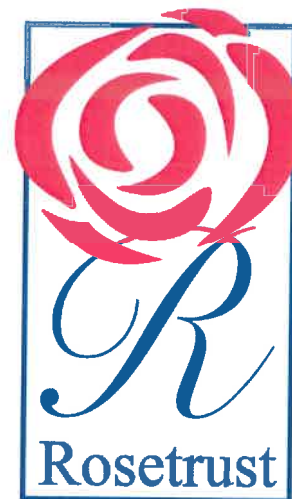


## HAVING YOUR CAKE AND EATING IT

**Can trustees hand assets over to settlors without imperilling the trust?**

By Howard Rosen M.A. (Oxon.) Solicitor, T.E.P.  
Managing Director, Rosetrust AG, Zug, Switzerland

*The demands of settlors to use assets either directly or indirectly placed in the hands of trustees is a dilemma which constantly worries professional trustees. This article examines the possibility of using the concept of leasing to solve that problem.*



**Rosetrust AG**  
Baarerstrasse 98  
P. O. Box 7262  
CH - 6302 Zug  
Switzerland

It is the classic dilemma for the trust professional: the client wants to transfer assets into a trust for various sound reasons, whether it be tax minimisation, confidentiality, estate planning or estate protection. Yet he wants to have use and control of the assets concerned. We then have to explain painstakingly that he really is alienating assets and that, as was upheld in the recent *Rahman* case, if the settlor retains control over trust assets, the trust could be regarded as a sham. Further, trustees are generally nervous of giving settlors unrestricted rights over assets, mindful of the trustees' duty to the beneficiaries (which may or may not include the settlor). Placing assets into a trust makes sense objectively, but clients still worry about the situation. They are concerned about how those assets are to be managed and about the fact that they are transferring substantial resources which they would also like to use for their own purposes.

The classic solutions to this problem often revolve around corporate vehicles established by, or contributed into, the trust, which hold the main assets of the trust. The settlor may be a director of the company; often he will have a bank signature and will exercise direct or indirect day-to-day control over assets held by the company. The obvious concern of every trustee in this situation is to ensure that there is no unbalanced concentration of assets and risk in such a vehicle. The trustee will also need to ensure that he is informed fully about the activities of the company and that he has as defensible a position as possible against any creditor of the settlor claiming that the trust should be disregarded - with all the dire consequences and costs not just for the client, but also for the trustee personally.

There may also be tax issues. If an offshore company wholly owned by an offshore trust is effectively operating through the settlor, there must be a serious risk that the company itself could be deemed to have a tax residence in the settlor's jurisdiction. As a result, the use of an asset held by that company can raise a number of tax risks. Not only could the worldwide income of the company be subject to tax in the settlor's jurisdiction (hardly on the top of the settlor's wish list) but there could be tax implications both for the company and for the settlor if an asset is placed at his disposal for no consideration (effectively a benefit in kind). Further, any ultimate profitability (post tax) of the offshore company could then be subject to withholding tax against which there is unlikely to be any double taxation treaty relief.

Tel.: +41 41 760 64 66  
Fax: +41 41 760 10 14

E-mail: [info@rosetrust.ch](mailto:info@rosetrust.ch)  
Website: [www.rosetrust.ch](http://www.rosetrust.ch)

Lastly, a trustee should always be nervous about a situation where assets are placed in a structure which ensures that the trust does not obtain a proper return on them. Here, a distinction has to be made between assets placed in a corporation under control of a settlor which are generating income for the corporation, and assets which are made available through a corporation for the settlor's own use. Clearly, it is the latter scenario which causes more concern.

In general, careful planning, trustee involvement and good documentation should make the system work, but is it watertight? Probably not. Ultimately, it is a matter of judgment. How substantive is the structure if the settlor retains day-to-day control of the company? The flaw in the position is clear. Some control is ceded back to a settlor. It would of course be fine if the control was sold back to the settlor, but that defeats the object of the whole structure. Trustees are often, rightly, nervous about otherwise ceding control of a company back to a settlor. Instinctively, one has a feeling of "going against the grain". Of course, in practice it is happening constantly and the prudent trustee ensures that the control is not absolute, that he has representation on the board of the company and, if possible, has the ability to countermand any instructions given by a settlor. There is, however, a clear tension. The more "bureaucratic" the trustee becomes, the more resentful the settlor becomes, particularly when he notes that the trust is paying for the attendance of the trustee at board meetings of the subsidiary company, etc. In practice, trustees probably resign themselves most of the time to the fact that the solution cannot be a perfect one.

There may, however, be another answer, albeit a more radical one. The starting point for an alternative way of dealing with this problem is the recognition of one basic fact: money itself has little benefit; it is what can be done with it that creates its value. Usually, the same applies to other assets. Few settlors want to be the King "in his counting house counting out his money". They often want to use the money to buy things, from holiday villas to cars to yachts to aircraft, which they can enjoy without compromising the purpose of the trust.

Let us assume that the settlor is a professional. He places \$1 million into an offshore trust; this represents about 50% of his net wealth. There is no immediate prospect of litigation but he wants to insulate some of his wealth in the unlikely event that a client somewhere does want to attack him for malpractice in 10 years' time. He also has other legitimate reasons for establishing an offshore discretionary trust. At the same time, the settlor also wants to buy a small aircraft for personal use at a cost of \$500,000, but he is concerned about the impact on his net disposable assets of making the purchase. He does not want to borrow moneys from third parties. The trust has the money, and the settlor resents "having the money" (as he sees it despite the trustee's plaintive explanation to the contrary) but not being able to use it. He tells the trustee this. What should the trustee do?

The answer could be to lease. Leasing is a long-established commercial relationship built around the idea of separating ownership from use of an asset and designed principally as an asset-protection concept. It is a well used and accepted commercial structure which provides a perfect control mechanism for the trustee (through the implementation of the lease agreement) outside the use of a corporate vehicle, thereby sidestepping the principal problem raised above. Fundamentally, however, it provides a mechanism for ceding use and day-to-day control of the asset at a cost which can be fixed on market terms.

In our example, therefore, there is a significant improvement in the position of the trust if the aircraft is purchased by the trust or (more likely) by an entity totally controlled by it, and leased to the settlor at a market rent, as opposed to allowing the settlor some control of the owning vehicle and *de facto* use of the asset. Certainly it means that the settlor has to pay for

the use of the asset, but now the moneys are going to an entirely acceptable source and in certain cases, may be tax deductible. The settlor may just regard this as a shifting of assets from one pocket to another (which in fact may be an advantage in its own right). The trustees own the asset; it is registered in the name of the trust or its controlled vehicle. Assuming a company is used to hold the physical asset, the settlor will have no representation on the board of that company and will not even be a signatory on any corporate bank accounts. Therefore, the asset itself is *prima facie* protected from claims of third party creditors of the settlor. It will be difficult for a creditor or other claimant to argue that a lease on commercial terms is a sham. It is probably a good investment for the trust without the costs usually associated with trust investments. Moreover, if the asset is leased to the settlor for a fixed period, the trust, not the settlor, will benefit from any residual value of the asset, whereas the settlor is in possession of a wasting asset. Further, there are other significant benefits of using a leasing structure. By placing the assets in a vehicle which is clearly at a distance from the settlor, this will ensure a more credible layer of confidentiality for the structure.

Leasing, therefore, offers a trustee a fascinating, if slightly unusual, route to solving the classic dilemma. Aside from the technical details however, trustees should feel much more comfortable with a clear and more regulated division of ownership and control of assets. Through the lease itself, leasing allows a settlor to hold an asset on an arm's length basis under clearly regulated conditions. From that point of view, the trustee may lose possession of the asset but not control. For the many reasons well known to professional trustees, that will be a source of considerable comfort. It could also generate substantial revenue for the trust into a tax favourable environment. For example, if the trust has purchased real estate, it may not want to lease that real estate to the settlor continuously. A time sharing structure may well be more acceptable in the case of a holiday villa.

Accordingly, the leasing structure can also allow the settlor, through his trust structure, to ensure that the asset is used more efficiently than if he just held the asset himself or through a controlled company where he was the exclusive user. However, (and there's always a 'however') the trustee will have to be mindful of certain issues that must be dealt with. Of course, the basic concerns about not over-concentrating the trust assets in one particular asset will continue to apply. Further, the trustee will need to understand how leasing works or, as in the case of any other asset investment, retain the services of someone who does. It should always be borne in mind that leasing can justify a higher return on investment often due to the fact that there is a clearer credit risk (even though the settlor would not necessarily see it in that way). In addition:

- Documentation will have to be prepared, and after signature there may be registration of a security or Lessor interest.
- There may be regulatory issues. In certain jurisdictions in Europe, there may be a requirement for a lessor to have a licence from the local central bank if it is conducting leasing business in a particular way.
- The contract will need to be administered on an on-going basis by professionals who understand what is required.
- Lease rentals across borders are often subject to withholding tax; this can be usually be resolved but it must not be ignored.
- There may be VAT issues.
- Initial costs may be higher (although running costs may be lower) but since these are costs the leasing industry also has to bear they will be factored into the market lease rate and



effectively borne by the user. By comparison, asset management costs will be borne by the trust.

- The trustees must ensure that they have authority to lease assets under the trust deed and in the memorandum and articles or statutes of the corporate vehicle used as lessor.

Normally, however, none of these issues will be insuperable and in certain cases, such as VAT issues, the problems may have to be addressed anyway. From the settlor's perspective, this may even bring an additional benefit of using a leasing structure in that the mechanics of asset management can be left with the professionals and he can devote his time to other ventures.

In conclusion, leasing is a radical but also highly effective solution to the basic problem of the settlor wanting to use an asset that he has either devolved to a trust or the trust has purchased using trust funds - without compromising the integrity of the trust and indeed providing a structure for the trust to generate an excellent and highly tax efficient yield on its investments. In this way, the client is left to enjoy "his" asset in peace: To have his cake and eat it.

*Rosetrust offers its clients considerable expertise in the leasing and trust business. For more information, please contact us at telephone +41 41 760 64 66 or fax +41 41 760 10 14.*