The use of trusts in Guernsey

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PREFACE

This memorandum has been prepared for the assistance of clients considering creating a trust in Guernsey. It is intended to provide a summary of the main legal requirements and general principles applicable to the establishment and administration of trusts. It is not intended to be comprehensive in its scope and it is recommended that a client seek legal advice on any proposed transaction prior to taking steps to implement it.

A series of briefings on other aspects of Guernsey law have been produced by Ogier and are available on request. This memorandum has been prepared on the basis of the law and practice as at 1 July 2010.

INTRODUCTION

Constitutional position of Guernsey

Guernsey is a self-governing dependency of the British Crown and does not form part of the United Kingdom. By constitutional convention established over some 900 years the Island has complete autonomy in all matters of internal government, including taxation. The legal system is derived in part from the customary laws of Normandy but has been strongly influenced by English law in trust, company and commercial matters and the English Supreme Court remains the Island’s ultimate court of appeal. The Island’s special constitutional position has been recognised by the European Union in a protocol (No.3) attached to the United Kingdom’s Act of Accession to the EU. The protocol provides that the Treaty of Rome shall apply to Guernsey only to the extent necessary in relation to the arrangements for the free movement of goods. Accordingly, European Union directives on fiscal harmonisation, financial services and company law do not have effect in Guernsey. The Island has as a result of its constitutional position developed into a leading international finance centre.

Introduction to the trust concept

A trust is a legally binding arrangement whereby a person (known as a settlor) transfers assets to another person (known as a trustee) who is entrusted with legal title to the trust assets, not for his own benefit, but for the benefit of other persons (known as beneficiaries, who may include the settlor).

The instructions from the settlor to the trustee as to the disposition of trust assets will normally be contained in a document called the trust instrument. This is for the benefit of all parties as it will ensure that the settlor, the trustee and the beneficiaries know precisely what their respective rights and duties are. The trust instrument will usually provide that the trustee has the power to manage the trust assets in accordance with the terms of the trust instrument and the strict duties imposed on the trustee under Guernsey law.

In addition to the trust instrument it is also usual for a settlor to indicate to the trustee his wishes as to the management and disposition of the trust fund in the future in a less formal manner. His expression is often contained in a letter of wishes which, although not legally
binding, will generally be considered by the trustee to be of persuasive effect when performing his duties and, for example, determining to make a distribution out of the trust fund.

The trust system in Guernsey

While trusts have been established in Guernsey for many years, their operation is now governed by a modern, comprehensive statute entitled the Trusts (Guernsey) Law, 2007 (the ‘Trusts Law’). The Trusts Law provides that a trust exists, and will be enforced by the Guernsey Courts, where a trustee holds or has vested in him assets for the benefit of a beneficiary, whether or not yet ascertained or in existence, or for a charitable purpose or a non-charitable purpose. Section 72 of the Trusts Law confirms that the trust assets constitute a separate fund and do not form any part of the personal property of a trustee. The Trusts Law also imposes fiduciary duties on trustees, regulates the administration of trusts and provides rights of beneficiaries. For example, any beneficiary has a legal right to force a trustee to act in accordance with the terms of the trust instrument and the Trusts Law. A Guernsey trust can exist for an indefinite period.

The performance of a trustee’s duties will be enforced by the Royal Court of Guernsey, if necessary, at the instigation of a beneficiary.

The Guernsey Courts will seek to ensure that a trust established under Guernsey law is administered by the trustee in accordance with the provisions of the trust instrument and the Trusts Law, thus providing a high degree of protection for both settlor and beneficiaries. The Royal Court of Guernsey has an acknowledged proficiency in the law of trusts and the senior British Judges who sit on the Court of Appeal in Guernsey provide added assurance to settlors and beneficiaries that litigation, while unwelcome, will be decided upon justly, fairly and with an expertise which may be lacking in less sophisticated jurisdictions.

There is no requirement under Guernsey law to register trust documents with any governmental office or agency. This enables complete confidentiality of the trust arrangements to be maintained. Indeed, a Guernsey trust may be established by means of a written declaration signed by the trustee alone without the requirement that the settlor appears as a party to the instrument.

The extension to Guernsey in 1993 of the Hague Convention on the Recognition of Trusts has given further impetus to the expansion of trust services on the Island. Under this convention, trusts which have duly been constituted under the laws of Guernsey must be recognised by the signatories to the convention. At present these include the following jurisdictions: the United Kingdom, Jersey, France, Italy, the Netherlands, Luxembourg, the United States of America, Canada, Australia, Cyprus, Malta, Hong Kong and San Marino.

Further protection for the settlors and beneficiaries of Guernsey trusts is provided by the Regulation of Fiduciaries, Administration Businesses and Company Directors, etc. (Bailiwick of Guernsey) Law, 2000 which imposes minimum standards on commercial trustees and requires them to be licensed by the Guernsey Financial Services Commission.

THE COMPONENTS OF A TRUST

The settlor

Once a trust is created the settlor will have divested himself of legal ownership of the trust assets. The settlor may be a beneficiary and, in certain circumstances, he may also act as a co-trustee. The settlor may also retain a degree of control over the trust, such as the power to
approve distributions, the power to appoint and remove trustees and the power to revoke the trust. However, it is essential to the validity of a trust that the settlor actually dispossess himself of the trust assets and he may not, for example, simultaneously be a sole trustee and a sole beneficiary.

Although once a settlor transfers assets to a trust he is deemed to have divested himself of legal ownership of the trust assets, under section 15 of the Trusts Law, a settlor may reserve to himself certain powers (or grant powers to a third party other than the trustee). These include the powers to revoke, vary or amend the terms of a trust or any functions; powers to advance, appoint, pay or apply income or capital of the trust property or to give directions for the making of such advancement, appointment, payment or application; powers to appoint or remove any trustee, enforcer, protector or beneficiary and powers to change the proper law of the trust.

The trustee

Legal title to the trust assets is vested in the trustee under the obligations imposed by the trust and he is responsible for the administration of the trust. A trustee is required by section 22 of the Trusts Law to observe the utmost good faith and act en bon père de famille, which is a phrase particular to Guernsey law meaning that a trustee must in all cases act as a good father would act towards his children. A trustee must exercise his powers solely for the benefit of the beneficiaries. The trust assets, however, constitute a separate fund and do not form any part of the trustee’s own estate.

Section 44 of the Trusts Law states that a trustee is entitled to a non-possessory lien over the trust property in respect of all expenses and liabilities (existing, future, contingent or otherwise), securing a trustee’s right to be reimbursed or to be paid from the trust fund. This lien continues after the trustee ceases to be a trustee and has duly surrendered all trust property in accordance with section 43 of the Trusts Law when the trustee resigns or is removed. The lien attaches to trust property except where the lien is expressly waived or released. The lien does not attach to real property, unidentifiable property, or property in the hands of a bona fide purchaser for value or a person (other than the trustee) who derived title through such a purchaser.

The beneficiaries are the persons entitled to benefit from the assets held on trust. As stated above, the settlor may himself be one of the beneficiaries. In order for a trust to be valid there must generally be sufficient certainty as to the identity of the beneficiaries. An express power for the addition of further persons to the class of beneficiaries may, however, be included in the trust instrument. The beneficiaries may enjoy equal or unequal benefits, as the trust instrument prescribes, or, in the case of a discretionary trust, as the trustee may determine.

It is also possible to include in the trust instrument a power to exclude beneficiaries from future benefit.

The trust fund

The assets constituting the trust fund may be of any type of moveable or immoveable property. At any time after settlement on trust of the initial assets, further assets may be added. Indeed, a common arrangement is to establish a trust with a nominal initial amount and subsequently to add more substantial assets.

The protector
It is not essential for the validity of a Guernsey trust that there be any protector. However, in order to counter-balance the wide discretionary and fiduciary powers conferred on a trustee it is often found useful for the settlor to appoint a trusted friend or professional advisor to act as a protector of the trust. In such cases the consent of the protector will generally be required before the trustee may exercise certain strategic powers under the trust instrument.

FORMS OF TRUSTS

Various types of trust have been developed over time and the most appropriate structure for the settlement will depend on the settlor’s particular circumstances and objectives. Some of the more common types of trust are described below.

Fixed interest in possession trust

Under the fixed interest trust the principal beneficiary will normally be granted a vested interest in the income of the trust fund throughout his lifetime and the discretion of the trustee regarding the disposition of the trust fund will be limited. For example, the trust instrument may specify that the trustee is required to distribute all of the income of the trust fund to a particular individual during that person’s lifetime and subsequently to distribute the capital of the trust fund in fixed proportions to named beneficiaries (such as the settlor’s children).

Accumulation and maintenance trust

An accumulation and maintenance trust is one where no beneficiary has a fixed entitlement to the benefits accruing to the trust for a certain period, during which time income is accumulated and becomes an accretion to capital. The persons who are ultimately entitled to the trust capital may thus benefit from the accumulation of capital. The trust instrument may give the trustee a discretionary power to make distributions amongst the beneficiaries up to a specific age for their education, maintenance and benefit and to provide thereafter for a designated share of the trust fund to be distributed to each child on attaining a specified age. An accumulation and maintenance trust may be particularly appropriate where the settlor wishes to benefit a group of children, for example, his grandchildren.

Discretionary trust

The discretionary trust provides maximum flexibility and is often the most efficient structure for both settlor and beneficiaries. Under the terms of a discretionary trust the trustee is given wide discretionary powers as to when, how much and to which beneficiaries he should distribute the income and capital of the trust. Such a form of trust is useful where at the time of creation of the trust the future needs of beneficiaries cannot accurately be determined. The beneficiaries are not regarded as having any direct legal rights over any particular portion of the trust fund but only a right to be considered to benefit when the trustee exercises his discretion.

Revocable trusts

Although for tax and other reasons it is generally desirable for a trust to be constituted as an irrevocable settlement, in certain circumstances the settlor may require the additional comfort of knowing that he has retained the power to revoke the trust and enforce the return of the trust fund. Careful consideration should be given to the possible consequences of a revocable trust because, under the jurisdiction of the settlor’s domicile, residence or nationality, revocation may negate some of the expected benefits of creating the trust.
Charitable and non-charitable purpose trusts

Generally, in order for a trust to be valid there must be identifiable beneficiaries. In brief, the onerous duties imposed upon trustees are owed to the beneficiaries and without ascertainable beneficiaries who may enforce these duties against the trustees a trust will not be upheld. A long held exception to this general rule has permitted trusts to be established in favour of charitable purposes. In such instances it is Her Majesty’s Procureur who has the role of enforcing the trustee’s duties and obligations.

The Trusts Law also permits the creation and enforcement of non-charitable purpose trusts, i.e. trusts in which property is held by trustees on trust to carry out specific purposes which do not qualify as charitable purposes. This type of trust is often simply referred to as a ‘purpose trust”. All the usual rules of Guernsey trusts apply save in three respects. First, the trust deed must set out the particular purpose or purposes for which the trust has been established (which can include simply holding assets). Second, the trust may have a combination of beneficiaries, charitable and non-charitable purposes. Third, the trust instrument must provide for a person whose duty it is to enforce the trust in relation to its non-charitable purposes (i.e. to ensure that the trustee acts in manner which is consistent with the attainment of the non-charitable purpose). This person is called the “enforcer” and must be a person different from the trustee or trustees. Non-charitable purpose trusts enable purposes which are not charitable in the strict sense but are, or may be, beneficial in a wider sense, to be fulfilled.

Practical applications of Guernsey trusts

In essence a trust is a legal device, first developed under English law, under which legal ownership of assets is vested in a trustee whilst the enjoyment of the trust fund is preserved for the benefit of the beneficiaries on terms determined by the settlor.

The range of uses to which a trust may be employed is still being developed but flexibility and confidentiality are the principal advantages which a trust has over other legal forms designed to hold, preserve and transmit wealth. The trust concept has proved to be enormously adaptable and is widely used in financial planning. Such is the flexibility of a Guernsey trust that it would be impracticable to define its potential. However, some typical applications are the following:

Preservation of wealth

Trusts may be used to preserve the continuity of ownership of particular assets, such as a business, within a family. By vesting legal ownership of the assets in the trustee, the relevant individuals may be able to continue to benefit from the assets, whilst avoiding fragmentation of ownership amongst a large number of second and third generation beneficiaries. The use of a trust avoids, on the death of a beneficiary, the risk of a share of assets becoming owned outside the family, and thus enables settled assets to be preserved intact for the benefit of future generations.

Forced heirship

Where a settlor disposes of assets during his lifetime by settling them on trust, the trust assets will not form any part of the settlor’s estate upon his death. This may enable a settlor to avoid forced heirship rules which may be mandatory under the laws of his domicile, residence or nationality and which would otherwise dictate the persons to whom and proportions in which
a settlor’s estate will devolve. Section 14 of the Trusts Law was specifically enacted to provide that no Guernsey trust will be invalidated nor will any person be subjected to any obligation or liability simply by virtue of the fact that the trust avoids or defeats (or might do so) their rights or claims which might arise under foreign heirship rights or by virtue of their marriage, common law relationship, or civil partnership or by their being a child of a person.

Succession planning

The effect of a trust is to divest the settlor of ownership of the settled assets. Accordingly, upon the death of a settlor there will be no need to obtain a grant of probate or similar formalities in order to deal with the trust fund. A trust, therefore, provides an efficient vehicle for the transfer of beneficial ownership interests on the death of a settlor. Further, because the interests of a beneficiary under a discretionary trust will not constitute a separate asset under Guernsey law, a trust structure may assist in the avoidance of stamp duty or inheritance taxes which would otherwise be payable on the death of a beneficiary. In addition, a trust can be used to hold shares in a company owning immovable property, rather than directly in the real property itself, with the effect of transforming the characterisation of an interest from immovable to moveable, which can present attractive opportunities for tax and financial planning. A trust may also be used to protect financially unsophisticated beneficiaries and to make financial provisions for the improvident.

Asset protection

Historically, trusts have been established for the principal purpose of protecting assets from risk. In a modern context, trusts may be employed to hold assets in a secure and stable political environment.

Trusts play a major role in financial planning for individuals, families and companies and are apt to serve as a shield to protect assets against the potential future liabilities of a settlor, such as punitive taxation. The use of a trust in conjunction with an underlying company can be used to convert an onshore asset into an offshore one and to interpose an additional layer of confidentiality in a chain of ownership. The use of the trust and company combination may also enable trust assets to be held in a jurisdiction which does not recognise the trust concept. Such an arrangement may be attractive to a lender for the purpose of obtaining security against assets. Trusts can also safeguard assets against strategic risks, such as confiscation or expropriation by the State in the country of the settlor’s domicile, residence or nationality. As a further protection, a modern trust instrument can provide for the proper law of settlement to be moved to another jurisdiction in the event of political or strategic emergency in the country of the trustee’s residence.

Commercial trusts

The variety of means to which a trust may be put in the commercial context has only been partly realised. Guernsey trusts have been, or could be, used for the following commercial purposes:

- as a unit trust for the collective investment of capital;
- in Eurobond issues, the interests of investors may be regulated pursuant to the terms of a debenture trust deed;
- in off-balance sheet transactions, the share capital of an “orphan” special purpose vehicle will typically be held by a trustee under the terms of a charitable trust or a non-charitable
purpose trust;
• in an inter-creditor agreement, the rights of one creditor group may be subordinated to
the rights of other creditors and regulated under the terms of a subordination trust forming
part of the overall security package;
• asset securitisation schemes have been structured to provide for mortgages and
receivables to be held pursuant to the terms of a trust; and
• employee share option and executive incentive schemes (as well as regular pension
schemes) often benefit from being established in a trust structure in a politically stable,
fiscally neutral jurisdiction.

Taxation
Where all of the beneficiaries are resident outside Guernsey a Guernsey trust will be exempt
from assessment both in respect of Guernsey income tax on income arising outside the Island
and income on bank deposit interest arising inside Guernsey. For practical purposes, therefore,
the trustee may make distributions out of a trust fund established in Guernsey without any
withholding or deduction for Guernsey income tax. There are no inheritance, wealth, gift or
capital gains taxes levied in Guernsey nor is there any stamp duty, value added tax or
equivalent forms of indirect taxation charged on the creation or transfer of assets to a trust. In
this respect Guernsey trusts differ from trusts created under the laws of other jurisdictions,
such as Bermuda and Liechtenstein

Creation of a trust
It is preferable for a trust to be created by the execution of a formal written instrument so that
all parties will know exactly what their respective rights and duties are. The Trusts Law does,
however, permit a trust (other than a unit trust) to come into existence by oral declaration or
by conduct. Trusts created in writing may be either by a settlement of trust signed by both the
settlor and the trustee, or by a declaration of trust signed by the trustee alone. Following
execution of the trust instrument a trust will come into existence upon settlement of the initial
property, which may be supplemented later. Ogier is able to assist with preparation of all of
the appropriate documentation.

In connection with the formation and administration of trusts in Guernsey we are able to
provide the following services:

• providing initial advice and liaison with professional advisers in other jurisdictions in order
to recommend the most practical and efficient structure to achieve the settlor’s objectives;
• preparing the trust instrument, letters of wishes and formation of underlying companies to
hold the trust assets;
• preparing and reviewing documentation relating to commercial transactions underlying
the trust; and
• assisting the settlor in the choice of a trustee for a Guernsey trust and the preparation and
review of all documentation to provide for the proper administration and operation of the
trust and underlying companies.

We also provide other legal services which are complementary to our trusts and business law
practice to ensure that our clients’ requirements are fully met.
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Ogier provides practical advice on BVI, Cayman Islands, Guernsey, Jersey and Luxembourg law through its global network of offices. Ours is the only firm to advise on these five laws. We regularly win awards for the quality of our client service, our work and our people.

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