Planning the family's future: a matter of trust?

Family business owners have long turned to trusts as a way of managing their estate planning – but are they the best option you can choose? Karen Jones looks at the benefits and asks what alternatives there are for those who prefer to keep everything "in-house"

While trusts have been around for hundreds of years, it is in the last decade that they have really begun to increase in number on a global scale. Although trusts were traditionally used to aid succession, they were used extensively in the 1970s and 80s for tax planning purposes. Today they are used for a wide variety of reasons such as for social and philanthropic actions, and asset protection in case of divorce.

The events that have led to both the increase in number and usage are multiple, depending on the jurisdiction. In the UK, for example, there was a significant change in direction with the announcement of taper relief which made trusts much less attractive. In Italy, there are currently a lot family businesses experiencing succession issues, so trusts are being used to aid this process. Finally, the amount of new money being generated in the Far East is fuelling a trust boom in that part of the world.

However, whatever your needs or wishes, it is important to analyse whether a trust is the best vehicle for you and your family, or whether another option is more suitable.

TRUSTING IN TRUSTS

"There are four main types of trust: a revocable trust, an irrevocable trust, a strict or fixed-interest trust or a discretionary trust," explains Richard Baldock, head of the trust operation at Rothschild Private Banking and Trust. "It's also possible - and indeed common practice - for the owner to be a beneficiary as well," he adds.

Trusts still play a large role in tax, as Geoffrey Todd, partner at Boodle Hatfield, is keen to highlight. "Tax planning using trusts is still alive and well," he says. "Families want to protect themselves against law changes and the recent Capital Gains Tax in the UK Pre-Budget Report is an example of this. The favourable treatment for business assets was more than a surprise."

However, tax avoidance may not be the principal reason for wanting a trust. Daniel Martineau, managing director of Close Trustees, Switzerland, has managed the transfer of wealth or assets from a family business into a trust for more than 20 years and believes that the primary use of trusts for family businesses is to organise succession.

"Taking this route, business owners would be provided with three elements of support: responsibility for business decisions; creating value for the children who don't want to participate in a business and assign roles to those who do; and looking for opportunities to grow the business and assist with profitable development," he says.

A big advantage of trusts for business owning families is that they can also be used to avoid the break-up of a family business. "If a business owner had a shoe factory, shoe shops and a leather tanning factory, the use of a trust mechanism would allow the different businesses to be formed into a group headed by a trustee," explains Brian Clarke, managing director of Key Trust, Jersey. "The family members could continue being in charge of separate businesses but have voting rights over the whole unit as trust beneficiaries."

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Trusts can also be advantageous for family members from different cultural backgrounds. "In Indian tradition, the male side of the family takes on the direction and governance of a business, like a managing director role, leaving the females, no matter how qualified, without a position in the family business," explains Clarke. "If the business was left in trust, the trust could serve the social and philanthropic actions of all family members derived from the assets and their value and create roles for the females."

One of the biggest areas of concern for some family business owners is how to protect assets in the event of a divorce. Peter Rice, senior relationship manager at Vistra Trust Company in Jersey, believes trusts are a way to do this.

"A wealthy individual I was dealing with in the UK wanted to retire to Spain," he says. "We organised fiscal planning and put assets into a trust before he got there. He had an ex-wife who had left him and a very young daughter. Sadly he died shortly after his move, but before he died he said 'Please put the assets in trust for my daughter; my wife left me so I don't want her to benefit.' With this arrangement there are no wealth taxes, probate or wills because trustees hold the assets. The ex-wife tried to get the assets but it survived the court case."

He adds some interesting points for those worried about trustee involvement. "Trustees work for the beneficiaries so careful thought will be applied to circumstances of beneficiaries and instructions amended if they aren't working appropriately." Rice also says there is a difference between common law and civil law trusts: "The legal strength will vary by jurisdiction."

However, many countries, such as Monaco, which is a civil law jurisdiction, allow residents to dispose of their estates in accordance with rules that are familiar to them. "It is called a Law 214 Trust and must be registered with the Monaco Court, who maintain a register," explains Andrew Cleeton, senior wealth planner at Lloyds TSB International Private Banking.

For those who have unique requirements for their wealth and assets, trusts are able to apply these elements. "For one trust, I put in a detailed plan where we had a management committee, composed of one bloodline family member and two employees of the business who had worked there for more than five years," says Rose Wong, head of international financial and trust planning at SG Hambros Bank in London. "The owner wanted 'honest and loyal staff with a track record and set out how he wanted the business run even after death. I also often highlight mental incapacitation as something business owners should prepare for. It offers peace of mind to the family if plans are in place."

Some trusts that are established can remain in place for future generations of the family. A good example of this is Fleming Family & Partners (FF&P), a family investment management and trust business that manages wealth from past family members who include Robert Fleming, a Dundee merchant and rail speculator, and Ian Fleming, who wrote the James Bond books.

"FF&P set up its trust business in 1923, which has now benefited six Fleming generations," says Penny Lovell, head of business development. "At a personal level, we know it's been successful because if you meet the younger generation they understand implicitly that they are simply passing along the Fleming wealth to future children."

Finding your way through the maze of trust and estate planning options can be tricky, but the results are vital to future generations

A WEALTH OF ALTERNATIVE OPTIONS

But if trusts are not your thing, there are various other options available to families in different countries. However, a lot depends on the jurisdiction of the family and their tax status. Marc Farror, director of Mourant Private Wealth, recommends that clients get written advice from a private client lawyer, accountant or tax advisor before choosing these routes.

"Tax laws change from country to country with many families having members spread across the world," he says. "The complexity is enormous. We use four alternatives to trusts: the first is setting up a company whereby a client can transfer an asset like a property into itfor tax efficiency. Then you have foundations, which are very popular with Europeans.

"Trusts are an English invention that are also used in the

TO TRUST OR NOT TO TRUST: THE OPTIONS

PRIVATE TRUSTS

A revocable trust
An irrevocable trust
A fixed-interest trust
A discretionary trusts

OTHER TYPES OF TRUST

Special Purpose Trusts
Charitable Trusts
Commercial Trusts
Offshore Employee Benefit Trusts

ALTERNATIVE OPTIONS TO TRUSTS

Transfer of assets
Foundations
Bonds
Waqf
Rearrange shareholding
Marital agreements
Insurance wrappers

US but foundations are very interesting for people from a civil law legislative background like Switzerland," he continues. "It's a civil law led structure that is half like a company, where directors are appointed, and half like a trust. It's a concept that is well understood by Europeans."

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Although Jersey doesn't have a foundation law, Farror says they run the foundation through Jersey but transfer administration to Liechtenstein or Panama.

"Other methods used by families are bonds which are a basic or 'vanilla' choice," he explains. "They allow tax advantages for the UK resident and domiciled client or family who we usually struggle to find offshore benefit for. You can put assets into a bond which, with an underlying fund investment will enable clients to withdraw 5% each year over 20 years and defer tax payments.

"The fourth structure is Islamic, using Sharia principles, called a Waqf," he continues. "It's set up for charitable, beneficial or faith purposes like donating to a mosque or supporting family members. Where we have clients from the Middle East we find it much easier to explain a Waqf structure than a trust.

"The difference is small; the main exception is that you apply Sharia rules," Farror expamins. "Culturally it's better because clients tend to understand it. However, if there were children in countries like the US, it would be better to use a trust for equality because a Middle Eastern focus may not help that child."

As an alternative idea, some families decide to rearrange their shareholding in the business. "You could also split the rights attached to shares so that those involved in the business have voting rights and those staying out of it just get the income," suggests Todd.

Joshua Rubenstein, managing partner at Katten Muchin Rosenman, a leading private client law firm in New York agrees. "Companies and partnerships are common alternatives to trusts and sometimes even additions," he says. "Other options include marital agreements, both prenuptial and postnuptial, especially in the US where they are legally enforced."

He adds that foundations in the US must be charitable and that excessive business holdings are not allowed. "Insurance wrappers can also be used to hold many kinds of investments and to direct the distribution of the proceeds, but business assets don't always lend themselves to being held in insurance wrappers so advice will be needed," he explains.

A NOTE OF CAUTION

Whether or not a family decides on a trust, it is important that they plan for the future, for the sake of the business and the family itself.

"Failure to implement lifetime structuring, be it trust, foundation or some other option will give rise to problems, delays and costs for the family at a later date," cautions Andrew Young, head of Private Tax and Capital at law firm, LG. "I make a modest living from helping clients with lifetime structuring but an extremely good living from sorting out problems left by clients who neglect to plan."

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Russell Bussey vice president of AllianceBernstein Global Wealth Management agrees. "Failure to plan leads to many problems and will have a detrimental effect on the family's future business success," he concludes.

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Fonte: Families in Business, n. 35, p. 48-50, Nov/Dec. 2007.