital, when they are to receive benefits etc).

**NB: PLEASE PROVIDE A CERTIFIED COPY PASSPORT OF THE SETTLOR, PROTECTOR AND BENEFICIARIES**

**PLEASE ALSO PROVIDE A BANKERS REFERENCE FOR THE SETTLOR AND THE PROTECTOR**

Signed .....

Date .....

**Please detach and return to Stuart Smalley & Co LLC**

# NOTES