

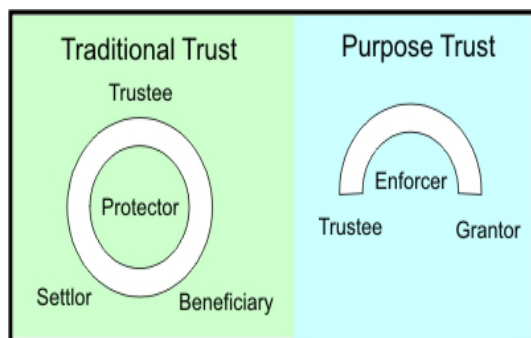
Purpose Trusts

Introduction

It has long been the position in the English legal system that trusts can only be one of two types, namely: private or charitable.

However, there now exists a creature of statute which introduces a third type of trust called a purpose trust.

A purpose trust is a trust which does not have any beneficiaries and exists for a specific purpose. A purpose trust for charitable purposes would not be valid under the act.



Purpose legislation exists in jurisdictions such as Liechtenstein, Cyprus, Cook Islands, British Virgin Islands, Nevis, Turks and Caicos Islands, Antigua and the Cayman Islands. Jersey and the Isle of Man introduced purpose trust legislation in 1996. The formation given below relates specifically to Isle of Man purpose trusts formed under the Isle of Man Purpose Trusts Act 1996.

Purpose trusts are not trusts in the true sense and are designed to be used as adjuncts to taxation planning structures in various ways.

How it works

A purpose trust is formed as a result of a deed of trust between a settlor and a trustee or trustees. To be enforceable the trust document must clearly define the purposes of the trust so that a court may determine these purposes.

There must be two or more trustees, at least one of whom must be a person in one of the categories specified in the act.

To enforce the trust there must be an 'Enforcer'. The Enforcer oversees the actions of the trustee to ensure that those actions further the purposes stated in the trust documents. The trust instrument must provide for the Enforcer to have an absolute right of access to any information or document which relates to the trust, the assets of the trust or to the administration of the trust.

The trust instrument must specify the event which causes the trust to terminate and must provide for the disposition of surplus assets of the trust upon its termination.

A purpose trust cannot have any beneficiaries, so all assets in the trust must ultimately be paid out towards the purposes of the trust, as set out in the trust document.

The designated trustee must keep a copy of the trust deed, a register and trust accounts. These accounts are open to inspection by the Attorney General but are not available for public inspection.

The trust deed and the purpose

Much care has to be taken in drafting the trust instrument particularly with regard to the purpose. Though we deal primarily with Isle of Man purpose trusts, there are differences in the laws of other jurisdictions which have to be taken into account if a trust is to be established elsewhere. Bermuda Law, for instance, now requires a substantive purpose beyond the mere holding of shares.

The document will set out the duties of the trustee or trustees and the enforcer.

The enforcer

The role of the enforcer is to oversee the trustees to ensure that the trust is administered in order to satisfy the purpose for which it was established.

An enforcer can be a corporate entity as can the trustees. There is nothing to prevent one being the subsidiary of the other.

The enforcer may not be a trustee of the trust, nor may he profit from the trust.

Provisions exist in the law for the registration or removal of the enforcer.

Should the enforcer die or become incapable, the Attorney General may apply to the court to appoint a successor.

Uses

Off balance sheet transactions

Where, for example, restrictive covenants have been entered into preventing a particular individual or company investing in certain areas, or companies, the investments may now be held within a purpose trust. Because there are no beneficiaries to the purpose trust, a link cannot be established between the investor and the investment. If the trust were set up with a short life, then the assets would revert to the settlor on termination.

Corporate finance/asset financing

Purpose trusts can be used to segregate investment funds or asset ownership within a subsidiary (as security from the lender) from group risk.

This is clearly an acceptable form of asset protection. It is becoming common in ship and aircraft finance/construction and in leasing transactions. In all of these cases the trust ends when the loan is satisfied, while in the interim the lender/financiers' cash flow is protected. The lender is further protected because the ownership of the subsidiary cannot change until the trust is terminated.

Division of voting and economic benefit

It is sometimes necessary to demonstrate that 'control' is not vested in a particular entity. Different classes of shares in a company can be created with voting control being in the hands of one party and dividend

rights in the hands of another. Thus voting shares may be placed in a purpose trust and the remaining shares held by the party seeking the economic benefit.

Ownership of trust companies

Some settlors of conventional trusts have concerns that control could be transferred to trustees over which a settlor has no influence. A purpose trust established to own a family trust company will usually overcome this difficulty. It enables the trustee to carry out its duties independently and gives assurance to the settlor that the board of directors of the trust company can be changed at any time by the shareholders i.e. the purpose trust. Another advantage is that on the death of the settlor the shares of the trust company are outside the settlor's estate and will therefore not pass to heirs who might otherwise control the trust company in a way not intended by the settlor.

Securitisation

Many structures creating international securitisation which in the past have used a charitable trust can now be set up using a purpose trust.

Social Benefits

A trust may have social, though not charitable, objects. For instance, a trust could be set up to benefit an area of outstanding beauty and to provide funds for its maintenance.

Investment in family companies

Much has been written about the difficulty of trustees of a non-purpose trust holding shares in family companies where the economic purpose is poor. If instead a purpose trust were put in place 'with the purpose of investing in Smith family companies' the trustees would have no need to be concerned that their actions could be criticised.

Acceptance

International recognition must be considered. Will the courts of the jurisdictions of the situs

of the trust property, of the domicile and residence of the settlor and beneficiaries, and any other relevant jurisdictions recognise the purpose trust as a valid trust? Those states which have ratified the Hague Convention on trusts have undertaken to recognise trusts 'for a specified purpose'.

Taxation

A taxable event occurs on the termination of the trust if the assets revert to the settlor. There may also be tax implications of the initial transfer of assets into the trust.

While the assets are under ownership of the trustees of a purpose trust the taxation will at least be neutral. In the case of assets which can physically be removed to the Isle of Man, the taxation can be seriously mitigated and, in some circumstances, possibly eliminated altogether.

Summary

The purpose trust has several significant advantages over conventional trusts in certain situations. An important factor is that there is a clearly defined trust deed and strong modern legislation supporting the structure.

Certain changes must be reported to the authorities. The records of the trusts may be inspected by the Attorney General (Isle of Man) and there is a much more visible and comprehensible regulatory framework.

The role of the enforcer is a key feature.

Its use in segregating assets, in dealing with fixed term events like loan replacement, and in providing a layer of confidentiality and its flexibility make it a valuable tax planning tool for the 21st century.

What ILS can provide

- Arranging drafting of the trust deed
- Providing a designated trustee
- Establishing related corporate structures
- Maintaining trust accounts
- Arranging banking facilities

Please note that ILS Fiduciaries (IOM) Limited does not offer tax advice. If you are not professionally qualified to give tax advice, we will be happy to make an appropriate introduction.