An Analysis: Trusts vs. Foundations

Introduction

Trusts and foundations are both useful vehicles for asset protection, succession planning and charitable endeavours. Whilst foundations are well-established in civil law jurisdictions, their relatively recent introduction in a number of common law jurisdictions raises questions on the differences between the two structures and their relative benefits and disadvantages. This article provides a brief comparative analysis of the two structures.

The Features of a Trust

A trust is established when the legal owner of assets (the 'settlor') transfers the legal ownership, power, and control of those assets to trustees.

A trustee can be an individual or a legal entity. The assets are held by the trustees for the benefit of beneficiaries who are identified (either by reference to a class or specifically named) by the settlor or for a specific purpose (charitable, non-charitable or both). Whilst the legal title of the trust assets vests in the trustees, the beneficiaries hold the beneficial (equitable) interest. The trust itself has no separate legal existence and is not a separate legal entity. Essentially, a trust is a private legal arrangement between the settlor and the trustees.

Most countries require that trustees are licenced to offer such a fiduciary service and act under such a capacity.

Trusts are usually created in writing by the execution of a trust deed / trust instrument. This deed sets out the powers and duties of the trustees and the entitlement of the beneficiaries.

Unless expressly reserved in the trust instrument ('settlor's reserved rights'), the settlor does not retain any powers, rights or control in the trust assets. In some cases, the settlor may provide the trustee with a non-binding letter of wishes to make known their views on how they wish the trust assets to be used, how they envisage the administration of the trust.

The trustees hold the property on trust for the beneficiaries subject to the terms of the trust. Trustees owe a fiduciary obligation to the beneficiaries and must act in their best interests. The beneficiaries have the right to enforce the terms of the trust.

In some jurisdictions, the settlor may also appoint an individual or legal entity to act as a protector of the trust. The role of the protector is to oversee the actions of the trustees and ensure the terms of the trust are complied with.

There are different types of trusts; fixed, discretionary, life-tenancy, charitable, asset protection, revocable and irrevocable. The most common type of trust used in estate planning is the discretionary trust as it is flexible and can be altered to adapt to changing family circumstances.

Trusts are used in common law countries, such as in England, Cyprus and other commonwealth countries.

The Features of a Foundation

Foundations are a less familiar concept than trusts. They are sometimes described as a hybrid of a trust and a company. A foundation resembles a company in that it is a body corporate (albeit without shareholders) with separate legal personality that owns its own property like a company. A foundation is governed by a council in accordance with its charter and regulations (its constitutional documents) in much the same way that a company is managed by its board of directors in accordance with its constitutional documents.

Foundations are jurisdiction specific and a creature of statute rather than the common law but have a number of characteristics and common features.

A foundation is a separate and distinct legal entity and is established by registration with the relevant registration body in the jurisdiction concerned. A foundation has its own legal personality separate from that of the founder and the council and is mostly a form closer to that of a company. A foundation can exercise the functions of a legal person – it can hold assets and is capable of suing or being sued in its own name.

The operative provisions of the foundation such as the management of the foundation, the administering of the assets, and the functions of the councillors are contained in the constitutional documents. The constitutional documents of foundations vary depending on the jurisdiction they are in.

The appointment of a guardian may be required or may be optional. The role of the guardian is to oversee the actions of the council and make sure that they are acting in accordance with the regulations and their duties. The founder may be able to reserve certain powers but, once again, this is jurisdiction specific. The rights of the beneficiaries as well as the duties of the council vary between jurisdictions.

Common Features

- ✓ **Flexibility**

Trusts and foundations are very flexible arrangements. They can both be discretionary in that it will be for the trustee/council to determine which of the beneficiaries are to benefit, when, on what terms and so on. It is also possible for a third party to be appointed to oversee and monitor the trustee/council in their management of the trust/foundation's property (typically a protector in connection with trusts and a guardian in connection with foundations).

Similarly, a settlor of a trust can reserve powers for himself or grant them to other persons such as certain key members of their family in connection with their trusts. Often, these will be the powers to direct the investment of trust assets (for example if a settlor or family member has specific expertise in that area); powers to direct distribution of trust assets to beneficiaries; and powers to add or remove beneficiaries of the trust, power to change the proper law of the trust. The same is available to the founder of a foundation, who may wish to reserve for himself certain key powers in connection with the foundation.

- ✓ **Purposes**

Both are regularly used for the efficient holding of wealth, asset protection and succession planning purposes.

- ✓ **Liability of the Trustee / Council**

In a Foundation, it is the Council who has powers to manage the assets. Comparably, in a Trust, the Trustees manage the assets in accordance with the terms of the Trust.

- ✓ **Confidentiality**

Trusts are private arrangements, and the beneficiaries are only known internally. Likewise, anonymity is provided by a Foundation. Although the statutes of a Foundation are registered, the regulations detailing the beneficiaries are only known internally.

With the implementation of the 5 Anti-Money Laundering Directive within the EU, a UBO Trust Registry has been established in member states requiring the details of the trust to be disclosed to the competent authorities however this registry is not open to the public, at least as in the case of Cyprus.

Main Differences

Legal structure

Foundation

- A foundation is a separate legal entity (similar to a company).
- A foundation can contract and hold assets in its own name.

- A foundation can sue and be sued in its own name.
- The foundation holds the legal and beneficial title to the assets.

Trust

- A trust is not a separate legal entity.
- The legal rights and obligations sit with the trustees rather than the trust itself and the trustee therefore contracts in his/her or its own name on behalf of the trust.
- Legal ownership of the trust fund sits with the trustees and beneficial (equitable) ownership with the beneficiaries.
- The trustees would sue and be sued in their own name, as opposed to action being taken by or against the trust.

Beneficiaries

Foundation

- A foundation does not need to have any beneficiaries.
- Beneficiaries of foundations have very limited rights unless the founder wishes to provide for rights to be granted under the foundation’s regulations.
- Beneficiaries of foundations do not usually have rights to information about the foundation.
- Beneficiaries of a foundation do not have any beneficial interest in a foundation unless the foundation council or the regulations confer some entitlement on them (such as a right to receive income).

Trust

- In order to be valid a trust must have beneficiaries.
- The only exception to this is a purpose trust, where there are no beneficiaries but an enforcer is appointed to ensure that the trustees run the trust in accordance with stated purposes.
- Beneficiaries of a trust have a beneficial interest in the assets, and therefore have legal rights which can go as far as forcing the trustees to take an action through the court or expressing their collaborative wish for an action to be taken which would be difficult for a trustee to refuse unless there were compelling reasons to do so (such as adverse tax consequences etc.)

- Beneficiaries also have rights to certain information about the trust. They are not entitled to disclosure of information as of right, but have a legitimate expectation of disclosure. A beneficiary's rights to information are based on the fiduciary duty of the trustees to keep the beneficiaries informed and to provide accounts.

Funds

<u>Foundations</u>

- A foundation can be established without any initial funds.
- The founder does not need to advance funds to the foundation, which comes into existence on registration.

<u>Trust</u>

- The settlor of a trust must pass some initial trust assets to the trustees in order to form the trust. Further assets can of course be added albeit generally with professional advice.

Duties

<u>Foundations</u>

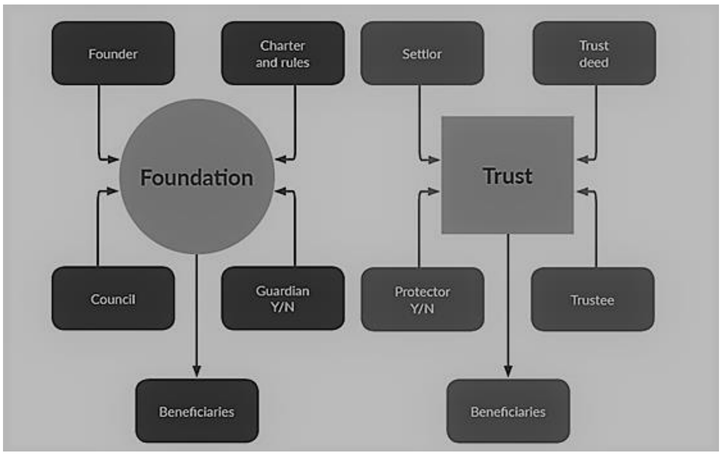
- The council has similar duties and functions to the board of directors of a company.
  The members of the council of a foundation must:
  - act honestly and in good faith with a view to the best interests of the foundation;
  - exercise the care, diligence and skill that reasonably prudent persons would exercise in comparable circumstances.
- The foundation council has no duty akin to a fiduciary duty towards the beneficiaries

<u>Trust</u>

- Trustees have far wider duties which on the one hand ensure the protection of the beneficiaries, but on the other may prohibit the actions that a trustee may take, or in some instances assets they may hold.

- A trustee must act with due diligence, as would a prudent person, to the best of the trustee's ability and skill and observe the utmost good faith.
- Subject to the terms of the trust, a trustee has a duty to preserve and enhance the value of the trust fund, meaning that a trustee could come under criticism for holding wasting assets which devalue over time.
- Some of the duties of trustees can be delegated to appropriate parties such as where investment managers are appointed. However, there is still a duty to oversee their performance.

Comparative Table



Conclusion

Trusts and foundations differ in a number of important respects, but can both be used to achieve similar objectives. Both can be effective structures to achieve succession planning, asset protection, charitable or philanthropic aims. They are both flexible tools that allow arrangements to remain private.

When deciding which structure to use, each circumstance will need to be considered on its merits, taking into account factors such as the aim of the structure, the country of establishment, and the level of control required to be retained.

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