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**Rechtswissenschaftliches Institut**

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# **Foundations and Trusts**

## **Block 2**

**Spring Semester 2021**

**RA Michelle Kalt, LL.M.**



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# **Part I: Common Law Foundations**

## **Lecture: Foundations and Trusts**

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# I. Common Law Foundations: What are they?

## Origins

- Common law foundations have emerged in jurisdictions that follow the **common law** (rather than civil law) tradition (*duh*)
- What is „**common law**“?
  - Common law vs. civil law
  - Common law vs. statutory law
  - Common law vs. equity
- Popular in so-called **offshore jurisdictions** (what is that?)
- Recent legislative development (since the early 2000s)
- Created by **statute** (as opposed to case law)



# I. Common Law Foundations: What are they?

## Origins

- Examples of jurisdictions that have enacted foundation legislation
  - St Kitts Foundations Act 2003
  - Bahamas Foundations Act 2004
  - Antigua and Barbuda International Foundations Act 2007
  - Anguilla Foundation Act 2008
  - Jersey Foundations (Jersey) Law 2009
  - Seychelles Foundations Act 2009
  - Vanuatu Foundation Act 2009



# I. Common Law Foundations: What are they?

## Origins

- Examples of jurisdictions that have enacted foundation legislation (cont'd)
  - Belize International Foundations Act 2010
  - Labuan Foundations Act 2010
  - Isle of Man Foundations Act 2011
  - Mauritius Foundations Act 2012
  - Cook Islands Foundations Act 2012
  - Guernsey Foundations (Guernsey) Law 2012
  - Barbados Foundations Act 2012



# I. Common Law Foundations: What are they?

## Origins

- Examples of jurisdictions that have enacted foundation legislation (cont'd)
  - Gibraltar Private Foundations Act 2017
  - Abu Dhabi Global Market Foundations Regulations 2017
  - New Hampshire Foundations Act 2017
  - Foundation Companies Law 2017
  - Dubai International Financial Centre Foundations Law 2018
  - Wyoming Statutory Foundation Act 2019



# I. Common Law Foundations: What are they?

## Origins

- Legal features can typically be traced back to European private foundations (e.g. Liechtenstein)
  - However, typically the common law foundation acts also borrow rules from both **local trust and company laws**
- Oftentimes, the legislative goal was to create a statutory arrangement that is „not quite like the trust“
  - Rationale: to offer the «target audience» of offshore financial services additional options to hold wealth apart from the trust (e.g. for individuals domiciled in civil law jurisdictions)
  - Concerns?





# I. Common Law Foundations: What are they?

## «Two Generations»

- First wave: 2003 – 2012
  - Largely confined to offshore financial centres
  - No single „common law foundation“ model
- Second wave: 2017 – now
  - Increasingly important financial centres adopt foundation statutes (Dubai, Abu Dhabi, USA)
  - Increasingly different from civil law foundations (e.g. „foundation companies“ in the Cayman Islands)



# I. Common Law Foundations: What are they?

## Commonalities between Foundation Models

- Independent legal entity with legal personality
  - See e.g. Guernsey, Jersey, Isle of Man
  - No single „common law foundation“ model
- Established when a person (**founder**) dedicates **assets** to a specific **purpose or object**
  - Assets leave the ambit of the founder and are henceforth „self-owned“
  - Assets, just like in a civil law foundation, **form a legal entity**, which in turn is *not* „owned“ by shareholders (unlike e.g. a stock corporation)
- Assets are managed by a **foundation council**



# I. Common Law Foundations: What are they?

## Commonalities between Foundation Models

- Registration requirements (less common for trusts and in civil law jurisdictions)
  - Exceptions: recent legislative changes to European foundation laws
- Use of local formal agents





# I. Common Law Foundations: What are they?

## Differences between Foundation Models

- Founder's rights
  - Broad possibilities to retain founder's rights (e.g. Jersey) vs. only specific founder's rights (e.g. Guernsey)
- Beneficiary rights
  - Beneficiary rights for enfranchised beneficiaries vs. no beneficiary rights unless founder specifies otherwise (opt-in system)
- Foundation governance
  - Use of «guardians» by default vs. use of guardians only in specific circumstances



# I. Common Law Foundations: What are they?

## Common Law Foundations and Trusts

- CLF tend to have legal personality, trusts never do
- No „beneficiary principle“
  - Foundation council does not have fiduciary duties towards the beneficiaries of the foundation (all duties are to the foundation)
  - Beneficiaries do not have „beneficial interest“ in the foundation's assets (at most, they have *personal* rights towards the foundation)
- Registration requirements
  - CLF require registration whereas trust can be established largely without formal requirements



# I. Common Law Foundations: What are they?

## Common Law Foundations and Trusts

- CLF are outside the inherent equitable jurisdiction of the court over fiduciary offices (with some exceptions)
- CLF are created by statute and are not a product of equity
- No „rule against perpetuities“ for CLF
- Foundation council can focus on preserving assets (as opposed to duties towards beneficiaries)
- No duty to diversify assets – a CLF can hold a single asset



## I. Common Law Foundations: What are they?

### Case Study: Foundations (Jersey) Law 2009

- Can be created for beneficiaries or a purpose or both
  - Purpose may be charitable or non-charitable or a mix of both
- Separate legal entity
- Required documents: foundation charter and regulations
- Foundation council of min. 1 member
  - min. 1 „Qualified Member“ of the foundation council
- Guardian required
- Weak beneficiary rights
- Founder may retain and assign almost any right (see section 18 of the Foundations (Jersey) Law 2009)



## I. Common Law Foundations: What are they?

### Case Study: Foundations (Guernsey) Law 2012

- Can be created for beneficiaries or a purpose or both
  - Purpose may be charitable or non-charitable or a mix of both
  - Beneficiaries may be enfranchised or disenfranchised
- Separate legal entity
- Required documents: foundation charter and rules
- Foundation council of min. 2 members, unless charter provides otherwise
  - „Resident agent“ required under certain conditions





## I. Common Law Foundations: What are they?

### Case Study: Foundations (Guernsey) Law 2012 (cont'd)

- Guardian required only for purpose foundations or in the case of disenfranchised beneficiaries
- Beneficiary rights depend on whether beneficiaries are „enfranchised“ or „disenfranchised“
  - Disenfranchised beneficiaries (section 33 of the Foundations (Guernsey) Law 2012) have no rights of information
  - Enfranchised beneficiaries (section 32 of the Foundations (Guernsey) Law 2012) enjoy information rights and can make applications to the court
- Limited founder's rights may be retained (see section 11 of the Foundations (Guernsey) Law 2012)



# I. Common Law Foundations: What are they?

## Recognition of CLF in Switzerland – Issues

- Mixed legal nature
  - Similarities to both trusts and (civil law) foundations
- Little case law (new development)
- Not a homogenous phenomenon – few generic statements can be made
- Precise legal nature is largely down to the individual founder
  - Extensive founder's rights might affect recognition negatively (cf. Liechtenstein foundation)
- Determination of applicable law (statute) requires decision on whether a legal instrument is a contract, a company or other legal person or – possibly – a trust within the meaning of the HTC



# I. Common Law Foundations: What are they?

## Recognition of CLF in Switzerland – Issues

- CLF: Recognition in Switzerland under the HTC or under art. 154 *et seqq.* PILA?
    - HTC employs broad definition of „trusts“, however it does appear to require the *trustee* to be the rights holder with regard to the trust property
    - legal personality of CLF indicates that CLF might not constitute a „trust“ within the meaning of art. 2 HTC
    - No beneficial interest of beneficiaries in the CLF's assets – „tracing“ rules of art. 11 para. 3 HTC do not fit
- HTC does not seem to be a good fit for the CLF



# I. Common Law Foundations: What are they?

## Recognition of CLF in Switzerland – Issues

- The term „company“ of art. 154 PILA is very wide
  - Art. 154 et seqq. PILA apply to virtually all legal entities with a **degree of organization** – legal personality alone will usually suffice
- Plus: International legal principle of **comity** requires openness and respect towards foreign legal concepts
  - Art. 154 *et seqq.* PILA seem to be a better fit for the CLF
- All in all, recognition of CLF should not constitute a massive hurdle given that Switzerland recognizes trusts
- The usual caveats apply (art. 17, 18 PILA)



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# **Part II: Introduction to Trusts**

## **Lecture: Foundations and Trusts**

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## II. What is a Trust?

### Origins

- Most commonly utilized in **common law jurisdictions** (England & Wales, Australia, New Zealand, USA, India, etc.)
  - But: popularity in civil law countries is increasing
- **No «legal definition»** but numerous attempts have been made at describing the concept
- Historically developed through *case law* (as opposed to statutory law) of the courts of Medieval England
  - How did it happen? Well...



## II. What is a Trust?

### Origins

- When the Crusades happened, men left real property behind at home
- Their wives and daughters could not own property, so they had to transfer it to another man to take care of, who became the legal owner of the property under the common law
- Upon return, they wanted their property back but did not have any legal claim
- The **common law** did not provide relief – that's when **equity** came in...



## II. What is a Trust?

### Core Characteristics

Recap: Hayton's Elephant Test

«Like an elephant, a trust is difficult to describe but easy to recognize»







## II. What is a Trust?

### Definition

- **No «legal definition»** but numerous attempts have been made at describing the concept
  - “A trust is an **equitable obligation**, binding a person (called a **trustee**) to deal with property (called **trust property**) owned by him as a separate fund, distinct from his own private property, for the benefit of persons (called **beneficiaries** [...]), of whom he may himself be one, and any one of whom may **enforce** the obligation.”
- HAYTON/MATTHEWS/MITCHELL, Underhill and Hayton, Law of Trusts and Trustees, 19<sup>th</sup> edn., London 2016, p. 2



## II. What is a Trust?

### Definition

«For the purposes of this convention, the term <trust> refers to the **legal relationships** created – *inter vivos* or on death – by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose.

A trust has the following characteristics -

- a) the assets constitute a **separate fund** and are not a part of the trustee's own estate;
- b) title to the trust assets stands **in the name of the trustee** or in the name of another person on behalf of the trustee;

[...]»

– Hague Trusts Convention, Article 2



## II. What is a Trust?

### Definition

«[...]

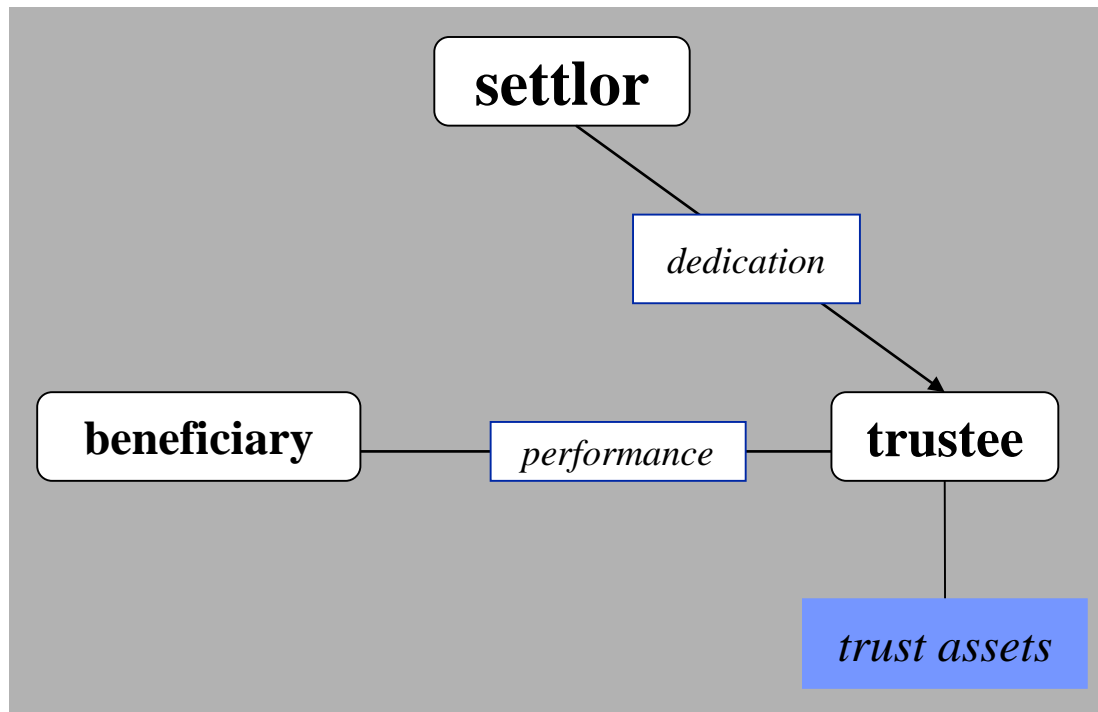
c) the trustee has the **power and the duty**, in respect of which he is accountable, to **manage, employ or dispose of the assets in accordance with the terms of the trust** and the special duties imposed upon him by law.

The reservation by the settlor of certain rights and powers, and the fact that the trustee may himself have rights as a beneficiary, are not necessarily inconsistent with the existence of a trust.»

– Hague Trusts Convention, Article 2



## II. What is a Trust?





## II. What is a Trust?

### Parties Involved

- **Settlor:** Established the trust by transferring the legal title in movable or immovable assets to the trustee «*in trust*». The settlor may himself be a beneficiary or the trustee
- **Trustee:** Holds «legal title» in the trust property, manages and uses the trust property in accordance with the terms of the trust for the benefit of the beneficiaries. A trust can have one or more trustees (co-trustees)
- **Beneficiary:** Enjoys the benefits of the trust property; holds «beneficial title» in the trust property
- **Protector (optional):** Monitor's the trustee's actions, has often the power to replace the trustee



## II. What is a Trust?

### Core Characteristics

- **No legal personality:** the trust (unlike the foundation) does not have legal personality; the trustee holds title in the trust property
- **No contractual (mandate) agreement** between the trustee and other parties: the trustee is **independent** from other parties involved
- **Split ownership** of the trust property
  - The trustee is the **legal owner** of the trust property (holder of the *legal title*), which is held separately from the trustee's private assets
  - Beneficiaries are **beneficial owners** of the trust property, i.e. holders of the *beneficial title*, a right *in rem* with legal effect *erga omnes* («towards all»)



## II. What is a Trust?

### Core Characteristics

- Flexibility (cf. next slide)
- **Wide variety of uses**: wealth and estate planning, asset protection, pensions, insurance, charitable ventures, banking, etc.
- **International significance** esp. for Switzerland as an international banking and financial services centre
- Finite duration: «**Rule against perpetuities**» in most jurisdictions



## II. What is a Trust?

### Types of Trusts

- Private trust

A trust for the benefit of a named individual or a named class of individuals; can be fixed or discretionary in nature

- Public trust

A trust that benefits charity (either a named charity or a charitable purpose)





## II. What is a Trust?

### Types of Trusts

- Express trust

A trust established **deliberately** (and usually in writing) by the settlor

- **Irrevocable trust** (cannot be revoked by the settlor)
- **Revocable trust** (can be revoked by the settlor; right to revoke expires upon the settlor's death)
- **Discretionary trust** (beneficiaries' rights to the trust property are largely within the trustee's discretion)
- **Fixed interest trust** (beneficiaries' individual shares have been specified by the settlor)



## II. What is a Trust?

### Types of Trusts

– Resulting trust

A trust that results automatically when legal title in property is transferred **without consideration** («equity assumes bargains not gifts») or when an express trusts fails to dispose of the entire equitable interest

– Constructive trust

A trust imposed to ensure **good conscience** when one party has been wrongfully deprived of its rights

- Equitable remedy imposed by a court when another party has obtained or holds a legal property right they should not possess, e.g. due to unjust enrichment or interference or a breach of a fiduciary duty



## II. What is a Trust?

### Types of Trusts

#### – Resulting trust

A trust that results automatically when legal title in property is transferred **without consideration** («equity assumes bargains not gifts») or when an express trusts fails to dispose of the entire equitable interest

- Presumed resulting trust: When you cannot prove a gift or when a purchase is made in someone else's name
- Automatic resulting trust: An express trust fails because one of the certainties is missing – the result is a resulting trust whose purpose it is to return the property to the settlor»

#### – Implied trust

A trust not established expressly but rather by conclusive action or by operation of law (sometimes also used as a collective term for resulting and constructive trust)



## II. What is a Trust?

### Types of Trusts

- Statutory trust

A trust imposed by statute (e.g. joint ownership in land, bankruptcy, conveyance of land to a minor)

- Testamentary trust

A trust arising upon the death of the settlor which is specified in the settlor's will

- Pension trust

A private trust rooted in a contractual relationship between employee and employer



## II. What is a Trust?

### Types of Trusts

- Spendthrift trust / protective trust

A trust created to protect the beneficiary (often a minor) from themselves by preventing the beneficiary (spendthrift) from wasting the trust property through mismanagement or overspending

- Asset protection trust

A discretionary trust set up to shield the assets from the beneficiary's creditors, e.g. in the case of bankruptcy, divorce or to avoid taxation



## II. What is a Trust?

### Types of Trusts

- Blind trust

A trust in which the trust beneficiaries have no knowledge of the holdings of the trust, and no right to intervene in their handling

- Sham trust

A trust where the settlor did not *actually* have the intention to create a trust but does so for an **unlawful purpose** while retaining **factual control** over the assets (e.g. to evade taxes) – sham trusts are considered **void**



## II. What is a Trust?

### Setting up an Express Trust

- Two-prong process
  - **Transfer of property** (movable or immovable) to a trustee
    - Or: self-declaration as trustee by the settlor
  - Act/instrument to subject the assets to a trust (**declaration of trust**)
- Declaration of trust
  - **Unilateral** declaration (*inter vivos* or upon death)
  - Does not need to be *received* nor *accepted* by the trustee («a trust never fails for want of a trustee»)
  - Must contain the «**three certainties**»
  - Optional: letter of wishes



## II. What is a Trust?

### Setting up an Express Trust

- Declaration of trust
  - Usually **in writing** and signed by the trustee
  - Written form is usually not required but serves evidentiary purposes (art. 3 HTC, art. 149a PILA)
    - **Exceptions** to lack of formal requirements depend on the jurisdiction
- No infinite trusts
  - **Rule against perpetuities** prohibits a duration «beyond lives in being plus 21 years» (dynasty trust)





## II. What is a Trust?

### Setting up a Trust

- The «**three certainties**»
  - Certainty of intention
  - Certainty of subject matter
  - Certainty of objects
- Certainty of **intention**
  - Settlor must intend to establish a trust as opposed to another legal relationship
  - Precatory words («in the hope that», «I desire that» etc.) are not sufficient; court looks for imperative words
  - Intent is more important than form (typically there is no need to declare a trust in writing)
  - The word «trust» is recommended but not absolutely necessary nor sufficient



## II. What is a Trust?

### Setting up a Trust

- The «**three certainties**»
  - Certainty of intention
  - Certainty of subject matter
  - Certainty of objects
- Certainty of **subject matter**
  - Settlor must identify what is to be the subject the trust (i.e. the **trust property**) and provide the means by which the interests of the beneficiaries may be ascertained
  - E.g. «whatever is left» of an estate is sufficient
  - **Tangible trust property** (something which has physical form, e.g. gold) must be segregated from the other property
  - If fixed interest trust: each beneficiary's share must be allocated



## II. What is a Trust?

### Setting up a Trust

- The «**three certainties**»
  - Certainty of intention
  - Certainty of subject matter
  - Certainty of objects
- Certainty of **objects**
  - Beneficiaries (objects of the trust) must be «**certain or capable of being rendered certain**»
    - This is because someone must be able to enforce the trust
    - Exception: public (charitable) trusts
    - Fixed trust: each and every beneficiary must be ascertainable («complete list test»)
    - Discretionary trust: a specified **class of beneficiaries** suffices



## II. What is a Trust?

### After the Trust's Constitution

- Settlor no longer holds a role in the trust's administration
  - Exception: revocable trust
- Administration of the trust property falls on the trustee
- Enforcement of the terms of a private trust falls (in principle) on the beneficiaries (the **beneficiary principle**)



## II. What is a Trust?

### After the Trust's Constitution

- The **beneficiary principle**
  - For a trust to be valid it must have a human beneficiary by whom the trust can be enforced
  - Exception: public (charitable) trusts
  - Private purpose trusts are therefore **void**
- Role of the **trustee**
  - Central figure in the administration of the trust – duty to protect the trust property, give rise to the settlor's instructions and promote the interests of the beneficiaries
  - **Fiduciary duty** imposed by equity is central to the trustee's role
    - obligation of **loyalty and faithfulness**



## II. What is a Trust?

### After the Trust's Constitution

- Role of the **trustee**
  - Must carry out their duties with utmost **diligence**, otherwise the trustee may be personally liable for **breach of trust**
    - **Exoneration clauses** in trust instruments may limit liability
  - Court may **remove** any trustee upon the appointment of a beneficiary (or on its own volition during proceedings) if the terms of the trust are violated
  - **Appointment of new trustees** can fall on the settlor (if reserved), the current trustee(s), personal representatives (e.g. executors), the beneficiaries or – as a last resort – the court



## II. What is a Trust?

### After the Trust's Constitution

- Role of the **trustee**
  - Must carry out their duties with utmost **diligence**, otherwise the trustee may be personally liable for **breach of trust**
    - **Breaches** include gaining an unauthorized profit, failing to act with care and skill in the administration of the trust property, and misapplications of trust property
    - **Remedies** against breaches include:
      - **Liability** for losses and personal gains
      - **Proprietary claims** and **tracing**



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**Thank you for your attention!**